



CHAPTER V SERVICE TAX

Service tax was introduced from 1 July 1994 through the Finance Act, 1994. The administration of service tax has been vested with the central excise department under the Ministry of Finance. The Central Board of Excise and Customs has set up a separate apex authority headed by the Director General Service Tax (DGST) at Mumbai for the administration of service tax. Commissioners of central excise/service tax have been authorised to collect service tax within their jurisdiction. Failure to deposit service tax attracts penalty equal to service tax not paid, under section 78 of the above Act.

During the course of our audit we have observed that manufacturers of pharmaceutical products have received services from foreign service providers and provided output services as well. However, some of them have not paid or short paid service tax on various categories of services. Those cases are illustrated below: -

5.1 Services received from foreign service providers

5.1.1 Banking and other financial services

The Service Tax Rules provide that a person receiving taxable services in India has to pay service tax on services received from a person/company who is a non-resident or is from outside India and does not have any office in India.

M/s Panacea Biotech Ltd., in Division II of Delhi commissionerate, issued foreign currency convertible bonds for US \$ one billion (equivalent to Rs. 446.20 crore) in February 2006 for which they paid commission of US \$ 30.85 lakh (equivalent to Rs. 13.77 crore) to Merrill Lynch International London, their foreign merchant banker.

We found that M/s Panacea Biotech Ltd. neither deducted nor paid the applicable service tax of Rs. 1.41 crore on such commission. Penalty of Rs. 1.41 crore and interest of Rs. 38.03 lakh from March 2006 to March 2008 was leviable.

On this being pointed out (March 2008), the department intimated (February 2009) that SCN for Rs. 1.41 crore was issued to the assessee.

5.1.2 Intellectual property rights and management consultancy services

M/s Ranbaxy Laboratories Ltd., Dewas, in Indore commissionerate, availed of taxable services namely intellectual property rights and management consultancy services from foreign service providers during the years 2005, 2006 and 2007.

We found that royalty and service charges of Rs. 412.61 crore in foreign currency were paid during that period but the applicable service tax of

Rs. 47.91 crore, including cess of Rs. 1.10 crore, was not paid by the assessee and was liable to be recovered together with interest of Rs. 12.65 crore (upto March 2009) and penalty of Rs. 47.91 crore. The total amount recoverable was Rs. 108.47 crore.

5.1.3 Business auxiliary services

5.1.3.1 M/s. Lupin Ltd. (Plant I), Mandideep, Raisen, in Mumbai (LTU) commissionerate, paid Rs. 203.57 crore to foreign service providers in foreign currency during April 2005 to March 2008 for business promotion and analytical charges. The assessee did not pay the service tax of Rs. 23.69 crore (including cess) under BAS which was recoverable with interest of Rs. 5.73 crore (upto March 2009) and penalty of Rs. 23.69 crore. The total amount recoverable worked out to Rs. 53.11 crore.

5.1.3.2 Similarly, M/s Modi Mundi Pharma (P) Ltd., in Meerut I commissionerate, paid commission and technical know-how fees to foreign service providers in foreign currency amounting to Rs. 12.35 crore during the period April 2005 to March 2008 but did not pay service tax of Rs. 1.44 crore. This was recoverable alongwith interest of Rs. 30.71 lakh (upto March 2009) and penalty of Rs. 1.44 crore. The total recoverable amount was thus Rs. 3.19 crore.

5.1.3.3 M/s Albert David Ltd., in Kolkata I commissionerate, sold medicines to different countries through foreign agents and paid them commissions/fees in foreign currency. The assessee also paid bank charges in foreign currency to foreign banks for banking services. These services fell under BAS and banking and other financial services. The assessee did not pay service tax and education cess of Rs. 36.52 lakh for these services during the period April 2004 to March 2007 which was recoverable with interest of Rs. 9.50 lakh (upto March 2009) and penalty of Rs. 36.52 lakh.

On this being pointed out (March 2008), the department admitted the observation and stated (February 2009) that SCN is being issued.

5.2 Technical testing and analysis services provided by assessee

The service of technical testing and analysis was covered under service tax with effect from 1 July 2003. In the context of pharmaceutical products, an insertion in Finance Act, 2006 clarified that technical testing and analysis includes testing and analysis undertaken for the purpose of clinical testing of drugs and formulations and does not include testing or analysis for determining the nature of diseased condition, identification of a disease and prevention of any disease or disorder in human being or animals.

5.2.1 M/s. Johnson & Johnson Ltd. India, in Mumbai (ST) commissionerate, conducted clinical trials of new drugs and formulations for its parent/associated company i.e., Johnson & Johnson PRD in USA. It received payments of Rs. 4.19 crore from May 2006 to February 2007 from the parent company but did not pay service tax of Rs. 51.26 lakh including cess.

On being pointed out, the company accepted the observation and paid (January 2009) the service tax and interest amounting to

Rs. 62.98 lakh.

