



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

We have arranged the audit findings in this chapter under two sections. Section A contains findings on procedural deficiencies in registration of assesseees, receipt of returns and scrutiny of returns. Section B covers ambiguities and inadequacy in rule provisions which result in foregoing of revenue. The relevant provision of Act/Rules is highlighted in a box at the beginning of the audit observation. Certain illustrative cases have been used to highlight the issues.

SECTION A: PROCEDURAL DEFICIENCIES

2.1 Registration

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

For registration of eligible service providers, the Government has relied largely on 'voluntary compliance' and an entity can evade tax by not applying for a registration. The Director General of Service Tax (DGST), Mumbai had in May 2003, issued a comprehensive action plan to monitor the administration of service tax.

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

In our earlier performance audit reports on Management consultant's services, Scientific or technical consultancy services, technical testing and analysis services and Technical inspection and certification (March 2006), Rent-a-cab scheme operators' services, Photography services and Health club and fitness centre services (March 2007) and Business auxiliary services (March 2008) we had commented on the inadequacy and ineffectiveness of surveys undertaken by the department. Our findings in this review are quite similar.

The 61 commissionerates test checked in audit had not fixed any targets for survey by its ranges during 2006-07 to 2007-08. Where some surveys had taken place, the outcome was not monitored as prescribed in the DGST circular dated 26 May 2003. No surveys were conducted in 29 out of 61 commissionerates, including four out of six exclusive service tax commissionerates. Out of 32 commissionerates where surveys were conducted, 22 commissionerates stated that 583 new service providers (for construction services) were registered through surveys resulting in additional revenue of ₹ 15.05 crore during the year 2006-07 to 2007-08. No new service

providers could be registered through surveys for these services in remaining 11 commissionerates. It was evident that a lot more had to be done by the department in this area.

We attempted, on a limited scale, to identify unregistered service providers who were liable to pay tax. For this purpose, we identified entities who had provided services to various departments of State and Central Government, Nigams/Corporation and PSUs. We also identified service providers by scrutinising returns in the Income Tax department and other secondary records in various Government departments. We found that in 41 out of 61 commissionerates, there were 3535 service providers for these three services, who, though liable to pay service tax, were not available on the departmental registration lists. As already stated in the previous sub-paragraph, 22 commissionerates had registered 583 service providers through surveys conducted in April 2006 to March 2008 and we found 898 unregistered service providers in the same 22 commissionerates during April 2008 to March 2009. This showed that there was ample scope to step up the efforts to identify the assesseees.

We attempted to quantify the extent of evasion by these identified potential assesseees. We were able to obtain data from various sources such as income tax returns (496 cases), payments made for construction contracts by CPWD (321 cases), various State Housing Boards (328 cases), records of registered contractors who availed services of sub-contractors (372 cases), agriculture marketing board (140 cases) and other sources (577 cases) for 2234 service providers out of 3535 identified by us. We found that these potential assesseees had not paid service tax to the extent of ₹ 181.54 crore. This also implied additional penalty upto ₹ 181.54 crore with further interest liability of ₹ 37.10 crore. All these cases require further detailed verification by the department. Some could be cases where the service providers are doing central billing and are, therefore, registered with some other commissionerate. The department had confirmed 27 cases of non registration upto December 2010 which had a revenue implication of ₹ 4.04 crore.

2.2 Creation of database

Under Rule 4(5) of Service Tax Rules, 1994, an application received for registration for service tax should be processed and verified and a certificate of registration should be issued within seven days from the date of receipt of the application by the Superintendent of Range.

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DGST instructed in 2001 that a database of these applications was to be created in each commissionerate wherein the assessee's profile could be comprehensively captured, as it would facilitate cross-referencing.

The information furnished by the department showed that the profiles of 20 per cent registered assesseees had not been created in the databases. Therefore the cross linkage of service tax related information furnished by the assessee with records of other Government Departments could not be done for these assesseees.

Recommendation Nos. 1 to 2

- *The department needs to take up various measures prescribed by the DGST, including surveys, to identify potential assessees for service tax and get them registered. It should also work in close liaison with Public Works Department, Stamps and Registration Department, Registrar of Companies and Commercial Taxes Department of the State Governments who regularly avail construction services and many other services.*

In the exit conference, the Board stated that surveys were primarily done when a new service was introduced. For construction services, the secondary methods recommended by DGST and audit would be more effective. However, the service tax wing is hampered by severe shortage of staff and the focus is therefore on anti-evasion and internal audit. The Board was considering a cadre restructuring and some of the core issues like identification of assessees would be taken up with greater focus after such restructuring.

