Chapter IV

Effectiveness of Internal Controls

4.1 Introduction

Internal controls in an organisation are designed to address risks and to provide reasonable assurance that in pursuit of the entity's mission, the following general objectives[42] are being achieved:

- fulfilling accountability obligations ;
- complying with applicable laws and regulations ;
- safeguarding resources against loss, misuse and damage.

In the era of self-assessment, recognizing the need for a strong compliance verification mechanism, CBEC has put in place systems of internal control by way of two functions i.e. Scrutiny of Returns and Internal Audit. With increasing reliance on voluntary compliance and new services regularly being brought under the tax net, there are also instructions in place to identify persons who were liable to pay tax, but had avoided to pay, so as to bring them into the tax net thereby broadening the tax base.

4.2 Results of Audit

During the course of examination of records, we came across several shortcomings in compliance to the instructions in place regarding return scrutiny, Internal Audit of assessees and functioning of jurisdictional officers. These suggest that the department should look into the adequacy of extant systems and procedures.

We communicated our observations to the Ministry through 103 draft audit paragraphs having financial implication of ₹ 165.88 crore. 41 cases accepted by the Ministry were included in ***Appendix IV.*** The remaining 62 cases ***(Appendix V),*** include 34 cases in which the Ministry did not accept departmental lapse and 28 cases, where the Ministry's response/final reply was awaited (October 2017).

[42] INTOSAI GOV 9100 – Guidelines for Internal Control Standards for the Public Sector

The observations had been discussed in the following paragraphs under four major headings:

- Scrutiny of Returns
- Non-conduct of Internal Audit
- Non-detection of lapse by Internal Audit
- Functioning of jurisdictional officers

4.3 Inadequacies in the system of preliminary scrutiny

After the introduction of ACES, preliminary scrutiny of returns was being done by the system itself. The purpose of preliminary scrutiny of returns was to ensure completeness of information, timely submission of return, payment of duty, arithmetical accuracy of the amount computed and identification of non-filers/stop filers. In case any discrepancy was found by the ACES systems, all such returns were marked for R&C[43]. These returns marked for R&C by ACES should be validated in consultation with the assessee and re-entered into the system. The preliminary scrutiny of returns and R&C was to be completed within three months from the date of receiving the returns.

During examination of ST-3 returns at ranges, we noticed 11 instances where due to inadequacies in the system of preliminary scrutiny, short/non-payment of tax liability exhibited in the ST-3 return or non-payment of interest on delayed payment of tax were not detected. In 10 cases pertaining to short/non-payment of Service Tax and interest (included in Section A of ***Appendix-IV***), the Ministry accepted the audit objection and attributed these lapses to non-availability of the facility in the ACES which would be addressed in the new GST regime. One case not accepted by the Ministry is discussed below:

4.3.1 Non-detection of short payment of Service Tax and non-payment of Interest

As per Rule 6 (1) of Service Tax Rules, 1994, Service Tax is to be paid on monthly basis by the 5th of following month. However, payment for the Month of March is required to be made by 31st of March itself. Further, Section 75 of the Finance Act 1994, provides that every person who fails to credit the tax or any part thereof to the account of the Central Government

[43] The process of resolving discrepancies in respect of marked returns is called R&C.

within the period prescribed shall pay simple interest at such rate as is for the time being fixed by the Central Government.

Scrutiny of ST-3 return of M/s. Essar Shipping Ltd., in Mumbai ST-II Commissionerate, revealed that the assessee had not paid interest of ₹ 9.14 crore on delayed payment of Service Tax for the FY15 and FY16. Further, against the total Service Tax liability of ₹ 13.90 crore including Swachh Bharat Cess for the month of March 2016, the assessee paid only ₹ 7.65 crore. This resulted in short payment of Service Tax of ₹ 6.25 crore, on which interest of ₹ 83.94 lakh was also payable.

When we pointed this out (December 2016) the assessee had partly paid (December 2016 to February 2017) an amount of ₹ 5.52 crore and stated that balance amount along with interest would be paid in due course.

The Ministry did not accept the audit objection (September 2017) stating that the matter was already in its notice and DGCEI investigation against the assessee was going on. The reply of the Ministry was not relevant as the audit objection related to inadequacies in the system of preliminary scrutiny of the returns, which had no link with DGCEI investigation quoted by the Ministry.

4.4 Non-conduct of Internal Audit

Compliance verification through audit entails conduct of audit by the Department's Internal Audit Parties (IAPs) of assessee units selected based on risk parameters. During the course of our regular compliance audit, we attempted to check the adequacy of coverage of assessees and the likely impact of non-conduct of Internal Audit by the department in case of assessee units due for audit. We detected lapses involving money value of ₹ 25.09 crore in case of 21 assessee units, which were due for audit as per departmental norms but not audited by IAPs. Of these, 19 cases were accepted by the Ministry (included in Section B of ***Appendix IV***). One case was not accepted by the Ministry and in one case reply of the Ministry was silent on non-conduct of Internal Audit, which had been discussed below:

4.4.1 Service Tax collected but not deposited

As per section 68 of the Finance Act, 1994 read with rule 6 of the Service Tax Rules, 1994, Service Tax shall be paid to the credit of the Central Government by the 6th day of the month if the duty is deposited electronically through internet banking, or, in any other case, the 5th day of the following month, as the case may be, except during the month of March where tax is to be paid by the end of the March itself. Rule 7 of the Service Tax Rules, 1994, read

with Section 70(1) of the Finance Act, 1994, stipulates that every person liable to pay Service Tax shall himself assess the tax due on the services provided by him and furnish to the Superintendent of Central Excise a half yearly return in form ST-3 by the 25th of the month following the particular half year.

