Chapter V

Scrutiny of Service Tax returns

5.1 Introduction

CBEC introduced self-assessment in respect of Service Tax in 2001. With the introduction of self-assessment, the department also provided for a strong compliance verification mechanism with Scrutiny of Returns. As assessment is now the responsibility of the assessee, the main function of the department is to scrutinize the tax return submitted by the assessee to ensure the correctness of duty assessed in terms of the effective rate of duty claimed, the taxable value declared, and the Cenvat credit availed. E-filing of returns through ACES was made mandatory with effect from October 2011. Scrutiny is done in two stages i.e. preliminary scrutiny by ACES and detailed scrutiny, which is carried out manually on the returns marked by ACES or otherwise.

5.2 Audit objective

The objective of the audit examination was to assess the effectiveness of preliminary and detailed scrutiny systems in place, as tools for compliance verification.

5.3 Audit coverage

We conducted test-check of Service Tax returns filed in 2011-12 and 2012-13 in 129 Ranges in 26 Commissionerates. However, depending upon the issues involved, we have included observations pertaining to earlier periods, wherever deemed necessary.

5.4 Audit findings

Scrutiny of assessee records in the audited units revealed certain compliance related as well as other issues having financial implication of ₹ 57.53 crore. The Ministry/Department accepted (December 2014) the audit observations having financial implication of ₹ 44.96 crore and recovered ₹ 3.67 crore. The major findings are illustrated in the following paragraphs:

A. Preliminary scrutiny

Rule 7 of the Service Tax Rules, 1994 envisages that every person liable to pay Service Tax has to submit half-yearly return in Form ST-3 within 25 days of the end of the half-year. Filing of returns by the assessees as well as preliminary scrutiny of returns by Range Officers is carried out online through ACES since 2009-10.

We discuss below our audit findings relating to preliminary scrutiny as seen during the course of examination in selected ranges.

5.4.1 Submission of returns

i) We observed that out of 2,45,240 returns receivable during 2011-12 and 2012-13 only 1,39,349 (57 per cent) returns were received in the selected Commissionerates. Out of the total returns received, 8091 (6 per cent) returns were received belatedly and 1,05,891 (43 per cent) returns were not received at all. Identification of non-filers/ stop-filers has also been listed as one of the purposes of Preliminary scrutiny in Para 1.2.1 of the Manual for Scrutiny of Service Tax Returns, 2009. However, the department did not identify non-filers/ stop-filers. We also observed that no action was taken by the department in cases of delayed filing of return.

When we pointed this out (August 2014), the Ministry (December 2014) intimated that action has been initiated against the non-filers/ stop-filers.

ii) Conduct of scrutiny

Time frame for completion of preliminary scrutiny has not been prescribed for scrutiny of Service Tax returns unlike in the case of scrutiny of Central Excise returns where the Manual for Scrutiny of Central Excise Returns, 2008 prescribes a norm of 3 months for completion of both preliminary and detailed scrutiny.

Applying the same norm of 3 months as a good practice, we tabulated the position of completion of scrutiny of returns as obtained from different Commissionerates. We observed that only 38,936 (28 per cent) of returns received in selected ranges were scrutinised within three months. 2,37,913 (seventy per cent) of returns were scrutinised belatedly. Out of 34,478 returns marked for review and correction, 26,863 (78 per cent) in the selected ranges remained pending for 'review and correction' for a period exceeding 3 months.

When we pointed this out (August 2014), the Ministry intimated that pendency in scrutiny cases is due to problems in ACES. Efforts are being made to reduce the pendency.

Recommendation No. 6

- *It is recommended to prescribe a time-frame for completion of scrutiny of Service Tax returns including corrective action in respect of 'review and correction' cases.*

5.4.2 Non-payment of late fee for delayed filing

Rule 7 C of Service Tax Rules, 1994, prescribes manner of filing of returns and also mandates that such return is to be filed by 25th of the month following the particular half yearly period to which returns relates. It further provides that if the return is not filed by the prescribed due date, the assessee is required to submit the return with late fee for the period of delay. As per Section 70 (1) of the Finance Act, 1994 such late fee may not exceed ₹ 20,000.