- *The department needs to complete the assessee profile databases to facilitate cross verification.*

In the exit conference, the Board stated that with the introduction of ACES, all new assessees had to mandatorily register through the system and this would automatically capture the complete assessee profiles in future.

2.3 Monitoring of receipt of service tax returns

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

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

2.3.1 Receipt of returns

The information furnished by the department showed that a large number of returns were either not received or received late but the department had not taken any corrective action. The position of receipt of returns by the department is shown in the following table: -

Table No. 1

Name of service	No. of returns due	No. of returns received	Returns received by due date	Returns received late	No. of returns not received	Penalty levied for late submission	Penalty not levied @ ₹ 1000/- per return
						(Lakh of rupees)	
CCS	49852 ¹	34154	30005	4149	15698	19	179
CON	22175 ²	15802	13849	1953	6373	12	71
WCS	6175 ³	3701	3116	585	2474	3	28
Total	78202	53657	46970	6687	24545	34	278
Percentage of returns due				12	31		

The above data relates to 72 commissionerates.

- The table shows that 12 per cent of returns were received late and 31 per cent of the returns were not received at all. We found that the test checked commissionerates had not followed any monitoring mechanism to ascertain the reasons for non-submission of returns.
- The Government had exempted small service providers delivering taxable service upto ₹ 4 lakh from payment of service tax from 1 April 2005. This limit was increased to ₹ 8 lakh from 1 April 2007. Amongst the returns not received, we found 366 service providers, whose annual receipts of CCS and CON had exceeded ₹ four lakh during the year 2005-06, but they had not submitted the returns for the year 2006-07. Similarly, 530 service providers whose annual receipt of CCS and CON had exceeded ₹ eight lakh during the year 2006-07, had not submitted the returns for the year 2007-08. The department had not taken any action to ascertain whether the value of services provided had fallen below exemption limits for these assesseees or they had stopped filing returns to evade payment of tax. Thus, it did not know why these service providers had abruptly stopped filing returns.
- The levy of penalty for delayed submission and non submission of returns serves as a deterrent but the department did not impose penalty of ₹ 2.78 crore on defaulting assesseees. This amount was 89 per cent of the total amount leviable (₹ 3.12 crore).

2.3.2 Registered service providers who have stopped filing returns

We did an independent verification, on a limited scale, of income tax returns and other connected records of some of the registered service providers who had stopped filing returns for service tax. We found 145 assesseees in 10 commissionerates, who had not filed their service tax returns, but had continued to provide services during the period of non-filing. This resulted in non-payment of service tax of ₹ 14.73 crore. Total interest of ₹ 3.07 crore and

¹ From the date of levy (10 September 2004) to March 2008

² From the date of levy (16 June 2005) to March 2008

³ From the date of levy (1 June 2007) to March 2008

penalty upto ₹ 14.73 crore was also leviable. Some illustrative cases are mentioned in the table below: -

Table No. 2

(Amount in lakh of rupees)

Sl. No.	Commissi- onerate	Name of Assessee	Revenue effect			Source of data
			Tax	Interest	Penalty	
1.	Jaipur II	M/s. Kamal Engineers and Contractor Pvt. Ltd.	62	13	62	IT return
2.	Bhubaneswar I	M/s Metro Builders Orissa (Pvt.) Ltd	46	18	46	IT return
3.	Nagpur	M/s Gupta Construction	22	5	22	Records of co-contractor

2.4 Scrutiny of returns

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

2.4.1 The compiled departmental data for all 72 commissionerates for the year 2007-08 showed that 28 per cent of the returns received for these three services (received: 30090 verified: 21758) were pending preliminary verification/scrutiny.

2.4.2 We also found 158 cases in 32 commissionerates where the departmental officers had scrutinised the returns but failed to detect irregularities like payment of service tax at lower rate, non-levy of interest and penalty, short payment of interest, etc. which had led to short levy of service tax totalling ₹ 17.48 crore. Interest of ₹ 2.38 crore and penalty upto ₹ 6.23 crore was also leviable in these cases. Of these, the department had accepted audit observations involving revenue of ₹ 3.18 crore and had recovered ₹ 2.69 crore and issued SCNs for ₹ 51.94 lakh. Two illustrative cases are given below: -

- Under the WC composition scheme, service tax was payable at the rate of two per cent of the gross amount charged which was enhanced to four per cent from March 2008. M/s. Larsen & Toubro Ltd, in Division-III of Kolkata ST commissionerate, paid service tax at lower rate in respect of WCS for the period from 1 March 2008 to September 2008 although the rate of service tax had been enhanced. This had resulted in short payment

of service tax of ₹ 2.52 crore. The assessee was also liable to pay interest of ₹ 25.42 lakh and penalty of ₹ 46.93 lakh.