M/s Newtime Contractors & Builders Pvt. Ltd., in Chandigarh-I Commissionerate, though was due for Internal Audit in FY16, was not audited by the department. Scrutiny of records of this assessee revealed that the assessee had provided construction services to their clients and charged Service Tax of ₹ 35.30 lakh through running bills during FY14 and FY15. However, the assessee neither filed Service Tax returns during the above period nor deposited the Service Tax of ₹ 35.30 lakh collected from clients into Government account. Further the assessee received (April 2013) an amount of ₹ 2.79 crore as mobilization advance from Oliver Engineering Pvt. Ltd., but the assessee did not discharge his Service Tax liability of ₹ 13.79 lakh on the advance received till the date of audit. Thus, a total amount of Service Tax of ₹ 49.09 lakh was recoverable from the assessee, besides levy of penalty for non-filing of returns.

When we pointed this out (February 2016) the Ministry (September 2017) stated that the department was aware of the matter as they sought record when the assessee did not file ST-3 returns. They further stated that as the assessee did not submit any records, using income details of FY13 and FY16 collected (January 2017) from the Income Tax department, they issued an SCN of ₹ 1.51 crore to the assessee for FY13 to FY16.

The fact remained that the department initiated action (January 2017) only after the matter was reported by us (February 2016) and that Internal Audit was not done when due.

4.4.2 Non-payment of Service Tax on import of service

As per Sl.No.10 of Notification No.30/2012 dated 20 June 2012, if the taxable service is provided by a person located in non-taxable territory to a person located in a taxable territory and the place of provision of service is in taxable territory, then Service Tax would be payable by recipient of services.

M/s Posidex Technologies Pvt. Ltd., in Hyderabad ST Commissionerate, was due for Internal Audit in FY15 but audit was not conducted. Our scrutiny revealed that the assessee had incurred an expenditure of ₹ 2.04 crore towards Technical Consultancy & Professional Services received from various foreign service providers during the period between April 2013 and

March 2015. In terms of provisions mentioned supra, the assessee was liable to pay Service Tax of ₹ 25.21 lakh on the said amount along with interest. This resulted in non-payment of Service Tax of ₹ 25.21 lakh on import of services.

When we pointed this out (January 2016) the Ministry accepted the objection and stated (December 2016) that the assessee paid Service Tax of ₹ 25.21 lakh along with interest of ₹ 7.12 lakh. The reply of the Ministry was silent on the non-conduct of Internal Audit.

4.5 Non-detection of lapses by IAPs

The IAPs carry out the audit of assessee units in accordance with the Audit Plan and as per the procedures outlined in the Service Tax Audit Manual, 2011 replaced with Central Excise and Service Tax Audit Manual, 2015 (CESTAM-2015).

During the course of our regular compliance audit, we attempted to examine the quality of audits undertaken by the IAPs by auditing a sample of assessees already audited by IAP. Of the 57 instances where we pointed out omission of IAPs to detect certain significant cases of non-compliance by assessees, the Ministry accepted nine cases (Section C of ***Appendix IV***). Of the remaining 48 cases (Section C of ***Appendix-V***), in 12 cases, for which the Ministry stated that explanation from officers responsible for the lapse was called for, final reply was awaited. The Ministry contested the audit objection in 25 cases and reply was awaited in 11 cases. A few instances had been illustrated below:

4.5.1 Non-detection of irregular claim of export benefit exemption

According to Rule 6A(1)(d) of Service Tax Rules, 1994, a service can be treated as export of service only if the place of provision as per the Place of Provision of Service Rules is outside India.

As per Rule 9(b) of Place of Provision of Services Rules, 2012, place of provision of 'Online information and database access or retrieval or both in electronic form through computer network service (OIDAR)', as defined under Rule 2(l) is the location of the service provider.

CBEC's Guidance Notes (query No.5.2.4) clarified that in the case of a service recipient, the place relevant for determining location is the place where service is "used" or "consumed". Further, Rule 4A of Service Tax Rules, 1994 provides that CENVAT credit should be availed on invoice bill or challan which

contains description and value of taxable service provided or agreed to be provided and the Service Tax payable thereon.

4.5.1.1 Irregular claim of exemption and export benefits

M/s OnMobile Global Ltd., in Bangalore ST-II Commissionerate, established a data centre in Bangalore for providing Value Added Services (VASs) to the customers of various telecom operators. The assessee classified the services correctly under Online Information Data Base Access and Retrieval (OIDAR) and paid Service Tax on these services provided to the telecom operators located in the taxable territory. However, in case of such services provided to the telecom operators located outside taxable territory, the assessee did not pay Service Tax of ₹ 23.35 crore for the period from FY13 to FY16, treating them as export of services. Although the Internal Audit Wing of the department audited the unit in February 2015, covering the period up to September 2014, this non-payment was not detected.