5.2.2 M/s Lupin Ltd. (Plant I) Mandideep, Raisen, in Mumbai (LTU) commissionerate, did technical testing and analysis of quality control samples on behalf of a sister concern and received Rs. 6.11 crore as service charges during the years 2005-06 to 2007-08. The applicable service tax of Rs. 74.09 lakh (including cess) was not paid and was recoverable alongwith interest of Rs. 14.98 lakh (upto March 2009) and penalty of Rs. 74.09 lakh.

5.3 Business auxiliary services provided within the country

Business auxiliary service has been brought under service tax net with effect from 1 July 2003. It is defined as any service in relation to production or marketing or sale of goods or promotion or marketing of services or any customer care services in any manner to a client.

5.3.1 Receipts on account of market authorisation fee

M/s. Ranbaxy Laboratories Ltd., Dewas, in Indore commissionerate had disclosed receipts of Rs. 18.16 crore for services rendered and on account of market authorization fee for the years ended 2005, 2006 and 2007. These receipts were covered under BAS. The assessee did not pay service tax of Rs. 2.20 crore (including cess) which was recoverable with interest of Rs. 49.59 lakh (upto March 2009) and penalty of Rs. 2.20 crore.

5.3.2 Services provided by job worker on conversion charges

Service tax is exempted when a service provider acts as a job worker i.e. it processes raw material or semi finished goods supplied by a client and returns the processed items to the client for manufacture of a final product on which excise duty is leviable. The exemption is not available for final products liable to 'nil' rates of duty or otherwise exempted.

M/s Rugby Pharma Pvt. Ltd., in Kolkata V commissionerate, was processing, as a job worker, raw material or semi finished goods supplied by a client M/s Organon (India) Ltd. We found that the assessee did the processing for some pharmaceutical products viz., Novelon, Femilon, Cerazzat, Elogen, Zerocen, Pavulon which were either exempt or had 'nil' rate of excise duty. The assessee collected Rs. 8.10 crore as conversion charges from the client for processing related to these exempted medicines during April 2005 to June 2008. Since no duty was finally paid on these medicines, the assessee was liable to pay service tax under BAS on the conversion charges which was not done. The service tax of Rs. 95.21 lakh including education cess of Rs. 2.59 lakh and penalty of Rs. 95.21 lakh were recoverable with interest of Rs. 18.02 (till March 2009).

5.4 Incorrect grant of exemption from 75 per cent of value of services

Notification No. 32/2004 ST dated 3 December 2004 stipulates that 75 per cent value of taxable service provided by 'Goods Transport Agency (GTA)' to its customer is exempt from the levy of service tax subject to the condition that cenvat credit is not taken by the GTA on inputs or capital goods used for providing such services. The Board clarified on 27 July 2005 that the person availing of exemption under this notification will have to obtain a declaration from its GTA on the consignment notes to the effect that conditions of aforesaid notification have been satisfied.

M/s Albert David (P) Ltd., in Ghaziabad commissionerate, engaged in the manufacture of patent or proprietary medicaments, availed of the services of GTA and paid freight charges of Rs. 14.11 crore during the period January 2005 to March 2008. It paid service tax of Rs. 41.04 lakh, after availing of exemption of 75 per cent on the gross freight charges paid to GTA. The declaration on not availing of cenvat credit was not available on any of the consignment notes issued by the GTA. Exemption of service tax of Rs. 63.65 lakh was, therefore, recoverable alongwith interest of Rs. 8.24 lakh (upto

March 2009) and penalty of Rs. 63.65 lakh totalling to Rs. 1.36 crore.

5.5 Other cases

In 57 other cases, the assessee either did not pay or short paid service tax of Rs. 3.51 crore including education cess. In 29 of these cases, the assessee was also liable to pay interest of Rs. 35.68 lakh on short payment of service tax and in 20 of these cases, penalty of Rs. 1.16 crore was chargeable. In 19 out of 57 cases, the department accepted the related audit observations involving service tax of Rs. 1.53 crore and recovered Rs. 1.43 crore in 16 cases (February 2010).

In our opinion, the root cause of cases of non payment of service tax pointed out in this chapter was the absence of any mechanism to ascertain whether manufacturers were providing any output services. This facilitated 67 manufacturers of pharmaceutical products to avoid payment of total service tax of Rs. 182.81 crore under various services.

Recommendation No. 8

➤ *The Government may consider integrating the excise and service tax returns to mitigate the risk of evasion of duties/tax more so as the environment of all tax administration is becoming e-enabled, especially post introduction of ACES (Automation of Central Excise and Service Tax).*

The Ministry stated (January 2010) during the exit conference that prescribing a common return would not solve the problem. However, the concern flagged by audit would be taken care of when GST is introduced by Government. In the light of the discussions, it is suggested that till the introduction of GST, it

may be made mandatory that manufacturers should declare on their excise returns whether they have provided any output services or received any service from foreign service providers.