

Chapter V

Effectiveness of Internal Controls

5.1 Introduction

Internal control is an integral process that is effected by an entity's management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of the entity's mission, the following general objectives⁴⁸ 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 viz. audit and return scrutiny. The return scrutiny is envisaged in a two-part system - a preliminary scrutiny which would be online covering all the returns and a detailed manual scrutiny of select returns, identified on the basis of risk parameters, to be done by the Division/ Range offices. The audit commissionerates carry out Internal Audit of select assesses to verify their compliance with rules and regulations relating to Service Tax. 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.

5.2 Results of Audit

During the course of examination of records, we came across several shortcomings in compliance of field formations to the instructions in place regarding broadening of tax base, return scrutiny and Internal Audit of assesseees. These suggest that the department should look into the adequacy of extant systems and procedures. We communicated these observations to the Ministry through 91 draft audit paragraphs having financial implication of ₹ 118.66 crore. Out of these, 63 cases which have been accepted by the department and recoveries made/ recovery proceedings initiated are mentioned in Appendix III and 28 cases are discussed in the following paragraphs under four major headings:

⁴⁸ INTOSAI GOV 9100 – Guidelines for Internal Control Standards for the Public Sector

- Broadening of Tax Base
- Scrutiny of Returns
- Internal Audit of Assesseees
- Other Issues

5.3 Broadening of Tax Base

As per the Board's instruction dated 23 November 2011, the special cell in the Commissionerate had to obtain information on unregistered service providers 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.

Two cases where the department failed to identify the Service Tax defaulters are narrated below:

5.3.1 Non Levy of Service Tax including Interest on Consultancy Services

As per section 65A of the Finance Act, 1994, the term 'Insurance auxiliary service' means any service provided by an actuary, an intermediary or insurance intermediary or an insurance agent in relation to general insurance business or life insurance business and includes risk assessment, claim settlement, survey and loss assessment. Interest also payable for delayed payment of Service Tax.

Audit (September 2015) of income tax records at Circle-2, Pr. CIT, Hazaribagh charge of an assessee M/s Life line Advisory & Consultancy Pvt. Ltd. (PAN No. AABCL6766A) revealed that the assessee received ₹ 1.75 crore during 2010-11 as subscription and consultancy receipt, on which the assessee is liable to pay Service Tax including interest amounting to ₹ 31.05 lakh, which was not discharged by the assessee.

When we pointed this out (September 2015), the Ministry replied (December 2016) that the assessee is neither registered with the department nor traceable at the address given. Further, the Ministry described all the actions taken by the department from December 2015 (i.e. post audit objection) to December 2016 for tracing the assessee.

Thus, non initiation of timely action on the Board's instructions cited ibid by collecting details from Income Tax returns resulted in loss of Government revenue to the tune of ₹ 31.05 lakh.

5.3.2 Non-Registration and Non-Payment of Service Tax by Service Providers

Audit observed from the cross check of surrendered registrations with information collected from Vaikon Municipality, other assesses and websites that 15 assesseees⁴⁹ who surrendered registrations were continuing their activities for more than eight years. It was further noticed that no Service Tax registration was taken by nine other service providers.

When we pointed this out (January 2014) during audit of Central Excise Range, Vaikon, the Ministry replied (December 2016) that five SCNs were issued in acceptance of CERA objection. The Ministry further stated Vaikon Range had conducted investigations about the tax liability of 25 co-operative Banks/ societies and issued total number of 50 SCNs to 22 Co-operative Banks/ societies demanding Service Tax.

Analysis of SCNs issued to the Co-operative societies revealed that the action was initiated post CERA objection. Even if it is accepted that action has been initiated before we pointed these in audit, it is evident that follow up by the department was ineffective as the prospective assesseees took their own time to furnish the necessary details.

Delayed action by field formations in identifying non-registrants and non-filers might either render the demands time barred or the assesseees untraceable. Thus, there is a need for Board to ensure that its instructions regarding tax base broadening are implemented effectively by its field formations.

5.4 Inadequate Scrutiny of Returns

During examining ST-3 returns at ranges, 10 instances were observed by us where the liability to pay tax or interest on delayed payment of tax escaped the notice of the authorities due to inadequate scrutiny of returns as detailed in Table 5.1. In all these cases, action for recovery of tax / interest has been initiated and the Ministry attributed inadequate scrutiny of returns to problems associated with ACES as discussed in the Table 5.1.

