Chapter II

Non Compliance with Rules and Regulations

2.1 We examined the records maintained by assessees in relation to the payment of Service Tax and checked the correctness of tax payment and availing of Cenvat credit. We noticed cases of irregular availing and utilisation of Cenvat credit, non/short payment of Service Tax etc. involving revenue of ₹ 237.17 crore. We communicated these observations to the Ministry through 131 draft audit paragraphs. The Ministry/Commissionerate accepted (February 2014) the audit observations in 127 draft audit paragraphs and initiated/completed corrective action in all these cases involving revenue of ₹ 233.95 crore. We have furnished the details of these paragraphs in **Appendix II**. The Ministry contested three draft audit paragraphs and is yet to respond to one draft audit paragraph (February 2014).

2.2 Non-payment of Service Tax

2.2.1 Service Tax on Foreclosure charges

As per the erstwhile Section 65(12) of the Finance Act, 1994 (as amended), "banking and other financial services" *inter alia* includes lending. Ministry of Finance vide letter F. No. 345/6/2008-TRU dated 11-06-2008 clarified that pre-closure/foreclosure charges collected for early payment of loans, are leviable to Service Tax.

M/s Bajaj Auto Finance Ltd in Pune I Commissionerate collected ₹ 12.38 crore on account of foreclosure charges of loans during April 2007 to March 2011, on which Service Tax amounting to ₹ 1.41 crore was not paid which was recoverable along with interest. We observed that though the Commissionerate's audit party audited the assessee in August 2009 and September 2010, it failed to detect the non-payment of Service Tax.

The Commissionerate intimated (February 2013) that it had issued show cause cum demand Notice for ₹ 1.49 crore along with interest and penalty covering the period from 2007-08 to 2011-12. *However, the Ministry contested (November 2013) the audit observation on the ground that the foreclosure charges are treated as loss of interest. As interest is excluded from the levy of Service Tax, this does not amount to service as per the provisions of the Finance Act 1994. The Ministry further added that CESTAT New Delhi had taken the same view in the case of SIDBI vs CCE Chandigarh (January 2011).*

We observed that the Ministry's reply is silent about TRU's clarificatory letter cited above according to which foreclosure charges collected for early payment of loans are leviable to Service Tax. Further, in the case of HUDCO vs Commissioner of Service Tax

Ahmedabad, CESTAT, Ahmedabad (November 2011) had held that Service Tax is leviable on the reset charges and pre-payment charges paid by the customers.[51]

Recommendation: CBEC may issue a clarification concerning the applicability of TRU letter F. No. 345/6/2008-TRU dated 11 June 2008 keeping in view the various CESTAT decisions on the subject.

2.2.2 Non-payment of Service Tax under Import of Services

Section 65(55b) of the Finance Act, 1994 defines intellectual property service to mean transferring temporarily or permitting the use of any intellectual property right.[52] Further, intellectual property right under section 65(55a) of Finance Act, 1994 means any right to intangible property viz. trademarks, designs, patents or any other similar intangible property under any law for the time being in force but does not includes copyright.[53] Intellectual property service is taxable with effect from September 2004. Rule 2(i)(d) of Service Tax Rules, 1994 envisages, *inter alia*, that the person receiving taxable service in India is liable for payment of Service Tax on services provided by person who is non resident or is from outside India or does not have any office in India.

M/s Mark Exhaust Systems Ltd, Gurgaon, entered into an agreement with Futaba Industrial Co. Ltd. Japan and Sankai Giken Kagyo Co. Ltd. Japan for getting technical assistance. As per the agreement, the service receiver was liable to pay 3 per cent of the aggregate "Net Saleable Price" for use of intellectual property right and technical information to Futaba Industrial Co. Ltd., Japan and Sankai Giken Kagyo Co. Ltd., Japan on six-monthly basis in March and September of each year. Test-check of records indicated royalty payment of ₹ 428.47 lakh to Futaba Industrial Co. Ltd., and Sankai Giken Kagyo Co. Ltd. pertaining to the year 2010-11. As this service was chargeable to Service Tax in India, the assessee was required to pay tax of ₹ 44.13 lakh under reserve charge method. However, the assessee did not pay the same.

