# Chapter VI
# Non-compliance with rules and regulations

## 6.1 Introduction

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. having financial implication of ₹ 128.25 crore. We communicated these observations to the Ministry through 80 draft audit paragraphs. The Ministry/Department accepted (December 2014) the audit observations in 78 draft audit paragraphs having financial implication of ₹ 127.33 crore of which ₹ 26.93 crore had been recovered. Out of above 78 paras in 73 paras the Ministry/Department initiated/completed corrective action having financial implication of ₹ 108.21 crore. We have furnished the details of these paragraphs in Appendix II. The objections are covered under four major headings:

**Non-payment of Service Tax**

**Short-payment of Service Tax**

**Cenvat Credit**

**Non-payment of Interest**

## 6.2 Non-payment of Service Tax

### *6.2.1 Non- payment of Service Tax under tour operator service*

Notification dated 1 March 2006 as amended by Notification dated 23 August 2007 prescribes exemption to tour operator services by allowing abatement of 75 and 90 per cent of gross amount charged in relation to services of package tour and booking of accommodation respectively subject to certain conditions. This notification is not applicable when Cenvat credit of duty on inputs or capital goods or the Cenvat credit of Service Tax on input services used for providing such taxable services, has been availed under the Cenvat Credit Rules, 2004.

M/s Trade Wings Limited, in Mumbai ST I Commissionerate, was paying Service Tax on abated value claiming exemption under notification dated 23 August 2007 on account of tour operator services. Audit noticed that the assessee did not pay Service Tax on gross amount of commission received in Indian currency against outbound tour services amounting to ₹ 95.65 lakh and ₹ 4.63 crore during the period 2009-10 and 2010-11 respectively claiming it as export of services. Since the commission amount was not received in

convertible foreign exchange, Audit contended that services provided cannot be treated as export of services. Further, the assessee had availed input Service Tax credit and utilised the same thereby contravening the provisions contained in the aforesaid notification. The assessee was liable to pay Service Tax of ₹ 45 lakh on the net consideration of commission received (excluding the forex purchased) of ₹ 66.19 lakh and ₹ 3.71 crore in 2009-10 and 2010-11 respectively.

When we pointed this out (July 2012), the Commissionerate reported recovery of Service Tax of ₹ 7.65 lakh alongwith interest and penalty of ₹ 4.57 lakh in August 2012 and March 2013. This was after taking abatement into consideration. Further, the Commissionerate informed that the assessee reversed Cenvat credit availed on input services amounting to ₹ 1.31 lakh and ₹ 3.71 lakh for the years 2009-10 and 2010-11 respectively. Thus, a total recovery of ₹ 17.24 lakh was made at the instance of Audit. Further on Audit contention that the assessee was not eligible for abatement and was liable to pay Service Tax at full rate, the Commissionerate issued show cause notice (February 2014) demanding Service Tax of ₹ 57.59 lakh on the gross value of commission received amounting to ₹ 95.65 lakh and ₹ 4.63 crore against outbound tour services for the financial years 2009-10 and 2010-11 respectively.

The reply of the Ministry is awaited (December 2014).

### *6.2.2 Works contract Service*

Section 65(105)(zzzza)(i) and (ii) (c) of chapter V of Finance Act, 1994, defines works contract as a contract wherein transfer of goods involved in the execution of such contract is leviable to tax as sale of goods, and such contract is for carrying out construction of a new residential complex or a part thereof. As per Section 65(91a) of the Act, 'residential complex' means any complex comprising of a building or buildings having more than twelve residential units, a common area and any one or more services such as park, lift, parking space, community hall, common water supply or effluent treatment system, located within a premises.

Board in its circular dated 29 January 2009, clarified vide para no. 3 that, when the initial agreement between the promoters/ builders/developers and the ultimate owner is in the nature of "agreement to sell", any service provided by such seller in connection with the construction of residential complex till the execution of such sale deed, would be in the nature of self service and consequently would not attract Service Tax.

According to explanation inserted with effect from 1 July 2010 under Section 65(105)(zzzh) of the Act ibid, for the purposes of this sub-clause, construction

of a complex which is intended for sale, wholly or partly, by a builder before, during or after construction (except in cases for which no sum is received from or on behalf of the prospective buyer by the builder before the grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force), shall be deemed to be service provided by the builder to the buyer.