⁴⁹ Ten co-operative banks, Vaikon Kuries (Non-banking financial institution), Travancore Devaswom Board, St.Thomas Parish Hall and Commercial Centre, Chembu Welfare Centre and NSS Union

Table 5.1 : Observations on Inadequate Scrutiny of Returns

Sl. No.	Name of Commissionerate/ Assessee	Gist of Audit Objection	Reasons given for Shortcomings by the Ministry
1.	Ludhiana/M/s. Creative Cable Network Pvt. Ltd.	Non-payment of interest and late fee	The ACES was showing returns for view only and not for Review.
2.	Bhubaneswar-II/ nine service providers	Short payment of Service Tax	Returns were not available in ACES/ manual form.
3.	Mumbai ST-IV/ M/s. Aban Offshore Pvt. Ltd.	Short payment of interest	Due to the time taken to establish ACES network at the newly acquired premises of the reorganized Commissionerate.
4.	Siliguri/ M/s. Subba Micro System Ltd.	Non-payment of interest	Due to technical reasons in the ACES system, ST-3 returns filed by the assessee online were not being reflected in the dashboard of the concerned Range Officer.
5.	Mumbai ST-VII/ M/s. Blue Star Ltd.	Non detection of access availing of CENVAT credit	Return not taken up for detailed scrutiny as the unit was a category A unit to be mandatorily audited every year.
6.	Chandigarh-I/ M/s. Jaycon Infrastructure Ltd.	Short payment of interest	Returns not scrutinized due to heavy work load and connectivity issues in ACES.
7.	Mumbai ST-VII/ 108 returns	Non recovery of late fee on delayed filing of ST-3 returns	Due to non functioning of ACES during relevant period.
8.	Kolkata ST-I/ M/s. Nicco Corporation Ltd.	Short payment of Service Tax	Due to acute shortage of manpower.
9.	Siliguri/ M/s. Subba Micro System Ltd.	Short payment of Service Tax	Due to technical reasons in the ACES system, ST-3 returns filed by the assessee online were not being reflected in the dashboard of the concerned Range Officer.
10.	Nagpur-II/M/s. Avaneesh Logistics Pvt. Ltd.	Non-payment of interest	Returns not marked for 'Review and Correction' by the ACES.

The roll out of ACES began in December 2008 and even after eight years, field formations cited technical problems in ACES as the reasons that hampered their return scrutiny work and these constraints were endorsed by the Ministry as the above reasons were forwarded by the Ministry in response to audit.

Two cases are illustrated below:

5.4.1 Non Detection of Non-Payment of Interest

Scrutiny of ST-3 Return and payment details of M/s Avaneesh Logistics Pvt. Ltd in Wanjra Range of Nagpur II Commissionerate revealed that the assessee

did not pay interest amounting to ₹ 35.71 lakh on delayed payment of Service Tax during the period 2012-13 to 2014-15.

When we pointed this out (September 2015), the Ministry intimated (December 2016) that the assessee had deposited an amount of ₹ 26.20 lakh for the period from June 2012 to March 2015. Further, for the departmental lapse the Ministry stated that the preliminary scrutiny of online periodic returns by the jurisdictional office is limited to the returns selected by ACES as “marked for review” and the ST-3 Returns of M/s Avaneesh Logistics Pvt. Ltd. for the period July 2012 to March 2015 were not “marked for review” by ACES.

In preliminary scrutiny of returns, identification of delay in payment of Service Tax is a very important check to ensure that interest thereon is paid by the assessee. Preliminary scrutiny of returns was automated through ACES to free manpower for detailed scrutiny of returns. But the above reply of the Ministry shows that non-payment of interest on late payment of Service Tax is not identified by the ACES to mark the return for ‘Review and Correction’. The Ministry also forwarded the above reply without examining or explaining reasons for this lacuna in ACES. This serious lacuna in ACES needs to be examined and suitably addressed by the Ministry.

5.4.2 Non Detection of Excess Availing of CENVAT Credit

Scrutiny of ST-3 Return of M/s Blue Star Ltd. in Service Tax-VII Mumbai Commissionerate, a registered service provider under the category of Works Contract Services revealed that during the period 2012-13 and 2013-14, the assessee had carried forward the CENVAT credit balances with an excess amount of ₹ 17.53 lakh including Cess. This was reflected on the face of the return filed in November 2013 for the aforesaid period under ‘Following issues have been found in your return’. However, no corrective action was taken till pointed out by CERA party in September 2015. This resulted in excess availing of CENVAT credit of ₹ 17.53 lakh which was irregular.

When we pointed this out (September 2015), the Ministry intimated (November 2016) that the assessee had reversed the said CENVAT credit ₹ 17.53 lakh. Further, for the departmental lapse, the Ministry stated that since the unit was under category ‘A’ and to be mandatorily audited every year, the same was not taken up for scrutiny.

The reply of the Ministry is not acceptable as preliminary scrutiny is to be done on all the returns and this mistake was marked for ‘Review and Correction’ by the ACES.

5.5 Shortcomings Noticed in Internal Audit of Assesseees

Compliance verification through audit entails conduct of audit at assessee premises by following prescribed procedures including selection of assessee units based on risk parameters and scrutiny of records of the assessee to ascertain the level of compliance with the prescribed rules and regulations. Every Commissionerate has, within its Internal Audit section, an Audit cell, manned by an Assistant/Deputy Commissioner and Auditors and headed by an Additional/Joint Commissioner. The Audit cell is responsible for planning, monitoring and evaluating the audits conducted. Internal Audit Parties (IAPs) consisting of Superintendents and Inspectors carry out the audit at assessee premises in accordance with the Audit Plan and as per the procedures outlined in the Service Tax Audit Manual, 2011.