We observed that out of 1,39,349 returns, 8,091 returns were filed belatedly in the audited units during 2011-12 and 2012-13. A test check of 865 returns received belatedly revealed that ₹ 31.65 lakh was due to the Government as late fee.

When we pointed this out (August 2014), the Ministry/Department intimated (December 2014) a recovery of ₹ 24.02 lakh in 14 cases.

B. Detailed scrutiny of assessment

The purpose of the detailed scrutiny is to ascertain the correct reason for abnormal trends exhibited for the risk parameters identified in the Board's guidelines. Besides establishing the validity of the information furnished in the tax return, the other major purpose of detailed scrutiny is to establish the correctness of self-assessment by ensuring correctness of valuation, dutiability in respect of services which may have escaped assessment, correctness of Cenvat availing etc.

Chapter 4 of the Manual for Scrutiny of Service Tax Returns, 2009 envisages that not more than two per cent of the total returns are to be selected on the basis of identified risk parameters for detailed scrutiny.

5.4.3 During our audit examination at the selected ranges, we observed as follows:-

a) ACES system did not list out returns for detailed scrutiny.

b) Out of 1,39,349 returns received in 2011-12 and 2012-13 only 121 returns were scrutinised by the selected Commissionerates which is less than 0.1 per cent of the total returns received.

When we pointed this out (September 2013), the Ministry intimated (December 2014) that action has been initiated to conduct the detailed scrutiny.

5.5 Non-compliance by assessees

We attempted scrutiny of a few returns where the department had conducted the detailed scrutiny and also where the department had not

conducted the detailed scrutiny to assess the efficiency of the scrutiny process and to curtail revenue leakage.

We observed that in several instances, there were lapses in self-assessment by assessees involving revenue implication. The non-compliance by assessee was not detected until CERA pointed out the same. A few of these lapses that escaped the compliance verification mechanism of the department, but observed during our examination of the assessee returns and other records, are illustrated:

5.5.1 Non/short payment of Service Tax

We observed non/short payment of Service Tax and interest of ₹ 41.03 crore in respect of 56 cases. Ministry/Department accepted the observation in 19 cases and recovered ₹ 1.07 crore. Three cases are illustrated:-

i) As per Section 65(105)(zzm) of the Finance Act, 1994, service provided or to be provided to any person by airports authority or by any other person in any airport is chargeable to Service Tax.

M/s Mihan India Ltd. (MIL) in Nagpur Commissionerate, a joint venture of Maharashtra Airport Development Co. Ltd. and Airports Authority of India (AAI), has been recovering license fee from clients for use of facilities in Dr. Babasaheb Ambedkar International Airport, Nagpur. It was noticed that the license fee from Reliance Industries was collected by AAI and in-turn it was passed to MIL.

We observed that neither the assessee nor AAI paid Service Tax on airport services in respect of license fee collected from Reliance Industries Ltd. during the period from March 2010 to March 2013. This resulted in short payment of Service Tax of ₹ 4.57 crore.

When we pointed this out (December 2013), the Ministry admitted the observation and intimated (December 2014) that SCN is under process for issue.

ii) As per Section 65(105)(zzzzj) of the Finance Act, 1994, service in relation to supply of tangible goods including machinery, equipment and appliances for use, without transferring right to possession and effective control of such machinery, equipment and appliances is a taxable service.

We observed that M/s Transafe Services Ltd. (TSL), in Kolkata Service Tax Commissionerate received rental income of ₹ 27.72 crore for supply of freight container/equipment in 2011-12. The contract/lease agreement entered into with clients revealed that such transactions were operating leases only and not a sale. The only right acquired by lessees was a right to permissive custody and use of the leased container. Thus, such transactions of allowing

use of the freight container to different parties, without giving legal right to possession and effective control, not being treated as deemed sale of goods, was covered under 'supply of tangible goods service' for use. However, Service Tax on the amount received towards rental income was not received which resulted in non-payment of Service Tax of ₹ 2.85 crore.