When we pointed this out (August 2016) the Ministry contested (September 2017) the audit objection on the grounds that the DGCEI already started its investigation in June 2016 whereas CAG Audit had pointed out this issue in July 2016.

The reply of the Ministry was not relevant to the issue on hand about failure of IAP, that conducted audit of this assessee in February 2015, in detecting wrong claim of exemption by the assessee.

4.5.1.2 Incorrect claim of export of services and incorrect availing of CENVAT credit

M/s Deloitte, Haskins & Sells, in Vadodara-I (audited upto FY14 by IAP) claimed exemption from payment of Service Tax on services provided to overseas clients treating them as export of services. We noticed that the assessee had provided service to Foreign Institutional Investors (FIIs) with Head Office located overseas but working in India as well, which had invested in Indian share market and were set-up and registered in India with the Securities and Exchange Board of India (SEBI). Hence the services cannot be considered as export of service in terms of Rule 6A (1)(d) of Service Tax Rules, 1994. Assessee did not pay Service Tax on 50 service invoices/bills in FY15 involving such services on which it was liable to pay Service Tax of ₹ 91.21 lakh. Since details for FY15 only were made available to Audit, the department was requested to verify this aspect for all the transactions of the assessee after introduction of Place of Provision of Services Rules, 2012. Further, we noticed that the assessee had availed CENVAT credit on 14

invoices for which it could not provide any details of its nature and admissibility, in absence of which genuineness of availability of such credit could not be verified. Hence, the department was requested to verify admissibility of such invoices and take necessary action.

When we pointed this out (August 2015) the Ministry accepted the audit observation and informed (September 2017) that SCN of ₹ 10.96 crore was issued to the assessee. For the failure of IAP, it stated that as Internal Audit was done on test check basis, there was no lapse on part of IAP.

The reply of the Ministry was not acceptable as a specific check was prescribed in column 12 of annexure VIII of Service Tax Audit Manual, 2011 for checking the correctness of exemption claimed by the assessees.

4.5.1.3 Incorrect availing of exemption of export of services

As per section 65(105)(k) of the Finance Act, 1994 "taxable service" means/includes any service provided or to be provided to any person, by a manpower recruitment or supply agency in relation to the recruitment or supply of manpower, temporarily or otherwise, in any manner. Rule 6A of the Service Tax Rules, 1994 stipulates that the provision of any service provided or agreed to be provided shall be treated as export of service (among others) only when the recipient of service is located outside India and the payment for such service has been received by the provider of service in convertible foreign exchange.

Audit, during verification of records of M/s. Star World International Service (India) Pvt. Ltd., in Chennai ST-I Commissionerate (audited in April 2015 by IAP), noticed that during FY14 an amount of ₹ 63.84 lakh was short reported in the ST-3 Returns filed by the assessee. This amount pertained to service charges on manpower supply services provided to M/s. Shriram EPC Ltd., Chennai for their project work at Iraq and the assessee classified the service under Export of services and did not pay Service Tax. It was further noticed that the amount was received by the assessee in Indian currency only. Audit pointed out that as the service recipient was located in India and the payment for the services was received by the assessee in Indian currency, the service should not be considered as Export of services and the Service Tax of ₹ 7.89 lakh was recoverable along with interest of ₹ 2.84 lakh.

When we pointed this out (March 2016) the Ministry while informing (May 2017) that the demand was confirmed, did not accept the audit objection quoting para 2.53 of Foreign Trade Policy, as per which export

proceeds realised in Indian Rupees against exports to Iran were permitted to avail exports benefits and the same might be applicable to Iraq as well.

The reply of the Ministry was contradictory as on one hand it stated that the demand had been confirmed and on the other hand contested the audit objection on the presumption that provision made specifically for Iran might be applicable for Iraq as well. In view of non-fulfilment of conditions prescribed, the service should not be considered as export of service and hence Service Tax was leviable as pointed out by us.

4.5.2 Non-detection of short-payment of Service Tax

4.5.2.1 Short payment owing to non-adherence to Point of Taxation Rules

According to Rule 3 of Point of Taxation of Rules 2011 introduced with effect from 1 April 2011, the point of taxation shall be, the time, when the invoice for the service provided or to be provided is issued and in a case where the person providing the service receives a payment before issue of invoice, be the time when he receives such payment, to the extent of such payment. Proviso to Rule 9 stated that services for which provision was completed on or before 30 June 2011, or where the invoices were issued up to the 30 June 2011, the point of taxation shall, at the option of the taxpayer, be the date on which the payment was received or made as the case may be.

During the examination of records of M/s Jelitta Publicity, Kottayam, in Cochin Commissionerate (audited in May 2014 by IAP), it was noticed from the sundry debtors and provision for bad debt shown in the books of accounts that the assessee had short paid Service Tax amounted to ₹ 2.85 crore due to non-adherence to Point of Taxation Rules, 2011 in FY12.

When we pointed this out (September 2015) the Ministry accepted the audit objection and stated (July 2017) that SCN demanding Service Tax of ₹ 8.60 crore including cess for the period FY12 to FY15 along with interest and penalties was issued to the assessee. For the failure of IAP, it stated that the objection could not be detected as the Internal Audit was done on a test check basis.