Our observations on Effectiveness of Internal Audit conducted as a focused audit in selected commissionerates are reported in Chapter III. During the course of our regular compliance audit of Commissionerates, we attempted to check the adequacy of coverage of assesseees as well as the quality of audits undertaken by the IAPs by auditing a sample of assesseees falling under one of the following two categories a) already audited by IAP and b) due for audit but not covered by IAP. We noticed cases of non/short payment of tax / interest or irregular availing of CENVAT credit by the assesseees, of which 13 cases are narrated below:

5.5.1 Examination of Records of Selected Assesseees Already Covered by Internal Audit:

During the course of our examination of records of selected assessee already covered under Internal Audit, we came across certain instances where IAPs of the Commissionerate had omitted to point out certain significant cases of non-compliance by assesseees. Eleven such cases are illustrated below:

5.5.1.1 Short Payment of Service Tax under Credit Card Services

Section 65(105)(zzzw) of Finance Act 1994, as amended defined Credit Card Services, which became taxable from 1 May 2006, as any service provided or to be provided to any person, by any other person, in relation to credit card, debit card, charge card or other payment card service in any manner.

M/s. Federal Bank Ltd. Aluva, an assessee in Cochin Commissionerate provided Credit Card related services. As per report of M/s. National Payment Corporation of India (NPCI), a nodal agency for domestic card related transactions, amount and Service Tax receivable by the bank in respect of Credit Card related transactions was ₹ 41.15 crore and ₹ 5.09 crore respectively for the year 2012-13. The assessee, however, paid

Service Tax only on a value of ₹ 27.02 crore during the year 2012-13, resulting in short payment of Service Tax of ₹ 1.75 crore.

Internal audit covering the period upto October 2013 was conducted in November 2013 and lapse subsequently detected by CERA was not found out.

When we pointed this out (February 2014), the Ministry replied (November 2016) that the amount of ₹ 1.89 crore was paid along with interest of ₹ 0.64 crore by the assessee. For the failure of IAP, the Ministry stated that the IAP could not detect the lapse from the periodical returns as the reworked assessable value and taxes were not shown in the returns.

Reply of the Ministry is not acceptable as the main objective of Internal Audit is to ascertain the veracity of the details furnished by the assessee in periodical returns vis-à-vis its financial records and the IAP had failed to ensure that.

5.5.1.2 Non-Payment of Research & Development Cess on Payments Made for Import of Technology

Section 3 of the Research and Development (R&D) Cess Act, 1986 provides for collection of a cess at such rates not exceeding 5 percent (presently 5 per cent) to be levied and collected on all payments made towards the import of technology. Further, notification 17/2004 ST dated 10 September 2004 exempted the taxable service in relation to intellectual property rights (IPR) service from so much of the ST leviable thereon under section 66 of the said Act, as is equivalent to the amount of cess paid towards the import of technology.

M/s Vodafone South Ltd in Hyderabad ST Commissionerate, who are providing Telecommunication Service, had imported technology during the period from 2012-13 to 2014-15 and incurred an amount of ₹ 49.95 crore but did not pay Research and Development Cess (R&D Cess). As per the provisions of the Act *ibid*, the assessee is required to pay R&D Cess of ₹ 2.50 crore which needs to be recovered from the assessee along with interest.

Though Internal Audit of the assessee was conducted twice in May-June 2014 and April-May 2015 for 2012-13 and 2013-14 respectively but non-payment of R&D cess was not pointed out, resulting in error remaining undetected until pointed out by CERA party.

When we pointed this out (July 2015), the Ministry did not admit the audit objection (November 2016) stating that collection of R&D cess is not covered under Finance Act 1994, therefore no audit objection was raised by the

officers during the course of Internal Audit and no remedial action can be taken by the department.

The reply of the Ministry is not acceptable as exemption from payment of Service Tax under the notification *ibid* is dependent on R&D Cess paid by the assessee, it was the duty of the IAP to check the payment of R&D cess.

5.5.1.3 Non-Adherence to Rule 6 (3B) of CENVAT Credit Rules 2004

According to Rule 6(3B) inserted in CENVAT Credit Rules (CCR), 2004 with effect from 1 April 2011, notwithstanding anything contained in sub rules (1), (2) & (3), a banking company and a financial institution including a non-banking financial company engaged in providing services by way of extending deposits, loans or advances, shall pay for every month an amount equal to fifty percent of the CENVAT credit availed on inputs and input services in that month.

M/s UAE Exchange and Financial Services Ltd., a non-banking finance company in Cochin Commissionerate, availed CENVAT credit of ₹ 81.60 lakh and ₹ one crore respectively for the years 2011-12 and 2012-13 being Service Tax paid on input services. The assessee, however, did not pay 50 per cent of the credit availed on input services. This had resulted in non-payment of ₹ 90.92 lakh under Rule 6(3B) of CCR 2004 for the period 2011-12 to 2012-13.