M/s Chathamkulam Projects and Developers Pvt. Ltd., a Service Tax assessee in Calicut Commissionerate, providing works contract service, filed 'Nil' returns for the period up to September 2010 based on Board's circular dated 29 January 2009. The assessee intimated the Commissionerate that they were not providing any taxable service since they were constructing only independent villas for self occupation of customers. The assessee applied for surrender of registration and the surrender was allowed by the Department. The assessee again took Service Tax registration under "Construction of Complex services" on 8 August 2011 and started paying Service Tax.

Cross verification of VAT records of the assessee with Commercial Taxes Department, Palakkad showed that they have paid works contract tax at compounded rate of 3 per cent for turnover amounting to ₹ 2.81 crore and ₹ 6.65 crore for the years 2009-10 and 2010-11 respectively. As per the annual return on VAT in Form 10B and advertisements made in websites, the assessee completed various flats and villa projects having common facilities like security personnel, recreation/health clubs, play area, garden etc. The assessee also received advance amounts of ₹ 92.52 lakh and ₹ 15.71 lakh respectively for construction of villas and flats as per the balance sheet as at 31 March 2010. Since the Board's circular dated 29 January 2009 was about applicability of Service Tax to builders engaged in providing construction of residential complex service and in no way dealt with works contract service, the assessee was liable to pay Service Tax for works contract services provided during the years 2009-10 and 2010-11. The assessee, however, did not pay Service Tax of ₹ 39.04 lakh (based on the gross income shown in the VAT return) for the years 2009-10 and 2010-11, filed Nil returns up to September 2010 and then surrendered their registration. The Commissionerate failed to ensure taxability of the service provided by the assessee, as provided under rule 4(7) and (8) of Service Tax Rules, 1994, before granting the surrender of registration.

When we pointed this out (October 2011), the Commissionerate replied (September 2012, August 2013 and March 2014) that these contracts were undertaken by the assessee under individual construction contracts for construction of residential units whose ownership was already with the customers/service recipient and customers themselves had obtained the

building permits in their names. It was also stated that there was no common area or common facilities within the premises and as such, the activity of the assessee did not fall within the ambit of the taxable service of "Construction of Residential Complex Service". The Commissionerate further stated that the assessee had filed 'nil' ST-3 returns for the period up to September 2010 on the strength of Board's circular dated 29 January 2009. It was also replied that even in cases where VAT was payable under works contract, the service will be taxable only if it falls under the definition of "Construction of Residential Complex Service". The Commissionerate also stated that show cause notice dated 1 October 2013 had been issued to the assessee demanding Service Tax amounting to ₹ 39.04 lakh.

The reply of the Commissionerate is not acceptable since construction of residential units under works contract attracts Service Tax under works contract services by virtue of clause (c) of section 65(105) (zzzza) of Finance Act, 1994. As per advance ruling dated 7 April 2008, issued in the case of Harekrishna Developers by Advance Ruling Authority, New Delhi "when the buyer of the sub plot enters into a works contract, such a contract is not for the construction of an isolated house, but for one which will make available to the buyer, all the facilities such as a club house etc, provided for by the residential complex. Individual houses built through the works contract, therefore, have to be viewed as parts of a residential complex rather than a stand alone house. Thus the expression "or a part there of" occurring in clause (c) of (zzzza) of section 65(105) squarely applies". Further, as per the advertisements made by the assessee they were providing common facilities such as parking, play area, garden, security etc., to their customers and moreover, as per the sales deed of land, there was provision for right to use of common road in the name of the assessee. Moreover, the assessee also collected Corpus fund for meeting expenses for routine maintenance, from the buyers and as per a sale deed dated 24 June 2009, the builder obtained permission from Revenue Divisional Officer for filling the property with soil and obtained building permit from Kannadi Panchayat. Further, Board's circular dated 29 January 2009 was about applicability of Service Tax to builders engaged in providing construction of residential complex service and in no way dealt with works contract service.

The reply of the Ministry is awaited (December 2014).

### *6.2.3 Management, Maintenance or Repair Service*

Management, Maintenance or Repair service (as applicable prior to 1 July 2012), means any service provided by any person under a contract or an agreement; or a manufacturer or any person authorised by him, in relation to management of properties, whether immovable or not; maintenance or repair of properties, whether immovable or not; or maintenance or repair including reconditioning or restoration, or servicing of any goods, excluding a motor vehicle.