The reply of the Ministry was not acceptable as financial records of the assessee i.e. Balance Sheet, P&L account were to be scrutinised exhaustively while conducting Desk Review and not on test check basis.

4.5.2.2 Short payment of Service Tax on advances received

As per Section 67(3) of the Act, gross amount charged for taxable service shall include any amount received towards the taxable service before, during or after such provision of service.

M/s Skyline Builders in Cochin Commissionerate (audited in April 2014 by IAP), received advances (which included land value also) of ₹ 70.19 crore, ₹ 93.23 crore and ₹ 105.64 crore during FY13, FY14 and FY15 respectively. In the ST-3 returns for the years FY13, FY14 and FY15, this advance amount was not included in taxable value. The non-consideration of total amount received as 'advance from customers' for calculation of Service Tax had resulted in short-payment of Service Tax of ₹ 2.14 crore for the three years (after allowing abatement of 75 per cent of differential taxable value) and interest up to 31 August 2015 of ₹ 86.61 lakh.

When we pointed this out (September 2015) the Ministry accepted the audit objection and stated (July 2017) that SCN demanding Service Tax of ₹ 8.60 crore including cess for the period FY12 to FY15 along with interest and penalties was issued to the assessee. For the failure of IAP, it stated that the objection could not be detected as the Internal Audit was done on a test check basis.

The reply of the Ministry was not acceptable as financial records of the assessee i.e. Balance Sheet, P&L account, Trial Balance should be scrutinised exhaustively while conducting Desk Review and not on test check basis.

4.5.2.3 Short payment of Service Tax under reverse charge mechanism

In two cases[44], we pointed out that though IAP conducted audit of these assessees, they failed to detect short payment of Service Tax amounting to ₹ 1.61 crore under reverse charge mechanism. The Ministry accepted (April 2017 and July 2017) the revenue loss pointed out but stated that IAP had not audited these units. The reply of the Ministry was not tenable because as per the copies of IAP reports available with Audit, IAP had audited these units for part period covered in our audit objection.

[44] Hyderabad ST (M/s Globallogic Technologies Ltd.,) and Guntur Commissionerate (M/s GS Alloy Castings Ltd., Unit II)

4.5.2.4 Short payment of Service Tax due to misclassification of service

M/s Oswal Cables Pvt. Ltd., in Jaipur Commissionerate, was audited in October 2015 by IAP. Our examination of same assessee records (February 2016) revealed that the assessee provided Erection, Commissioning and Installation services to M/s Power Grid Corporation of India Ltd., for a value of ₹ 3.54 crore during FY13 and FY14, on which Service Tax amounting to ₹ 43.79 Lakh (including cess) was payable. Scrutiny revealed that the assessee paid Service Tax ₹ 17.49 Lakh on 40 per cent value of service after availing 60 per cent abatement incorrectly classifying the service as works contract service. Classifying this service as works contract service was incorrect as no transfer of property in goods was found involved in execution of this service. Therefore misclassification of service resulted in short payment of Service Tax of ₹ 26.30 lakh by the assessee.

When we pointed this out (February 2016) the Ministry stated (May 2017) that a SCN for the period April 2011 to March 2016 had been issued to the assessee for the recovery of Service Tax of ₹ 32.55 lakh. The reply of the Ministry was silent on failure of IAP.

4.5.3 Non-detection of non-payment of Service Tax

4.5.3.1 Non-payment of Service Tax due under reverse charge mechanism

Section 66B of the Finance Act, 1994 read with Rule 2(1)(d)(G) of Service Tax Rules, 1994, and Notification No.30/2012-ST dated 20 June 2012 stipulated that the recipient of services shall be liable to pay Service Tax on any taxable services received by a person in taxable territory from a person located in non-taxable territory.

Verification of the records pertaining to M/s Mercedes-Benz Research and Development India Pvt. Ltd., in Bangalore ST-II Commissionerate, revealed that the assessee received various services such as Information Technology Software Services, Professional and Technical Consultancy Services etc. from service providers located outside India and was liable to pay Service Tax thereon under reverse charge mechanism. However, the assessee did not pay Service Tax of ₹ 1.08 crore on these services received for the period from FY12 to FY16. This unit was audited by IAP in March 2014 but this lapse was not pointed out.

When we pointed this out (June 2016) the Commissionerate reported (March 2017) payment of Service Tax of ₹ 1.08 crore besides interest of ₹ 60.51 lakh on the basis of audit objection for the period FY12 to FY16. The

Ministry did not accept (October 2017) the lapse of the department by stating that the Internal Audit conducted in February 2012 (for the period upto FY11) had detected this issue on which SCN was issued for the period upto FY11. Therefore, the IAP which conducted the subsequent audit in March 2014 did not point out the same as the periodical SCN had to be issued/proposed by Range/Division concerned.

The reply of the Ministry was not acceptable in view of a specific check prescribed in column 17 of annexure VIII of Service Tax Audit Manual, 2011 for checking the previous SCN issued to the assessee and period covered therein to see whether the similar lapse continued. Further, despite the issue being in the knowledge of the department for the earlier period, if the issue had not been flagged by the CAG Audit, demand could have become time barred.

4.5.3.2 Non-payment of Service Tax on business support services

Services provided to a person by any other person in relation to support services of business or commerce, in any manner was taxable service till 30 June 2012. Service Tax on all services except those which were exempted vide any notification or were those which were entered in the negative list were liable to Service Tax with effect from July 2012.