Internal Audit conducted in August 2013 covering the period up to July 2013, did not identify this lapse.

When we pointed this out (February 2014), the Ministry accepted the audit objection (November 2016) and stated that two show cause notices amounting to ₹ 2.21 crore had been issued for period covering FY12 to FY15. Further, for the failure of the IAP, the Ministry stated that the party had detected other lapses involving revenue of ₹ 2.32 crore but could not detect the lapse pointed out by CERA party.

The reply of the Ministry is not acceptable as this objection was related to rule 6(3B) of CENVAT Credit Rules, 2004 specifically applicable for this sector units only and hence the IAP should have included this check in their audit plan for this unit.

5.5.1.4 Non-Payment of Service Tax on Land Owner's Share of Flats

Services in relation to construction of a new residential complex or a part thereof is liable to Service Tax under Sections 65(105)(zzzh) and under Section 66B (with effect from 1 July 2012) of the Finance Act 1994. Rule 3(a) of Point of Taxation Rules, 2011 stipulates that date of completion of service shall be considered as the point of taxation in case the invoice for the

provision of service is not issued within the time prescribed under Service Tax Rules, 1994. Paragraph 2 of CBEC Circular No.151/2/2012-ST dated 10 February 2012 clarifies that Service Tax is liable to be paid by the builder/developer on the construction service involved in the Joint Development Agreements (JDAs) for the flats to be given to the landowner. The value for these flats given to landowners would be equal to the value of similar flats charged by the developer/builder from other service recipients.

M/s Arya Gruha Pvt. Ltd., Bangalore, in ST-II Commissionerate, an assessee was engaged in construction of residential complexes. As per the JDAs entered into (March 2009 and April 2010) by the assessee with the landowners, possession of 33 residential units were handed over to the land owners during the period from June 2013 to April 2015 i.e. after issue of circular quoted *ibid*. Hence the assessee was liable to pay Service Tax on the construction service involved in these flats, which was not paid by the assessee.

This non-payment of Service Tax was not detected by the IAP of the erstwhile Service Tax Commissionerate, Bangalore during their audit (January 2014) which partially covered objection period.

When we pointed this out (January 2015), the Ministry accepted the revenue lapse (August 2016) and stated that a demand of ₹ 1.06 crore had been issued and that the assessee paid (July 2015) an amount of ₹ 20 lakh. For the failure of IAP, the Ministry further stated that the assessee did not provide all the details at the time of Internal Audit and the Balance Sheet for the FY14 was also not finalised by January 2014 i.e. at the time of audit and hence the IAP could not detect this lapse.

The reply of the Ministry is not acceptable as the IAP had not included the issue of non-furnishing of records by the assessee in its report.

5.5.1.5 Non-Payment of Service Tax on Works Contract Service under Partial Reverse Charge Method

As per Notification No.30/2012/ST dated 20 June 2012, the service provider and service recipient have to pay 50 per cent each of the Service Tax payable in respect of services provided or agreed to be provided in service portion in execution of works contract.

M/s. Hi-Build Coatings Pvt. Ltd. Kalamasserry, in Cochin Commissionerate received works contract services from M/s.SLN Balaji Constructions (AHAPR 5350DSD001), Kancheepuram, Tamil Nadu during the period 2012-13 to 2013-14. The assessee paid ₹ 6.57 crore to the service provider towards value of works contract service and Service Tax liability on this worked out to ₹ 32.49 lakh. The assessee, however, did not pay ₹ 16.25 lakh towards

50 per cent of Service Tax liability as service recipient under Partial Reverse Charge Method. The service provider also neither showed the amount of Service Tax in the invoice nor collected Service Tax from the assessee. The non-payment of Service Tax by the service provider (M/s SLN Balaji Constructions) was also pointed out.

Even though Internal Audit covering the period up to March 2013 was conducted in May 2013, this issue was not pointed out.

When we pointed this out (March 2014), the Ministry replied (November 2016) that an amount of ₹ 21.19 lakh including interest was recovered and SCN is being issued to recover the balance amount. The Ministry further stated that this issue was raised by IAP which conducted Internal Audit of the assessee in the last week of the March 2014.

The reply of the Ministry is not acceptable as the reply of the Ministry is silent on the failure of IAP which had conducted the audit of the assessee for FY13 but did not raise this issue then.

5.5.1.6 Non-Compliance with Point of Taxation Rules

Rule 3 of the Point of Taxation Rules, 2011, provides inter alia, that where the invoice is not issued within the time periods specified in rule 4A of the Service Tax Rules, 1994, the point of taxation shall be date of completion of provision of the service. 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 within the period prescribed shall pay simple interest at such rate as is for the time fixed by the Central Government.