This was pointed out in February 2009, the reply of the department was awaited (December 2010).

- Similarly, M/s. Gannon Dunkerley & Co. Ltd., in Division-I of Kolkata ST commissionerate, paid service tax at the rate of 10 per cent instead of 12 per cent applicable from 18 April 2006. This led to short payment of service tax of ₹ 29.00 lakh for the period from April 2006 to March 2008. The assessee was also liable to pay interest of ₹ 9.82 lakh and penalty of ₹ 19.96 lakh.

This was pointed out in December 2008, the reply of the department was awaited (December 2010).

2.4.3 We did a cross verification of ST returns with income tax returns and other records maintained by assessee. We found that 255 assessee (in 35 commissionerates) had evaded service tax of ₹ 110.08 crore by suppression of value assessable for tax during the period from September 2004 to March 2008. Interest of ₹ 25.97 crore and penalty upto ₹ 109.16 crore was also leviable in these cases:-

Some illustrative cases are mentioned in the following table: -

Table No. 3

(Amount in lakh of rupees)

Sl. No.	Commissionerate	Name of Assessee	Revenue effect			Source of detection
			Tax	Interest	Penalty	
1.	Nagpur	M/s. Sunil Hitech Engineers Ltd.	179.32	16.02	179.32	Scrutiny of records of service tax payment
2.	Meerut II	M/s. Alliance Builders	170.24	31.98	170.24	Comparison with IT return
3.	Bangalore ST	M/s IDEB Projects Pvt. Ltd.	162	59.28	162	Scrutiny of ledger account
4.	Delhi ST	M/s B.L. Kashyap & Sons (P) Ltd	724	354	724	Scrutiny of ST-3 return and other financial records

The replies of the department were awaited (December 2010).

2.5 List of books of accounts not filed

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

The shortfall in receipt of details of books of accounts for the period from September 2004 to March 2008 in 61 out of all 72 commissionerates, is shown below:-

Table No. 4

Name of service	No. of returns received from service providers for the first time	No. of first returns where details of books of accounts not received	Percentage
CCS	12603	7426	58.92
CON	5796	3871	66.78
WCS	2317	902	38.92
Total	20716	12199	58.88

We observed that fifty nine per cent of service providers had not given the details of books of accounts maintained by them. During the period from September 2004 to March 2008, in 17 commissionerates, not a single assessee had submitted the list of books of accounts at the time of filing of returns for the first time in respect of CCS. The Commissionerates had not pursued these cases to ascertain the reasons for non-submission of these details. Eleven commissionerates⁴ did not provide the data relating to accounts details being filed with the first ST return despite repeated pursuance for over six months.

Recommendation No. 3

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

During the exit conference, the Board stated that receipt and scrutiny of returns often did not get adequate attention because the officers in ranges were overburdened with multifarious tasks. It was stated that, with the introduction of ACES, these procedures had been automated and could be strengthened further after cadre restructuring.

SECTION B: RULES, REGULATIONS AND SYSTEMS

2.6 Exemption on construction of residential complexes having less than 12 residential units

According to Finance Act, 1994, service tax is leviable for construction of residential complexes comprising a building or buildings, having more than 12 residential units. They must also be located within premises having a common area, facilities such as park, lift, common water supply and the layout of such premises should be approved by appropriate authority.

The condition that service tax is payable only when the construction involves more than 12 residential units, ensures that small housing construction projects remain outside the tax net and only the larger projects are taxed. We found two projects where expensive flats were constructed with large plinth areas but

⁴ Hyderabad IV, Raipur, Delhi ST, Rohtak,, Belgaum, Mangalore, Mysore, Bolpur, Haldia, Siliguri, Chennai ST

were not liable to be taxed as they had less than 12 residential units. These are given below:-

2.6.1 M/s Vijay Shanti Builders Ltd., Chennai, in Chennai ST commissionerate, engaged in CON, constructed three residential units with total plinth area of 15000 square feet (5000 sq. ft. per unit) at a cost of ₹ 9.90 crore (₹ 3.30 crore per unit). The assessee availed service tax exemption as the numbers of residential units was less than 12. The revenue foregone was ₹ 40.38 lakh.

2.6.2 M/s Gina Engineering Pvt. Ltd., Bangalore, in Bangalore I commissionerate, had constructed an apartment for M/s Purvankara Projects Pvt. Ltd., 'Purve Grande'. No service tax had been paid on this project as the number of residential units was only eight. However, the floor area of each unit in the apartment ranged from 3339 to 3862 square feet, and the selling price of the units ranged from ₹ 6.34 crore to ₹ 7.34 crore.