M/s. Checkmate Services Pvt. Ltd., in Vadodara-I Commissionerate, rendered services of handling and transportation of municipal wastes worth ₹ 3.46 crore during FY13 to FY15 to M/s. UPL Environmental Engineers Ltd., (UPLEEL). These services fall under business support services, on which Service Tax of ₹ 42.80 lakh was payable. However, no Service Tax has been paid by the assessee on this amount.

When we pointed this out (January 2016) the Ministry accepted (September 2017) the audit observation and issued SCN for an amount of ₹ 2.15 crore. Further, for the failure of IAP, the Ministry stated that Internal Audit was done on test check basis due to which the Ministry said lapse could not be detected.

The reply of the Ministry was not acceptable because this non-payment of Service Tax continued for three financial years and hence non-inclusion of this issue in IAP's audit plan indicated poor quality of desk review.

4.5.3.3 Non-payment of Service Tax on declared service

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

Scrutiny of Service Tax and financial records of M/s M.P. Audyogik Kendra Vikas Nigam (India) Ltd in Indore Commissionerate revealed (August 2016) that for the period FY13 to FY16, the assessee had shown an income of ₹ 9.54 crore on account of "Penalty/Fine and Others". This falls under the ambit of declared service as per Section 66E(e) quoted ibid but Service Tax of ₹ 69.89 lakh (including cess), leviable on this amount of income, was not paid by the assessee. The same was liable to be recovered from the assessee along with interest and penalty.

When we pointed this out (August 2016) the Ministry did not accept the audit objection and stated (September 2017) that penalty/fine for violation of an agreement cannot be considered as "consideration received" under section 67 of Finance Act, 1994 and hence not a 'service'. They further held that penalties and fines, being levied for inability of person to meet commitment as agreed upon, should in no way be considered as ''rendering of service".

The reply of the Ministry was not acceptable because "to tolerate an act" had been specifically included in declared service as per section 66 of the Finance Act, 1994.

4.5.4 Non-detection of irregular availing/utilization of CENVAT credit

As per Rule 6(3)(ii) of CENVAT Credit Rules, 2004, service provider, having both taxable and exempted services has to maintain separate accounts for receipt and use of inputs/services. A service provider opting not to maintain separate accounts, has an option to proportionately reverse CENVAT credit pertaining to exempt services as prescribed under Rule 6(3A). To calculate this proportionate amount, total Cenvat credit availed on inputs/input services during the financial year should be considered.

4.5.4.1 Short-reversal of CENVAT credit

IAP conducted (December 2013) audit of M/s Motor World Ltd., 'Nandi Toyota', in Bangalore ST-II Commissionerate, covering the period up to September 2013. Our scrutiny (July 2015) revealed that the assessee availed CENVAT credit on inputs and input services utilised commonly for both taxable and exempted services and did not maintain separate accounts. The

assessee reversed a portion of CENVAT credit but calculated the amount reversible by adopting only the common input services used for both taxable and exempted services instead of all input services as prescribed. This resulted in short-reversal of ₹ 1.32 crore during FY13 to FY15.

When we pointed this out (July 2015) the Ministry did not accept the audit objection and stated (September 2017) that the assessee was eligible for CENVAT credit in full on input services exclusively used for providing taxable services and calculation of assessee was correct. It was also informed that an SCN demanding ₹ 1.05 crore was issued on the basis of the audit observation to safeguard revenue and that the assessee paid (September 2015 and January 2017) an amount of ₹ 1.10 crore under protest against this demand.

The reply of the Ministry was not acceptable because for an assessee not maintaining separate account for taxable and exempted input service, CENVAT credit reversal should be determined as prescribed in rule 6(3A) of CENVAT Credit Rules, 2004 in which whole of CENVAT credit was to be taken for calculation of reversal of CENVAT credit amount.

4.5.4.2 Irregular availing of CENVAT credit

As per Notification No. 26/2012-ST dated 20 June 2012 applicable with effect from 01 July 2012, an abatement of 75 per cent of the gross amount is given in case of Construction of a complex, building, civil structure or a part thereof, intended for sale to a buyer, wholly or partially except where entire consideration is received after issuance of completion certificate by the competent authority, provided that no CENVAT credit on inputs used for providing the taxable service has been taken under the provisions of CENVAT Credit Rules, 2004.

Scrutiny of Service Tax records of M/s. Paras Realtech Ltd., in Delhi ST-I Commissionerate (audited in June 2015 by IAP), revealed that during FY13 and FY14, the assessee had availed CENVAT credit of ₹ 77.35 lakh on inputs in addition to input services and capital goods, which was not admissible as per notification quoted. Hence, the CENVAT credit of ₹ 77.35 lakh irregularly availed on inputs was required to be recovered with interest.

When we pointed this out (November 2015) the Ministry (August 2017) while informing that a SCN had been issued (September 2016) stated that as the verification of CENVAT was carried out on sample basis of invoices submitted by the assessee to the IAP, the said lapse could not be detected.

The reply of the Ministry was not acceptable as a specific check was prescribed in column 12 of Annexure VIII of Service Tax Audit Manual, 2011 for checking the correctness of exemption claimed by the assessees and the required information was available in the ST-3 return itself.