M/s Grauer and Weil (India) Ltd. in Mumbai II Commissionerate, engaged in providing services of maintenance and repairs revealed that the assessee provided services to M/s HPCL through their sub-contractors on works relating to maintenance and repairs of huge tanks, painting of tanks to prevent corrosion etc. Audit scrutiny of ST-3 returns revealed that the assessee had discharged the Service Tax liability towards such services under the category of Maintenance and Repairs for the period upto 2009-10. However for the period April 2010 to March 2011, the assessee did not pay Service Tax of ₹ 24.65 lakh, payable on value of services rendered to M/s HPCL amounting to ₹ 2.39 crore. This resulted in non payment of Service Tax which was to be recovered alongwith interest.

When we pointed this out (June 2011), the assessee paid the amount of ₹ 24.65 lakh through Cenvat credit and paid interest of ₹ 0.68 lakh (June 2011). However, the interest payable worked out to ₹ 2.89 lakh and thus short payment of interest of ₹ 2.21 lakh was recoverable.

The Commissionerate intimated (September 2011) that the matter had been referred to Service Tax II, Mumbai Commissionerate for further pursuance. Further reply is awaited (December 2014).

The reply of the Ministry is awaited (December 2014).

## 6.3 Short payment of Service Tax

### *6.3.1 Service Tax under import of service*

Explanation to Rule 6(1) of the Service Tax Rules, 1994 read with Rule 7 of Point of Taxation Rules, 2011 stipulates that as regards associated enterprises, Service Tax is leviable from the person liable to such tax even if the amount is not actually received but the same is debited or credited in the books of accounts of the service provider. Any payment received towards the value of taxable service shall include any payment debited or credited to any account whether called suspense account or any other name in the books of accounts of the service provider.

M/s Emerson Climate Technologies (India) Ltd, in Kolhapur Commissionerate, engaged in providing Business Support Services, Supply of Tangible Goods Services, Business Auxiliary Services etc. During detailed scrutiny, including reconciliation of ST-3 return vis-à-vis financial records it was noticed that the assessee had incurred huge expenditure in foreign currency on account of agency commission, advisory and other service charges, design and consultancy charges etc. of ₹ 26.38 crore during the period 2009-10 to 2010-11. However, only an amount of ₹ 11.74 crore was taken as the value of taxable service for payment of Service Tax as recipient of service under various categories viz. Technical Inspection, BAS etc. Since these transactions were with associated enterprises, Service Tax is payable on gross amount as and when the same is reflected in the books of accounts under the provisions mentioned above. Non-adherence to above provisions resulted in short payment of Service Tax of ₹ 1.51 crore which was recoverable alongwith interest.

When we pointed this out (May 2013), the Commissionerate accepted the audit observation and reported (February 2014) that a SCN for ₹ 1.56 crore for the period from 2009-10 to 2012-13 is under issue. The Commissionerate also reported (May 2014) that an amount of ₹ 21.42 lakh was recovered towards delayed payment of Service Tax.

The reply of the Ministry is awaited (December 2014).

## 6.4 Cenvat credit

### *6.4.1 Irregular availing of Cenvat credit on ineligible invoices*

Rule 7 of Central Excise Rules, 2002 as amended vide Notification dated 17 March 2012 envisages that the input service distributor (ISD) may distribute the Cenvat credit in respect of the Service Tax paid on the input service to its manufacturing units or units providing output services subject to the condition that the credit of Service Tax attributable to service used in more than one unit shall be distributed pro rata on the basis of the turnover during the relevant period of the concerned unit to the sum total of the turnover of all the units to which the service relates during the same period.

M/s Rieter India Pvt. Ltd., In Kolhapur Commissionerate, is engaged in providing Erection Commissioning and Installation, Commercial Training and Coaching, Business Auxiliary services etc. and had centralised registration for payment of Service Tax at Coimbatore. The assessee availed Cenvat credit of input service on the basis of invoices that were issued to its other unit located at Koregoan, Pune. It was noticed that neither was the Pune unit registered as ISD nor was the procedure prescribed for distribution of Cenvat credit was followed by the head office unit at Coimbatore. This resulted in

irregular availing of Cenvat credit amounting to ₹ 1.77 crore for the period November 2012 to January 2013.

When we pointed this out (May 2013), the Commissionerate stated (June 2014) that the paragraph appears to be acceptable and draft show cause notice proposing disallowance of Cenvat credit for the period November 2012 to April 2014 amounting to ₹ 4.77 crore along with interest and penalty is under issue.

The reply of the Ministry is awaited (December 2014).

## 6.5 Non payment of Interest

### *6.5.1 Incorrect availing of Cenvat credit on capital goods*

As per Rule 4 (2) of Cenvat Credit Rules, 2004, Cenvat credit in respect of capital goods received in a factory or in the premises of the provider of output service at any point of time in a given financial year shall be taken only for an amount not exceeding 50 per cent of the duty paid on such capital goods in the same financial year. The balance of Cenvat credit may be taken in any financial year subsequent to the financial year in which the capital goods were received.