Since these expensive projects are staying out of the tax net, we feel that the single criterion of 12 units is not sufficient and other criterion, such as selling price or plinth area per unit should also be specified to ensure that expensive constructions come under the tax net.

This was pointed out in April 2009, in both the cases, the department stated (July 2009) that this was a policy matter.

Recommendation No. 4

➤ *The Government may consider supplementing the single criterion of 'more than 12 units' with additional criterion so that expensive constructions with less than 12 units are also brought into the service tax net.*

In the exit conference, the Board stated that introduction of value bases criteria would increase subjectivity and interpretation issues would creep in leading to more litigation.

2.7 Variation in admissibility of Cenvat credit in composition/abatment schemes

A service provider delivering WCS has to pay Sales Tax/VAT on the goods components of the contract and service tax on the service components of the contract at the prevailing rate. Under the Composition Scheme for payment of Service Tax on WCS effective from 1 June 2007, he has the option to pay two per cent (effective from 1 June 2007 to 28 February 2008 and revised to four per cent thereafter) of the gross amount charged for the works contract, excluding value added tax/sales tax. Service providers opting for this scheme cannot take cenvat credit on inputs.

A service provider delivering CCS and CON services has to pay service tax on the gross value of services provided if he avails cenvat credit of duty on inputs, capital goods and input services. He also has the option to avail abatment of 67 per cent and pay tax on 33 per cent of gross value if he does not take any cenvat credit on inputs or capital goods or input services. This translates to an effective rate of 3.96 per cent of the gross value.

A comparison of the optional composition/abatement schemes shows that the effective rate of service tax is almost the same for WCS (4 per cent) and CCS/CON (3.96 per cent) as percentage of gross value. However there is a significant difference between the two because cenvat credit of duty on capital goods and service tax on input services can be availed for WCS whereas these are disallowed for CCS/CON. This has introduced some degree of inequity between services within the construction sector.

We found that M/s Ahluwalia Contracts (India) Ltd and M/s Aksava Infrastructure Private Ltd, in Service Tax division, Gurgaon (Delhi III) commissionerate, realised an amount of ₹ 98.94 crore and paid service tax of ₹ 2.18 crore under composition scheme for various projects during 2007-08. They also availed Cenvat credit of ₹ 29.78 lakh on input services which would not have been available for services under CCS/CON while availing abatement scheme. Therefore, the effective revenue collection was lower in WCS by ₹ 29.78 lakh as compared to similar CCS/CON service.

This was pointed out in March 2009, the reply of the department was awaited (December 2010).

Recommendation No. 5

- *The Government may consider inserting a clause in the WCS composition scheme to disallow the availing of Cenvat credit on capital goods and input services.*

During the exit conference, the Board stated that the effective rate for CCS/CON had reduced further as the service tax rate had reduced to 10 per cent from 12 per cent while the WCS composition rate had remained at 4 per cent. This had brought parity between the two schemes even though the conditions for allowing cenvat credit were different.

2.8 Time limit for adjudicating service tax cases not prescribed

Section 73 of Finance Act, 1994, through which service tax was introduced, provides that SCNs in normal/fraud cases must be issued within one/five years for recovery of service tax short levied. These provisions are similar to section 11A of Central Excise Act.

Section 11A also prescribes a time-limit of six months/one year, where it is possible to do so, for finalisation of adjudication cases relating to central excise receipts, whereas time limit for adjudication of service tax cases has not been incorporated in section 73 or in any other rules. Therefore, the adjudication officers are not obliged to finalise SCNs relating to service tax within a prescribed time frame. This contributes to delays in finalisation of cases and recovery of service tax.

The information furnished by the department showed that there was no pendency in adjudication of SCNs in 34 commissionerates. However, in 30 commissionerates, 1744 SCNs relating to service tax on CCS and CON, involving revenue of ₹ 54.74 crore, were pending (as on 30 September 2008) for adjudication. Of these, 137 SCNs involving revenue of ₹ 3.27 crore were

pending for more than two years. Eight commissionerates⁵ did not provide data relating to pendency of adjudication of SCNs.

Recommendation No. 6

➤ *The Government should prescribe a time-limit for adjudicating SCNs alongwith suitable mechanism to monitor the time limit.*

During the exit conference, the Board stated that the time limit in central excise was only recommendatory and the real problem was the large number of adjudications which could not be handled by the existing set up. This was sought to be addressed through the cadre restructuring which would enhance the number of exclusive service tax commissionerates and separate formations were also being contemplated exclusively for doing adjudications.

⁵Patna, Rohtak, Belgaum, Mangalore, Mysore, Bolpur, Haldia and Siliguri