M/s Coal India Ltd. in Kolkata ST-I Commissionerate (erstwhile under Kolkata ST Commissionerate) engaged in providing Management Consultant service and Renting of Immovable Property service to its subsidiary companies. The assessee charged ₹ 5 per ton of coal produces as 'Apex charges' for providing consultancy services to such companies. Further, the assessee leased land, buildings etc. to Indian Institute of Coal Management at specified rent payable monthly. We observed that assessee issued invoices for such services on quarterly basis and also discharged Service Tax liability quarterly. Scrutiny however revealed that at the end of each month, quantity of monthly production of coal was available with the assessee. Thus for both the services, completion of provision of service was the last date of each month and the assessee was liable to pay interest of ₹ 19.96 lakh for the period 2011-12 on account of payment of service tax quarterly instead of monthly. For the subsequent period, the department was requested to ascertain the interest amount.

The assessee was audited by the department in February 2013 covering the period 2011-12. However, the lapse remained undetected until pointed out by us.

When we pointed this out (June 2013), the Ministry did not accept the audit objection (November 2016) stating that explanation 1 under Rule 6 of Point of Taxation Rules, 2011 provides that the date of completion of every event requiring the service receiver to make payment to service provider shall be deemed to be the date of completion of service. The agreement provides that the payment would be made at regular interval as mutually agreed upon, and invoices are raised on quarterly basis as agreed upon, the question of payment of Service Tax on monthly basis did not arise.

The reply of the Ministry is not acceptable as from the production reports collected from the assessee during verification, it is clear from the date of the said reports, that production figures were available at the end of each month which established the completion of provision of service at the end of each month. Since bills were not raised within 14 days in each subsequent month, the event which would require the assessee to pay the Service Tax i.e. "Point of Taxation" will be the date of completion of provision of such service at the end of each month.

5.5.1.7 Short Payment of Service Tax on GTA and Manpower Supply Agency Service Under Reverse Charge Method

Rule 2 (1)(d)(iv) of the Service Tax Rules, 1994, read with Notification No. 30/2012-ST dated 20 June 2012, inter-alia envisages that in respect of service provided by goods transport agency and manpower supply agency, the person receiving the taxable service is liable to pay Service Tax either partially or fully as prescribed in the statute.

Further, the Board has issued guidelines vide letter F. No. 137/27/2007 CX.4, dated 08 February 2007, which made it mandatory to scrutinize returns on a regular basis. Again as per Para 2.3B of the aforesaid Manual, preliminary scrutiny of returns is to be done through ACES but till the implementation of the same, preliminary scrutiny was to be done manually.

M/s Hindustan Unilever Ltd. in Haldia Commissionerate and M/s Karthik alloys Ltd. (U-II), in Bolpur Commissionerate discharged their Service Tax liability under the categories of GTA, Manpower Recruitment/ Supply agency etc as a recipient of services. Verification of ST-3 return via-a-vis financial records revealed that the assesseees have failed to pay their tax liabilities in

entirety, which resulted in short-payment of Service Tax of ₹ 16.11 lakh⁵⁰ which was recoverable along with applicable interest.

M/s Hindustan Unilever Ltd. was audited by the department in June 2013 covering the period 2012-13. Further, in respect of M/s Karthik Alloys Ltd. preliminary scrutiny of the ST-3 returns for the period 2013-14 was done by the department in ACES as well as manually. However, the lapses in both the cases remained undetected until pointed out by CERA Audit.

When we pointed this out (November 2013 and August 2014), the Ministry accepted (December 2016) the audit objection and reported recovery of the objected amount of ₹ 11.66 lakh from M/s Hindustan Unilever Ltd. and issue of Show Cause Notice to M/s Karthik Alloys Ltd. for an amount of ₹ 5.54 lakh. For the failure of IAP in the case of M/s Hindustan Unilever Ltd., the Ministry stated that the lapse could not be detected as at the time of Internal Audit financial statements/ balance sheet were not ready. In the case of M/s Karthik Alloys Ltd, they stated that only manual preliminary scrutiny of returns was done by the Commissionerate as during that time ACES was not working properly.

The reply of the Ministry is not acceptable as there is specific check for payment of Service Tax under reverse charge in Annexure-VIII of Service Tax Audit Manual 2011 and details about the same could be gathered from other financial statements like Trial Balance.

5.5.1.8 Short Payment of Service Tax on Works Contract Service Under Partial Reverse Charge Method

As per rule 2(1)(d) of Service Tax Rules, 2004, service portion in execution of a works contract is liable to Service Tax. Notification No. 30/2012-ST dated 20 June 2012 stipulated that both recipient and provider of works contract service shall pay 50 per cent of Service Tax payable each.

Rule 2A(ii) of Service Tax (Determination of Value) Rules, 2006 provides that person liable to pay tax on the service portion involved in the execution of the works contract entered into for finishing services, shall pay Service Tax on 60 per cent of the total amount charged.

M/s Agarwal Metal Works Private Limited, Bhiwadi, in Alwar Commissionerate, received works contract services for office building from M/s Shusheel Construction, Gurgaon during the period November 2013 to July 2014. The value of services received was ₹ 2.10 crore, on which Service Tax payable after allowing abatement of 40 per cent works out to

⁵⁰ ₹ 9.29 lakh for the period 2012-13 in the case of M/s Hindustan Unilever Ltd. and ₹ 6.82 lakh for the period 2013-14 in case of M/s Karthik Alloys Ltd.