During the examination of records of M/s Dish TV India Ltd. Noida, in Noida Commissionerate, it was noticed (September 2011) that the assessee had availed 100 per cent Cenvat credit on capital goods such as set top boxes, dish antennas', LNB, viewing cards, RCA cables etc. received during the period 2008-09, 2009-10 and 2010-11, against admissibility of 50 per cent as per Rule 4 (2) ibid. This resulted in excess availing of Cenvat credit to the tune of ₹ 89.87 crore upto March 2011, on which the assessee was liable to pay interest amounting to ₹ 11.68 crore as per Rule 14 of Cenvat Credit Rules, 2004.

When we pointed this out (February 2012), the Commissionerate stated (July 2013) that a show cause notice demanding interest amounting to ₹ 12.29 crore for the period from October 2007 to March 2011 has been issued during March 2013. Further progress is awaited (December 2014).

The reply of the Ministry is awaited (December 2014).

### *6.5.2 Interest on delayed payment of Service Tax*

Section 75 of the Finance Act, 1994 provides that every person, liable to pay the tax in accordance with the provisions of section 68 or rules made thereunder, who fails to credit the tax or any part thereof to the account of Central Government within the period prescribed, shall pay simple interest at such rate not below ten per cent and not exceeding 36 per cent per annum,

as is for the time being fixed by the Central Government by which such crediting of the tax or any part thereof is delayed.

Rule 3 of the Point of Taxation Rules, 2011, provides inter alia, that where the invoice is not issued within the time period specified in rule 4A of the Service Tax Rules, 1994, the point of taxation shall be date of completion of provision of the service. Rule 3 also provides that in case of continuous supply of service, where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the receiver of service to make any payment to the service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service.

Rule 4A of the Service Tax Rules, 1994, provides that every person providing taxable service shall, not later than thirty days from the date of completion of such taxable service or receipt of any payment towards the value of such taxable service, whichever is earlier, issue an invoice, a bill or, as the case may be, a challan signed by such person or a person authorised by him in respect of taxable service provided or agreed to be provided.

The rule also provides that in case of continuous supply of service, every person providing such taxable service shall issue an invoice, bill or challan, as the case may be, within thirty days of the date when each event specified in the contract, which requires the service receiver to make any payment to service provider, is completed.

A telecom service provider (Service Tax assessee) in Jaipur-I Commissionerate had provided Interconnect usage charges services relating to SMS termination (roaming) to other telecom service providers between April 2011 and September 2012 on which owing to certain dispute between telecom operators, the billing was to kept suspended under "bill and keep" mode. The assessee subsequently got a favourable decision from TDSAT on 30 August 2012. Since the other party chose to file appeal before the Supreme Court, issue of invoice was delayed until the Apex Court passed order in October 2012 rejecting any interim relief to the other party. The assessee issued invoices at this stage and deposited Service Tax on interconnect usage charges (IUC) on SMS during December 2012 and January 2013. The Service Tax amount paid was ₹ 2.35 crore for the period April 2011 to September 2012.

We observed that as the service provided was a continuous supply of service under Rule 2 (C) of the Point of Taxation Rules, 2011, the point of taxation was to be determined according to Rule 3 (similar provision in Rule 6 covered the period prior to 1 April 2012).

Invoices had not been issued within 30 days from the date when each event, i.e., provision of service of interconnect usage relating to SMS termination for the billing period, was completed, though required by Rule 4A of the Service Tax Rules, 1994. Hence, as per Rule 3 of the Point of Taxation Rules, 2011, the 'point of taxation' would be the date of completion of provision of service which in this case would, by the proviso, be the date of completion of provision of service pertaining to each billing period (monthly/bimonthly etc.). Hence, the assessee was liable, as per the extant provisions to pay interest of ₹ 35 lakh.

When we pointed this out (November 2013), the Commissionerate replied (March 2014) that for the period post 1 July 2011, the point of taxation had not arisen as date of completion or the issue of invoice, whichever was earlier, would determine the point of taxation. The Commissionerate also stated that no amount had been collected from the service receiver.

The reply of the Commissionerate is not acceptable since rule 6 (or Rule 3) of the Point of Taxation Rules, 2011, Service Tax liability would arise in this case of continuous supply of services (where no invoice had been issued), on the completion of provision of IUC services pertaining to each billing period.

The reply of the Ministry is awaited (December 2014).