When we pointed this out (May 2013), the Ministry admitted the observation intimated (December 2014) that demand of ₹ 15.32 crore had been confirmed alongwith equivalent penalty and applicable interest.

iii) Section 66A of the Finance Act, 1994 (as applicable prior to 1 July 2012) read with Taxation of Services (Provided from outside India and received in India) Rules, 2006 provided that import of services is taxable in the hands of service recipient in India. Further, as per Rule 3 (4)(e) of Cenvat Credit Rules, 2004 read with Rule 5 of Taxation of Services (Provided from outside India and received in India) Rules 2006, Service Tax on such service can be paid only through cash and not by utilizing the Cenvat credit of tax paid on input services.

M/s Tutor Vista Global Pvt. Ltd. in Bangalore Service Tax Commissionerate imported services worth ₹ 7.43 crore during 2011-12. The assessee paid Service Tax on such imported services through Cenvat credit, which was irregular. It resulted in non-payment of Service Tax of ₹ 76.55 lakh which is recoverable alongwith interest.

When we pointed this out (July 2013), the Ministry admitted the observation intimated (December 2014) that SCN was issued to the assessee for an amount of ₹ 76.55 lakh.

5.5.2 Incorrect valuation of services

We observed incorrect valuation of the value of services provided resulting in short payment of Service Tax of ₹ 28.37 lakh in respect of two cases which are illustrated:-

i) M/s. Maitri Advertising Works Pvt. Ltd. in Cochin Commissionerate had centralised registration and raised invoices from their offices located in Kochi and Chennai. However, while paying Service Tax, the assessee did not reckon the Service Tax invoices raised from Chennai office which resulted in short payment of Service Tax of ₹ 12.66 lakh during the period from April 2012 to September 2012.

When we pointed this out (September 2013), the Ministry intimated (December 2014) that the assessee had paid the amount along with interest of ₹ 1.78 lakh.

ii) M/s. Ganesh Benzoplast Ltd. in Cochin Commissionerate, issued invoices for ₹ 1.92 crore during the period 2011-12 but declared the value of service as ₹ 56.40 lakh in the return and paid Service Tax thereon. This resulted in suppression of value of service of ₹ 1.35 crore. It resulted in short payment of Service Tax of ₹ 13.93 lakh.

When we pointed this out (August 2013), the Ministry intimated (December 2014) the recovery of ₹ 13.93 lakh.

5.5.3 Incorrect availing of exemption

We observed that exemption from Service Tax of ₹ 6.58 crore was incorrectly allowed to different assessees in respect of five cases. One case is illustrated:-

Notification 1/2006 (Sl. No.10) dated 01 March 2006, provided for abatement of 67 per cent on value of taxable services in respect of construction of complex service subject to the condition that no Cenvat credit is taken on inputs, capital goods or input services used for providing such taxable services.

M/s. Larsen and Toubro Ltd., ECC Division in Mumbai ST-II Commissionerate, paid Service Tax on construction of residential complex service after availing benefit of abatement under the said notification. However, the assessee also availed credit of Service Tax paid on input services used for such construction which contravened the conditions specified in the notification. This resulted in incorrect availing of abatement of ₹ 29.36 crore during the year 2011-12. It resulted in short levy of Service Tax of ₹ 3.02 crore.

When we pointed this out (July 2013), the Ministry replied (December 2014) that that the assessee has not utilised any Cenvat credit for works contract service.

The Ministry's reply is not acceptable as the benefit of the abatement is not available if the Cenvat credit has been availed on the input service irrespective of fact whether the credit has been utilised for this service or any other taxable services.

5.5.4 Incorrect availing of Cenvat credit

We observed that Cenvat credit of ₹ 6 .97 crore was incorrectly availed by different assessees in 35 cases. Ministry/Department accepted the observation in 12 cases and recovered ₹ 84.94 lakh. Three cases are illustrated:-

i) Rule 6(1) of Cenvat Credit Rules, 2004 envisages that Cenvat credit shall not be allowed on such quantity of input or input service which is used in the manufacture of exempted goods or for provision of exempted services.