₹ 15.57 lakh. Out of this, ₹ 7.78 lakh was to be paid by assessee and the service provider each. Invoices issued by the service provider neither mentioned the Service Tax registration number nor charged the Service Tax resulting in non-payment of balance Service Tax amount ₹ 7.78 lakh by the service provider. Further, assessee paid Service Tax ₹ 3.33 lakh only against payable ₹ 7.78 lakh. Thus, assessee has short paid Service Tax by ₹ 4.45 lakh. Total Service Tax short paid works out to ₹ 12.33 lakh on the works executed.

Internal Audit, though conducted for the period April 2014 to March 2015, which covered part of period mentioned in audit objection, had not pointed out the lapse detected by CERA.

When we pointed this out (August 2015), the Ministry accepted the revenue portion of audit objection (September 2016) and stated that the assessee deposited ₹ 4.26 lakh of Service Tax along with interest ₹ 2.53 lakh. In case of service provider it was stated that the jurisdictional office was requested to take necessary action. For the failure of IAP, the Ministry stated the IAP could not detect this lapse as the assessee did not produce relevant records at the time of audit.

The reply of the Ministry is not acceptable as the IAP had not included the issue of non-furnishing of records by the assessee in its report.

5.5.1.9 Irregular Availing of CENVAT Credit on Services Rendered in Jammu and Kashmir

Section 64(1) of the Finance Act, 1994 stipulates that the provisions of Service Tax will be applicable to the whole of India except the State of Jammu and Kashmir. As per Rule 2(e) of CENVAT Credit Rules, 2004, exempted service includes a service on which Service Tax is not payable under Section 66B of the Act. Further, as per Rule 6(1) of CENVAT Credit Rules, 2004, CENVAT credit shall not be allowed on such quantity of inputs / input services used for the provision of exempted services.

M/s Onmobile Global Ltd., Bangalore in Bangalore ST-II Commissionerate, was paying Service Tax on service income received from the customers all over India except for the service income for services rendered in Jammu and Kashmir, which were exempted services. The assessee availed CENVAT credit of all inputs and input services used for providing these output services. Though the assessee is providing both taxable and exempted services, neither separate accounts were maintained for the inputs and input services utilized for the taxable services and the exempted services, nor did the assessee reverse proportionate CENVAT credit for the period from 2010-11 to 2011-12 for the exempted services.

The IAP of the erstwhile Service Tax Commissionerate, Bangalore, did not detect this non-payment though the unit was audited (August 2011 to November 2011) covering the period up to September 2011.

When we pointed this out (June 2013), the Ministry accepted the audit objection and stated (November 2016) that the assessee had paid total amount of ₹ 59.41 lakh including interest and penalty. For the failure of IAP, the Ministry stated that Internal Audit was done on the basis of test check of sample documents and not on the basis of 100 per cent verification. Therefore, the lapse could not be detected.

The reply of the Ministry is not acceptable as this lapse related to services provided in the state of Jammu and Kashmir for which there is a specific check in Service Tax Audit Manual 2011.

5.5.1.10 Excess Availing of CENVAT Credit

According to third proviso of Rule 4(7) of CENVAT Credit Rules, 2004, if any payment or part thereof made towards an input service is refunded or a credit note is received by the service provider after availing the CENVAT credit on such input service, then he shall be required to pay an amount equal to the CENVAT credit availed in respect of the amount so refunded or credited. Thus in case of refund or receipt of credit note, the proportionate amount of CENVAT credit is to be reversed by the service recipient.

Scrutiny of CENVAT credit records of M/s Trackon Courier Private Limited in Delhi ST Commissionerate for the period 2012-13 to 2014-15 revealed that the assessee had received discount from its input service providers on monthly/annual basis through credit notes/invoices after procurement of input services. However, the assessee did not proportionately reverse the CENVAT credit as required under the rule *ibid*. This resulted in irregular availing of CENVAT credit of ₹ 13.36 lakh. The same was payable by the assessee along with interest of ₹ 5.26 lakh.

The Internal Audit of the unit was conducted (June 2015) by the department for the period upto FY14 covered in the LDP but this lapse was not detected by them.

When we pointed this out (October 2015), the Ministry accepted the revenue portion of the audit objection (September 2016) and stated that the assessee deposited the objected amount in September 2015. For the lapse of IAP, the Ministry stated that this issue was in the notice of the department and was being examined in light of the Board's Circular No. 877/15/2008-CX dated 17 November 2008.

Reply of the Ministry is not acceptable as the Circular mentioned in the Ministry's reply relates to CENVAT credit availed on inputs whereas audit objection was related to excess availing of CENVAT credit of input services which was reversible as per Rule cited above.