4.5.5 Non-detection of non-remittance of Service Tax collected

M/s Writers & Publishers Pvt. Ltd., in Bhopal Commissionerate, was audited by IAP covering the objection period. Our scrutiny (August 2016) of records of this assessee revealed that during FY13 to FY16, the assessee paid Service Tax on Renting of Immovable Property Service on abated value of service ₹ 24.11 crore, but charged and collected the Service Tax on full gross value of service of ₹ 25.41 crore from its client. Thus, the assessee collected Service Tax of ₹ 0.17 crore, on amount of abatement so availed, from its client but did not deposit to the credit of Central Government.

Similarly in case of M/s. Vishwa Infrastructures and Services Pvt. Ltd., in Hyderabad ST Commissionerate, covered by IAP for the period upto March 2013, we noticed that the assessee did not remit Service Tax amounting to ₹ 0.20 crore collected by them.

When we pointed these out (September 2016 and February 2016) the Ministry accepted the audit objection (October 2017 and April 2017) but were silent on failure of IAPs in both cases.

4.5.6 Non-detection of short/non-payment of interest

As per Section 75 of the Finance Act, 1994, interest is payable on payment of Service Tax at the prescribed rates.

M/s. Durga Construction Co., in Kutch Commissionerate, had made delayed payment of Service Tax in FY15 and FY16. However, interest applicable for the delay in payment amounting to ₹ 1.25 crore was not paid by the assessee. The IAP which audited (September 2016) the assessee's records did not point out the same.

When we pointed this out (November 2016) the Ministry accepted the audit objection and informed (June 2017) that the assessee had paid the interest amount. For failure of IAP, the Ministry stated that Internal Audit was done on test check basis.

The reply of the Ministry for IAP failure was not acceptable in view of a specific provision for checking all ST-3 returns under column 20 of Annexure IV of Service Tax Audit Manual, 2011.

4.5.7 Non-identification of unregistered service providers/tax defaulters by Internal Audit

We noticed during verification of M/s Eastern Coalfields Ltd., in Dhanbad Commissionerate that 27 service providers of the assessee did not levy Service Tax amounting to ₹ 22.44 lakh on work contracts service provided to the assessee. Similarly our examination of records of M/s Popy Umbrella Mart in Cochin Commissionerate revealed that the service provider of this assessee neither obtained registration nor paid Service Tax amounting to ₹ 10.01 lakh. Though IAP audited (January and August 2014) the assessees, they did not detect these lapses.

When we pointed these out, the Ministry accepted the revenue loss in both cases (May 2017 and September 2017) and for the failure of IAP stated that the IAP had conducted audit of the service recipient and not the service provider. The reply of the Ministry could not be accepted as a specific check was prescribed for scrutiny of expenditure accounts of the assessee to see whether Service Tax liability on those accounts had been fulfilled or not.

4.5.8 Cases where details of internal audit were not provided

In five instances (included in Section C[45] of ***Appendix V***) of short/non-payment of Service Tax etc. noticed by us, the details of Internal Audit such as selection of these units for audit, conduct of audit, IAP Report etc were not provided to us. Hence we were unable to examine the efficacy of Internal Audit in these cases. Two such cases had been illustrated below:

4.5.8.1 Non-payment of Service Tax under reverse charge mechanism

Section 66B of the Finance Act, 1994 read with Rule 2(1)(d)(G) of Service Tax Rules, 1994, and Notification No.30/2012-ST dated 20 June 2012 stipulated that the recipient of services shall be liable to pay Service Tax on any taxable services received by a person in taxable territory from a person located in non-taxable territory.

Scrutiny of the annual accounts of M/s Johnson & Johnson Ltd., in Mumbai LTU Commissionerate for the period FY12 and FY13 revealed that the assessee paid an amount of ₹ 122.80 crore and ₹ 137.14 crore respectively as royalty to M/s Johnson & Johnson, USA. However, a prima facie reconciliation of this expenditure with the ST-3 returns revealed short-reporting of taxable value offered for tax in the ST-3 returns.

[45] Sl. Nos. 8, 10, 12, 24 and 38 of Section C of Appendix-V.

When we pointed this out (August 2014) the Commissionerate (August 2016) intimated that assessee had paid Service Tax amount of ₹ 1.65 crore along with interest of ₹ 1.19 crore but details of Internal Audit were not provided. The reply of the Ministry was awaited (October 2017).

4.5.8.2 Short payment of Service Tax due to non-reflection of CENVAT credit utilization in the return

Section 68 of the Finance Act, 1994, provides that every person providing any taxable service shall pay Service Tax at the rate prescribed. Rule 6 of the Service Tax Rules, 1994, stipulates that Service Tax shall be paid to the credit of the Central Government by the 5th/6thof the month, immediately following the calendar month in which the payments are received except for the month of March where tax is to be paid by the 31st of March itself.

Scrutiny of records M/s. Starlog Enterprises Ltd in Mumbai ST-II Commissionerate revealed that as per reconciliation statement of FY16, the assessee had paid total Service Tax liability of ₹ 4.98 crore (₹ 3.41 crore in cash & ₹ 1.57 crore by utilisation of CENVAT credit) for the period from October 2015 to March 2016. However, CENVAT Credit utilization was not reflected in the ST-3 Return and the entire amount of ₹ 1.57 crore was included in closing balance of CENVAT Credit in the ST-3 return. This resulted in short payment of Service Tax of ₹ 1.57 crore which was to be recovered along with interest and penalty.