When we pointed out the non-payment of Service Tax and interest (December 2011), the Commissionerate informed (August 2012) that the assessee had deposited Service Tax of ₹ 53.38 lakh including R & D Cess of ₹ 22.26 lakh against the actually paid royalty amounting to ₹ 518.37 lakh for the year 2010-11. Recovery of interest was still pending (June 2013).

However, the Ministry contested the audit observation in its reply (February 2014) stating that as the services were rendered in 2010-11, Service Tax was applicable only on payment basis. As the payment for the services received during 2010-11 was made to service providers on 20 June 2011 and 29 December 2011 against which the Service Tax was

[51] 2011-IST-671-CESTAT-Ahm.
[52] as applicable before 1 July 2012.
[53] as applicable before 1 July 2012.

deposited by the assessee on 15 June 2011 and 23 December 2011 respectively, there was no delay in payment of tax.

The reply of the Ministry is not acceptable in view of notification No. 19/2008 (ST) dated 10 May 2008 (introducing explanation below proviso (3) to Rule 6(1) of Service Tax Rules, 1994) to the effect that where transaction of taxable service is with any associated enterprise, any payment received towards the value of taxable service, shall include any amount credited or debited, in the books of account of a person liable to pay Service Tax. As per section 65(7b) of the Finance Act, 1994 (as applicable prior to 1 July 2012) read with clause (g) of section 92A (1) of the Income Tax Act, 1961, there exists a relationship of associate enterprise between the assessee and the service provider. The technical collaboration agreement signed between the assessee and the Japanese companies indicates clearly that the assessee was wholly dependent on the use of their certain intellectual property rights. Therefore, the assessee was liable to pay Service Tax on accrual basis in respect of the services received.

2.3 Short payment of Service Tax

2.3.1 Irregular suo motu adjustment of Service Tax

Rules 6(4A) and 6(4B) of the Service Tax Rules, 1994 envisage that where an assessee has paid any amount in excess of the amount required to be paid towards Service Tax liability for a month, he may adjust such excess amount against his Service Tax liability for the succeeding month subject to the following conditions viz. (i) excess amount paid is on account of reasons not involving interpretation of law, taxability, classification, valuation or applicability of any exemption notification, (ii) excess amount paid by an assessee having centralized registration, on account of delayed receipt of details of payments towards taxable services may be adjusted without monetary limit, (iii) in other cases, the excess amount paid may be adjusted with a monetary limit of one lakh rupees for the relevant month and (iv) the details and reasons for such adjustment shall be intimated to the jurisdictional Superintendent of Central Excise within a period of fifteen days from the date of such adjustment.[54] Further, as per section 83 of the Finance Act, 1994, read with Section 11B of the Central Excise Act, 1944, any person claiming refund of Service Tax and interest, if any, paid on such Service Tax may make an application, for refund of such duty and interest, to the Assistant Commissioner or Deputy Commissioner of Central Excise, before the expiry of one year from the relevant date.

M/s ICICI Securities Ltd., in ST I Mumbai Commissionerate, registered service provider under the category of Stock Broking service, filed ST-3 return on 26 October 2009 for the period April 2009 to September 2009 and declared ₹ 35.11 crore towards the value of taxable services rendered during this period. The assessee paid ₹ 3.56 crore as against

[54] Rules as applicable during the period covered by CERA.

Service Tax liability of ₹ 3.62 crore. On scrutiny of the reconciliation statement provided by the assessee, we observed that the gross receipt of services rendered was ₹ 37.83 crore but the assessee had declared it as ₹ 35.11 crore in the ST-3 return after considering a reduction of taxable services valued at ₹ 2.72 crore. The differential amount had been returned to various clients and related to transactions pertaining to the months of January, February and March 2009; this was meant to be a benefit under a promotional scheme wherein the rates of brokerage were reduced with retrospective effect. Thus, the assessee adjusted Service Tax of ₹ 33.64 lakh suo motu. We observed that the adjustment pertained to the valuation of services which had in fact been fully rendered. Moreover, though the assessee was centrally registered, the adjustment was not on account of delayed receipt of details of payments towards taxable services. Further, the amount adjusted was also more than one lakh rupees. In view of the above, the suo motu adjustment done by the assessee was not possible under Rules 6(4A) and (4B). The assessee should have applied for refund of the said amount. This resulted in short payment of Service Tax of ₹ 33.64 lakh which was recoverable with interest and penalty.