5.5.1.11 Irregular Availing of CENVAT Credit of Service Tax on Invoices of Input Service Distributor (ISD)

As per Rule 9 (2) of CENVAT Credit Rules, 2004, no CENVAT credit under sub-rule (1) shall be taken unless all the particulars as prescribed under the Central Excise Rules, 2002 or the Service Tax Rules, 1994, as the case may be, are contained in the said document.

M/s Jaquar & Company Pvt. Ltd. Unit I and Unit II in Alwar Commissionerate, irregularly availed CENVAT credit of ₹ 13.07 lakh during 2013-14 & 2014-15 on the basis of the invoices, which were in the name of corporate office, Gurgaon which was already registered as ISD. When we pointed this out (September 2015) the assessee debited the amount.

Internal audit though carried out up to March 2014 (Unit-I) partially covering the period mentioned in our LDP, had not pointed out the lapse detected by CERA party.

When we pointed this out (September 2015), the Ministry intimated (November 2015) that the assessee already debited the amount. For the failure of IAP, the Ministry stated that at the time of Internal Audit, along with the ER1 and ER6 returns, the documents related to CENVAT credit taken by assessee were not submitted to Internal Audit. Hence, the wrongly taken CENVAT credit could not be detected.

The reply of the Ministry is not acceptable as the IAP had not included the issue of non-furnishing of records by the assessee in its report.

5.5.2 Inadequate Compliance with Norms for Coverage of Units by Internal Audit

Para 5.1.2 of the Service Tax Audit Manual, 2011 envisages that service providers paying Service Tax of ₹ one crore to ₹ three crore (Cash + CENVAT) in a year are to be audited once in two years. We noticed following instances where Internal Audit of the unit was not conducted, although due, resulting in non detection of lapses committed by the assessee until pointed out by us.

5.5.2.1 Non-payment of Service Tax on Late Delivery Charges and Forfeiture of Deposit

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

M/s Security Paper Mill, Hoshangabad in Bhopal Commissionerate, for the period 2012-13 to 2014-15 had disclosed receipt aggregating to ₹ 4.71 crore on account of late delivery charges and forfeiture of deposit during the said period. The assessee, however, did not pay Service Tax including cess aggregating to ₹ 58.25 lakh on the same which was recoverable with applicable interest and penalty.

Though the unit was due for Internal Audit once in two years as per norms, it was not covered in Internal Audit during FY13 to FY15.

When we pointed this out (August 2015), the Ministry accepted (October 2016) the audit objection and stated that show cause notice amounting to ₹ 80.71 lakh had been issued covering period from FY13 to June 2016. For not auditing the assessee, the Ministry stated that the assessee falls under category D during the relevant period of which ten percent units only are to be audited every year as per audit manual.

The reply of the Ministry is not correct because the assessee had paid more than ₹ one crore in cash during FY14 and FY15 and hence it falls under category B units, of which fifty percent units are to be audited per year as per audit manual.

5.5.2.2 Short Payment of Service Tax under Works Contract Service

Notification No.26/2012-ST dated 20 June 2012, effective from 01 July 2012, provides for payment of Service Tax on 25 per cent of the total value in case of construction of residential complex service provided that the value of land is included in the amount charged from the service receiver. Only VAT/Sales Tax paid on transfer of property in goods involved can be excluded from gross amount charged for Works Contract as per Explanation to Para 3(1) of Notification No.32/2007-ST dated 22 May 2007.

M/s Cybercity Builders & Developers Pvt. Ltd., in Hyderabad-IV Commissionerate undertook construction of a residential complex near Hi-Tech City Station, Hyderabad and discharged Service Tax liability at the rate of 4.944 per cent (on 40 per cent value) for the amounts received towards agreements entered up to 30 June 2012 under Works Contract Service and at the rate of 3.09 per cent (on 25 per cent value) for the amounts received towards agreements entered into with effect from 01 July 2012. However, it

was noticed that the assessee discharged Service Tax liability on the amounts after excluding the cost of land (undivided share of land).

As per the Rules and Notifications mentioned *ibid*, the entire amount received towards sale of flats including the cost of land except VAT/Sales Tax paid shall form part of the taxable value for payment of Service Tax on 25 percent of the total value. Thus, the non-inclusion of land cost in gross amount resulted in short payment of Service Tax of ₹ 54.48 lakh, which was recoverable from the assessee along with interest.

Although the assessee was a category B unit to be audited once in two year, it was last audited upto March 2012 resulting in non-detection of error until pointed out by CERA (February 2015).

When we pointed this out (February 2015), the Ministry replied (September 2016) that the objection was accepted and a show cause notice was under preparation. Further, for the departmental lapse, the Ministry stated, that the unit was not figuring in the list of units issued by the DG Audit hence, it was not selected for audit in FY16.

The reply of the Ministry is not acceptable as this unit had not been audited since FY13, despite being a category B unit.