In case the service provider fails to maintain separate accounts relating to taxable and exempted services, then as per rule 6(3), the assessee shall follow either of the following options, as applicable to him, namely:-

(i) the manufacturer of goods shall pay an amount equal to five per cent of value of the exempted goods or exempted services till 31 March 2011 and six per cent thereafter of value of exempted goods or exempted services; or

(ii) the manufacturer of goods or the provider of output service shall pay an amount equivalent to the CENVAT credit attributable to inputs and input services used in, or in relation to, the manufacture of exempted goods or for provision of exempted services.

Notification dated 1 March 2011 further clarifies that exempted services include trading.

As per Rule 3D(c) of Cenvat Credit Rule, 2004, value for the purpose of Rule 6 of the rules ibid, in case of trading, shall be the difference between sale price and cost of goods sold or 10 per cent of the cost of goods sold, whichever is higher.

M/s Gupta Global Resources Pvt. Ltd. in Nagpur Commissionerate provided business auxiliary services (washing of coal) and paid Service Tax accordingly through cash as well as through Cenvat credit account. However, the assessee was also engaged in trading activity and traded coal during 2011-12 and 2012-13. Since trading is an exempted service, the assessee ought to have maintained separate accounts as per Rule 6(2) of the Cenvat Credit Rule, 2004, which was not done. Therefore, the assessee was liable to reverse Cenvat credit of ₹ 4.92 crore.

When we pointed this out (December 2013), the Ministry admitted the observation and intimated (December 2014) that SCN will be issued in due course.

ii) As per Rule 3 of Cenvat Credit Rules, 2004, a provider of taxable services is allowed to take Cenvat credit of Central Excise duty or service sax paid on inputs/capital goods/input services received by him.

M/s Blues in Kolkata Service Tax Commissionerate, availed Cenvat credit of ₹ 50 lakh on input services and utilised the same for the payment of Service Tax during the year 2011-12 though Cenvat credit available to the assessee during the period was only ₹ 18.35 lakh. This resulted in excess availing of Cenvat credit of ₹ 31.65 lakh which was irregular and recoverable with interest and penalty.

When we pointed this out (June 2013), the Ministry intimated (December 2014) the recovery of ₹ 31.65 lakh. Further action in respect of interest is still awaited.

iii) As per notification number 30/2012-ST dated 01 July 2012 (as amended by notification number 45/2012-ST) in case of the service of supply of manpower services and security services recipient will pay 75 per cent of Service Tax and provider will pay 25 per cent of the Service Tax. Therefore, where service receiver has not discharged his liability, Cenvat credit will not be available to that extent.

M/s Kejriwal Casting Ltd., in Haldia Commissionerate, had availed input service credit of 100 per cent Service Tax charged on bills raised by various service providers (contractual labour suppliers) during July 2012 to July 2013. However, the assessee did not discharge his Service Tax liability under reverse charge mechanism as per the notification cited above and wrongly availed full credit of the said input services. This resulted in irregular availing of Cenvat credit of ₹ 37.70 lakh which is recoverable with interest.

When we pointed this out (September 2013), the Ministry intimated (December 2014) that the assessee had reversed the Cenvat credit of ₹ 37.70 lakh. Ministry further intimated that the assessee had paid Service Tax of ₹ 53.09 lakh alongwith interest of ₹ 12.48 lakh.

5.6 Other cases

Besides the cases discussed above, we also observed 87 cases of short payment/ non-payment of Service Tax, failure to pay tax electronically etc. involving revenue of ₹ 2.35 crore. The Ministry/Department accepted observations in 52 cases and recovered ₹ 1.23 crore.

5.7 Conclusion

Though CBEC's expectation was that with the introduction of online automated scrutiny of returns, efficiency would increase and manpower would be released for detailed scrutiny which would become the core function of the ranges, the actual situation in field leaves much to be desired. A lot more needs to be done before scrutiny of assessments can claim its place as the core function of the Ranges.