When we pointed this out (January 2017) the Ministry accepting the audit objection (September 2017) reported payment of Service Tax liability of ₹ 91.24 lakh including interest of ₹ 12.95 lakh by the assessee and stated that an SCN was being issued for the balance amount. But the Ministry could not confirm the details of Internal Audit due to non-availability of this information in the newly constituted GST Audit I Commissionerate, Mumbai and final reply was awaited (October 2017).

4.6 Shortcomings in functioning of Jurisdictional Commissionerates

We noticed 14 cases indicating shortcomings in functioning of jurisdictional Commissionerates. The Ministry accepted three cases (Section D of ***Appendix-IV***) whereas in 11 cases (Section D of ***Appendix-V***), the Ministry did not accept the Audit observation/reply was awaited.

Some cases are illustrated below:

4.6.1 Non-identification of defaulters from Government records

As per the Board's instruction dated 23 November 2011, the special cell in the Commissionerate had to obtain information from different sources such as yellow pages, newspaper advertisements, Income Tax department, regional registration authorities and websites, information from municipal corporations and major assesses including PSUs and private sector organisations regarding various services being availed by them.

During test check of records of Mission Director, National Health Mission, Panchkula (Haryana) for FY12 to FY16, it was noticed that the said office hired the taxis for the officers of their department from M/s Shagun Enterprises, Chandigarh. We scrutinized the records/bills & vouchers of M/s Shagun Enterprises, registered under Service Tax in Chandigarh I Commissionerate, and found that the assessee had received ₹ 2.60 crore for providing Rent-a-Cab service for the period FY13 to FY16 from the Office of the Director, National Health Mission, Panchkula and was liable to pay Service Tax. But the assessee had neither filed Service Tax return (ST-3) nor paid Service Tax amounting to ₹ 13.05 lakh which was recoverable with interest of ₹ 6.48 lakh.

When we pointed this out (April 2016) the Ministry admitted the audit objection and reported (September 2017) that the assessee had paid the total Service Tax liability including interest and penalty amounting to ₹ 25.22 lakh. The Ministry had further stated that the assessee had not filed any ST-3 returns, therefore, no scrutiny of returns/Internal Audit was conducted.

The Ministry's reply was not relevant to the point that we made about utilizing information available in Government records to identify tax defaulters.

4.6.2 Non-realisation of late fee on delayed submission of returns

Section 70 of the Finance Act 1994, provides for levy of late fee not exceeding ₹ 20,000/- for delayed submission of return.

Audit examination of the records of Service Tax Range Moradabad, under Hapur Commissionerate, revealed that 325 ST-3 returns pertaining to FY15 were submitted with delay ranging from one day to 482 days. The department did not ensure the recovery of late fee amounting to ₹ 34.55 lakh on these delayed returns.

When we pointed this out (April 2016) the Commissionerate admitted the audit observation and intimated (September 2016) that recovery proceedings had been initiated and so far 10 SCNs were issued and SCNs regarding remaining defaulters were under process.

Further progress and reply of the Ministry were awaited (September 2017).

4.6.3 Short coming in follow-up action

The internal control mechanisms in the department like scrutiny of returns or Internal Audit would have the required impact only if the jurisdictional officers take proper follow up action on the lapses noticed earlier. We noticed two instances of short coming in follow-up action by departmental officers and revenue loss of ₹ 0.44 crore would have remained undetected if not pointed out by audit. Both the cases are illustrated below:

4.6.3.1 Short payment of Service Tax

Our scrutiny of M/s Vishwa Infrastructures and Services Pvt. Ltd., in Hyderabad Service Tax Commissionerate revealed that the assessee short paid Service Tax of ₹ 30.62 lakh for FY15. Further, Internal Audit conducted for the period up to March 2013, had pointed out four similar objections for FY13. But still the jurisdictional range office had not taken action to ensure payment of Service Tax in subsequent years until pointed out by CAG Audit.

When we pointed this out (February 2016) the Ministry accepted (April 2017) the audit objection and recovered ₹ 30.62 lakh, while the interest still remained to be recovered. The Ministry further stated that as the assessee had already declared the default, no separate action was required.

The reply of the Ministry indicated failure of the department in ensuring compliance by assessees even in known cases of default in earlier period.

4.6.3.2 Short reversal of CENVAT credit

As per Rule 2(e) of CENVAT Credit Rules, 2004 read with section 66B and 66D of the Finance Act 1994, effective from 1 July 2012, the activity of trading specified in the negative list is "exempted service". Further in case where both taxable and exempted services are provided and the service provider did not opt to maintain separate accounts relating to common input services, then as prescribed in Rule 6(3) of the said Rules, the service provider is liable to pay either an amount equal to six per cent of the value of the exempted

services or reverse the Cenvat credit attributable to exempt stream as prescribed in Rule 6(3A).

On verification of records of M/s. ISS SDB Security Services Pvt. Ltd., in Chennai ST-II Commissionerate, we noticed that during FY13 to FY16, the assessee had availed CENVAT credit on common input services relating to both taxable and exempted services (Trading) and utilised the credit for payment of Service Tax on taxable services, without reversing CENVAT credit of ₹ 10.28 lakh attributable to trading activity which has to be paid along with applicable interest.