5.6 Other Issues

5.6.1 Short Coming in Follow-up Action

M/s Akbar Travels of India (P) Ltd, in Calicut Commissionerate, did not include Productivity Linked Bonus (PLB) and Incentives received from Air Carriers in taxable value under Air Travel Agent Service. During the period 2010-11 to 2012-13, Calicut, Kannur and Tirur Branches of the assessee together collected ₹ 1.92 crore towards PLB and Incentives. Service Tax liability was, however, discharged only for an amount of ₹ 31.39 lakh. This had resulted in short-payment of Service Tax of ₹ 16.71 lakh. Similar issue relating to Tirur and Edappal branches of the assessee for the period 2008-09 to 2010-11, converted as DAP No.16A/ST/2012-13 was accepted by the department and had featured under consolidated para No.2.1 (Annexure II) of AR 6 of 2014.

When we pointed this out (July 2013) during audit of Service Tax Range, Kozhikode, the Commissionerate accepted the objection (July 2014 and January 2016) and stated that the PLB and Incentives related to amount received by their four branches at Calicut, Kannur, Tirur and Edappal, should be part of assessable value. It was also stated that SCNs were issued to all the four branches of the assessee in October 2015 totalling ₹ 1.33 crore.

Even though similar issue had already been brought to the notice of the department, failure to take remedial action against the other branches of the

assessee revealed absence of an effective mechanism in the department for ensuring follow up action even in respect of issues brought to the notice of CBEC. This had resulted in continued tax evasion by branches of the same assesses in respect of whom mention was made in Audit Report No.6 of 2014.

Further progress of adjudication of the SCNs and the reply of the Ministry is awaited (December 2016).

5.6.2 Non Issuance of Periodical SCNs

Section 68 of the Finance Act 1994, read with notification no. 30/2012-ST dated 20 June 2012, as amended from time to time, inter-alia provides that in respect of manpower services, 75 per cent of the Service Tax liability is to be paid by recipient of the service and 25 per cent by the service provider.

M/s Supreme & Co. Pvt. Ltd. (Unit-II) in Kolkata ST-II Commissionerate (erstwhile under Haldia Commissionerate) engaged in manufacture of article of iron, steel, aluminium and for such manufacturing activity used different input services. Verification of ST-3 return vis-à-vis financial records revealed that the assessee had paid ₹ 3.86 crore during the year 2012-13 and 2013-14, to various manpower service providers for receiving contract labour in their factory. However, the assessee failed to discharge the 75 per cent of the Service Tax liability as the recipient of the service. This resulted in non-payment of Service Tax of ₹ 35.81 lakh during the period from 2012-13 to 2013-14, which was recoverable along with applicable interest.

When we pointed this out (September 2014), the Ministry accepted the audit observation (December 2016) and intimated that SCN is under process. Further, for the failure of the IAP, the Ministry stated that the IAP had also pointed out the same issue for the period of FY12.

The reply of the Ministry confirms the lapse on the part of jurisdictional officers as on an issue which was already pointed out by the IAP, the omission was continued by the assessee but no periodical SCN was issued by the department. Further, after again being pointed out by CERA party, the SCN could not be issued even after lapse of more than two years.

5.6.3 Non Reversal of CENVAT Credit in Consequence to Refund Order

As per rule 3 of CENVAT Credit Rule, 2004 a service provider shall be allowed to take credit of duties or tax or cess paid on any input or input services. Rule 5 of CENVAT Credit Rules, 2004 allows refund of CENVAT credit of inputs and input services used in the manufacture of exported goods or provision of output service which is exported without payment of Service Tax.

LTU Mumbai Commissionerate disallowed (April and July 2014) inadmissible credit of ₹ 11.52 lakh on account of deficiencies in some invoices while sanctioning refund claims of M/s Sonata Information Technology Ltd. pertaining to the period 2012-13 and 2013-14. The assessee also agreed with the deficiencies pointed out by the department. Audit scrutiny of records revealed that on receipt of refund orders, neither the assessee reversed the said credit in their CENVAT Account nor the department took any action to ensure reversal of CENVAT credit by the assessee. This resulted in non-reversal of CENVAT Credit of ₹ 11.52 lakh.

When we pointed this out (July 2015), the Ministry (December 2016) stated that the assessee had reversed (August 2015) CENVAT credit of ₹ 11.52 lakh but did not accept the department failure stating that the deficiencies were detected by the department itself and debit of CENVAT credit after one year had no revenue implication. The Ministry, however, regretted the overall delay in recovery.

The reply of the Ministry is not acceptable as the department stated in response to Statement of Facts that compliance on the matter was sought from the assessee after receipt of CERA objection. Moreover, no Internal Audit was conducted by the department for the period FY13 to FY15 though the unit is to be audited annually. Thus the non-reversal by assessee would have in fact gone unnoticed if not pointed out by CERA, thereby indicating ineffective follow up by the department.

New Delhi
Dated: 24 January 2017


(HIMABINDU MUDUMBAI)
Principal Director (Service Tax)

Countersigned

New Delhi
Dated: 24 January 2017


(SHASHI KANT SHARMA)
Comptroller and Auditor General of India