When we pointed this out (March 2008), the Commissionerate intimated (March 2013) that demand of ₹ 33.64 lakh had been confirmed against the assessee with interest at applicable rate and penalty of ₹ 33.69 lakh.

However, the Ministry contested (February 2014) the audit observation stating that adjustment of Service Tax was on account of refund of brokerage received and was done in accordance with Rule 6(3) of the Service Tax Rules, 1994. The Ministry added that though the assessee did not show the adjustment in its ST-3 return in the manner required, this was only a procedural lapse involving no revenue loss.

We observe, however, that the prerequisite for Rule 6(3) of the Service Tax Rules, 1994 to apply viz. the non-provision, either wholly or partially for any reason, of the service to be provided, is not satisfied in this case. Here, the service had been provided fully to the clients. Later, the clients were given the benefit of a promotional scheme through reduction in the rates of brokerage with retrospective effect. The claim of excess tax amount paid was accordingly, purely on account of reasons involving valuation. 'Valuation' is specifically mentioned in Rule 6(4B) as one of the reasons not permissible for making tax adjustments under Rule 6(4A). Besides, the amount adjusted was in excess of the amount permissible, viz. ₹ one lakh for the relevant month. The assessee had also not complied with the requirement under Rule 6(4B) of intimating the department within 15 days from the date of adjustment. Thus, the assessee could not take the benefit of either Rule 6(3) or of Rule 6(4A) read along with Rule 6(4B).

Moreover, we observe that the audit observation and the Ministry's reply, which was contrary to the Commissionerate's reply and the Order-in-Original, also highlight a lacuna in the then extant rules viz. that they did not cover the aspect of the date relevant

for determining the value of a taxable service and whether the value of taxable services could be lowered retrospectively in a manner detrimental to Revenue. This is not explicitly covered in the Point of Taxation Rules, 2011 either.

2.4 Availing/utilisation of Cenvat Credit

2.4.1 Wrong utilization of Cenvat credit for payment of tax on input service.

Cenvat credit can be utilized for payment of Service Tax on output services.[55] However, by virtue of omission of "explanation" below the definition of "output service" with effect from 19 April 2006, only such taxable services as are provided by a service provider shall be considered as output service.[56] CBEC Circular No. 97/8/2007 dated 23 August 2007 clarified that service provided by a goods transport agent for which the consignor or consignee is made liable to pay Service Tax does not become an 'output service' for such consignor or consignee and that the payment of such Service Tax cannot be made through credit accumulated by such consignor or consignee. Moreover, GTA services have been specifically excluded from the purview of output services with effect from 1 March 2008.[57]

M/s Neo Carbons Pvt. Ltd., Barauni in Patna Commissionerate utilized Cenvat credit of ₹ 12.11 lakh during April 2006 to March 2009 for payment of Service Tax towards the GTA services received by them. As these services were input services, the utilization of Cenvat credit of ₹ 12.11 lakh for these input services was irregular, which was recoverable along with interest.

When we pointed this out (July 2009), the Commissionerate stated (November 2012) that it had issued a demand-cum show cause notice dated 19 April 2012 for ₹ 10.99 lakh covering the period February 2007 to March 2009. The Commissionerate did not intimate reasons for not covering the period April 2006 to January 2007 in the show cause notice.

We await the Ministry's response (February 2014).

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55 as per rule 3(4)(e) of the Cenvat Credit Rules, 2004.
56 by Finance Act, 2006 and notification No. 08/2006/CE dated 19 April 2006.
57 By Cenvat Credit (Amendment) Rules, 2008 w.e.f 1.3.2008.