IAP of the department had also pointed out the same mistake for FY13 and FY14 and assessee reversed the CENVAT amount. But CAG Audit on verification of the ST-3 returns with annual accounts of the assessee found that the assessee had made short reversal of CENVAT credit of ₹ 8.92 lakh for FY13 to FY14 and non-reversal of ₹ 1.36 lakh for FY15. Hence, the department failed to ensure correctness of the CENVAT reversal by the assessee even after IAP noticed this lapse on part of the assessee.

When we pointed this out (March 2016) the Ministry while not accepting the audit objection (September 2017) stated that the matter was already in its knowledge as IAP had already pointed out the lapse and that the assessee had reversed the incorrectly availed CENVAT credit of ₹ 10.28 lakh and also paid due interest of ₹ 2 lakh.

The reply of the Ministry was not acceptable as Audit had not pointed the failure of IAP but the lapse in follow up action of the department which resulted in short recovery of objected amount, which was corrected only after being pointed out by CAG Audit.

4.6.4 Excess grant of refund

As per Board's circular dated 1 March 2005, all refund/rebate claims involving an amount of ₹ 5 lakh or above should be subjected to pre-audit at the level of Jurisdictional Commissioner.

M/s. Sonata Information Technology Ltd., in LTU Mumbai Commissionerate, engaged in providing Information Technology Software Services, filed revised refund claim of ₹ 82.65 lakh for the quarter October 2012 to December 2012 which was sanctioned by the department in April 2014. Audit scrutiny revealed that there was excess grant of refund of ₹ 20.46 lakh on account of availing pre-mature CENVAT credit of Service Tax paid under reverse charge

and non-exclusion of TDS of from export turnover. Though the refund claim was pre audited in April 2014, these discrepancies were not pointed out.

When we pointed this out (June 2015) the Ministry (July 2016) informed that an SCN demanding recovery of excess refund of amount of ₹ 20.46 lakh was issued (September 2015) to the assessee. The Ministry stated that pre audit of the refund claim was confined to confirming the amounts of CENVAT credit availed in returns filed with the amount claimed in refund application which was found to tally. The Ministry further stated that the refund claim was also accompanied by a certificate duly signed by an independent Chartered Accountant (CA) certifying the correctness of refund claim.

The reply of the Ministry was not tenable as it can not absolve itself of the responsibility of ensuring correctness of refund sanctioned by quoting certification by a CA and the Ministry also needed to ensure proper action against the CA who had certified the refund claim incorrectly.

4.6.5 Lacunae in issue of SCNs

As per the provision under Section 73 of Chapter V of the Finance Act, 1994 where any Service Tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded, the Central Excise Officer may within eighteen months from the relevant date, serve notice on the person chargeable with the Service Tax.

4.6.5.1 Non-issuance of SCN in time

M/s National Hydro Power Corporation Ltd., (NHPC) in Patna Commissionerate, received ₹ 31.09 crore during FY13 to FY15 from the Ministry of Road as agency fee. But the assessee did not deposit Service Tax and Education Cess amounting to ₹ 3.84 crore.

When we pointed this out (March 2016) the Commissionerate replied (January 2017) that on the same issue the assessee has filed an appeal before the CESTAT for the period FY09 to FY12 on which stay was granted.

The reply of the Commissionerate could not be accepted as this issue covering the period FY09 to FY12 was reported in CAG's Report no. 4 of 2015 (Para 7.4.1.1) where failure of internal audit in detecting the lapse was pointed out and the department intimated confirmation of the demand in this case during adjudication. Even after being pointed out by CAG during earlier period, the department did not issue SCN of ₹ 3.84 crore for the subsequent period i.e. FY13 to FY15. This carried the risk of a part of the tax payable becoming time barred.

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

4.6.5.2 Non-inclusion of demand in the SCN

Scrutiny of the records of North Division under Kolkata ST-I Commissionerate (November 2015) revealed that the IAP raised the observations for ₹ 1.70 crore for the period from FY10 to FY12 and of ₹ 13.10 lakh for the period from FY10 to FY11 in respect of M/s Genius Consultants Ltd. and M/s Nomura Research Institute Financial Technologies India Pvt. Ltd. Both the issues were discussed in the Monitoring Committee Meeting (MCM) held in February 2013 and February 2014 respectively and decision for issue of SCNs was taken. Finally, the department had issued SCNs in October 2015 excluding demands of ₹ 29.26 lakh and ₹ 5.42 lakh respectively pertaining to FY10 as the same had got time barred. Thus delay in issue of SCN had resulted in revenue loss of ₹ 34.68 lakh.

When we pointed this out (November 2015) the Ministry admitted the audit objection (September 2017) and stated that delay in issuance of SCN was due to late forwarding of Draft SCN by the concerned division and an explanation from the concerned officers was called for.

New Delhi **(HIMABINDU MUDUMBAI)**
Dated: 27 November 2017 **Principal Director (Goods and Services Tax-I)**

Countersigned

New Delhi **(RAJIV MEHRISHI)**
Dated: 27 November 2017 **Comptroller and Auditor General of India**