Chapter III

Non-compliance with rules and regulations

3.1 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 non/short payment of Service Tax, irregular availing and utilisation of CENVAT credit etc. We communicated these observations to the Ministry through 98 draft audit paragraphs having financial implication of ₹ 216.34 crore. The Ministry/Department accepted (up to January 2016) the audit observations in 97 draft audit paragraphs involving financial implication of ₹ 206.70 crore and in one case the Ministry did not accept the audit objection. Out of the 97 paragraphs, the Ministry accepted the 95 paragraphs involving an amount of ₹ 162.54 crore (Appendix-II) and in two cases the Ministry's reply is awaited. Of this accepted amount, ₹ 33.20 crore had been recovered. The interesting observations are discussed under two major headings:

- Payment of Service Tax
- Availing of CENVAT Credit

3.2 Payment of Service Tax

3.2.1 Mining of Mineral, Oil or Gas Service

As per Section 65(105) of the Finance Act, 1994, mining of mineral, oil or gas service was leviable to service tax with effect from 1 June 2007 and was defined as any service provided or to be provided to any person in relation to mining of mineral, oil or gas.

As per Notification No 1/2002-ST dated 1 March 2002 extended the provisions of chapter V of the Finance Act 1994, to the designated areas in the continental shelf and Exclusive Economic zone of India as declared by the notification of the Govt. of India in Ministry of External Affairs Nos. S.O.429 (E) dated 18th July 1986 and S.O. 643(E) dated 19 July 1996.

The two notifications issued by the Ministry of External Affairs indicated the names of the wells and corresponding coordinates which were declared to be designated areas.

Notification No. 21/2009 dated 7 July 2009 further amended the notification no. 1/2002 of 1 March 2002 and substituted the words 'designated areas in the continental shelf' and ending with the words "with immediate effect" with installations, structures and vessels in the continental shelf of India and the exclusive economic zone of India".

This meant that all the services, irrespective of whether rendered in designated or non designated areas, were taxable provided they fall within the continental shelf of India and economic zone of India.

3.2.1.1 M/s Transocean Offshore Deepwater Drilling Inc. and M/s Sedco Forex International Drilling Inc. in Mumbai Service Tax-II Commissionerate, rendered service of mining of oil to ONGC Limited in areas other than those declared as designated areas, during the period 7th July 2009 to 12th November 2009. Audit observed that for providing these services, the assessees received an amount of ₹ 288.49 crore (₹ 196.75 crore + ₹ 91.74 crore) during September 2009 to December 2009. It was also noticed that no service tax was not paid on this amount, which was not correct since service tax was payable on all services pertaining to the continental shelf of India and the exclusive economic zone of India as per Notification cited above. This resulted in non-payment of service tax amounting to ₹ 30.27 crore (₹ 20.27 crore + ₹ 10 crore) for the services rendered for the above-mentioned period.

When we pointed this out (February and March 2010), the Ministry accepted the audit objection and stated (December 2015) that SCNs, demanding an amount of ₹ 38.70 crore and ₹ 14.31 crore issued to M/s Transocean Offshore Deepwater Drilling Inc. and M/s Sedco Forex International Drilling Inc. respectively, were adjudicated and demand confirmed in both cases.

3.2.1.2 M/s B.G.Exploration and Production India Ltd. (BGEPIL) in Service Tax-IV Mumbai Commissionerate, in consortium with ONGC and Reliance Industries Ltd. (RIL) had formed an Unincorporated Joint Venture and were engaged in the mining of mineral oil and natural gas activities, thereby sharing the cost and profit in the ratio of share holding in the Joint Venture (ie. BGEPIL 30 per cent, ONGC 40 percent and RIL 30 per cent). ONGC provided transportation service for transportation of mineral oil from offshore to shore (distribution point) for which transportation charges amounting to ₹ 83.85 crore were recovered from the Joint Venture.

Further scrutiny revealed that ONGC charged Service Tax on 60 percent of invoice value (i.e. BGEPIL and RIL's share). The balance 40 percent being ONGC's interest in the Joint Venture was treated as 'stock transfer' and thereby the value was reduced to the extent of 40 percent . Thus in view of the above provision, the total value of service (ie. Total transport charges) were required to be considered for the payment of Service Tax and not the partial amount. Non-adherence to the above provision resulted in short

payment of Service Tax amounting to ₹ 48.62 crore for the period[38] from May 2007 to March 2011 which was to be recovered along with interest and penalty.

When we pointed this out in (April 2012), the Commissionerate (May 2015) stated that Show Cause Notice for the period from October 2007 to September 2014 amounting to ₹ 39.43 crore was issued to the assessee.

Further reply of the department about the reasons for difference in Tax Effect and period covered between the audit observation and the SCN and the reply of the Ministry were awaited (January 2016).

3.2.2 Registration of assessees

Section 69(1) of the Finance Act, 1994, provides that it is mandatory for every person liable to pay Service Tax to get registered with Service Tax department. Further section 68(1) of the Act provides that every person providing taxable service to any person shall pay Service Tax.

It was observed that M/s B.L. Kashyap and Sons Ltd. provided construction services to M/s HPCL Mittal Energy Limited (HMEL), Bathinda (Chandigarh II Commissionerate). However, the Service provider was neither registered with the department nor discharged his Service Tax liability during 2009-10 to 2011-12. The Service provider received ₹ 139.22 crore during the period 2009-10 to 2011-12 towards construction services but did not charge Service Tax from service recipient. This resulted in non-payment of Service Tax of ₹ 4.73 crore. The Service provider was also liable to pay interest and penalty under section 75, 76 and 78 of the Finance Act, 1994.

When we pointed this out (June 2012), the Commissionerate replied (January 2013) that the matter was referred to the Jurisdictional Commissioner of Service Tax Commissionerate, New Delhi, to conduct an enquiry and take the necessary steps to recover the government dues and further stated that the subject case was referred to Assistant Commissioner (Anti evasion), Service Tax Commissionerate, New Delhi to initiate the necessary action against the Service provider and recover the objected Service Tax amount.

The reply of the Ministry was awaited (January 2016).

3.2.3 Payment of Service Tax under Import of Service

As per Section 66 A(1) of the Finance Act 194, where any service specified in clause (105) of section 65 is provided or to be provided by a person who has established a business or has fixed establishment from which the service is

[38] assessee had mentioned that till April 2007, Service Tax was paid on total value of transportation charges

provided in a country other than India, and received by a person (recipient) in India then in such cases the recipient of such service is liable to pay Service Tax.

M/s Ocap Chassis Parts Pvt. Ltd., Bhiwadi, a 100 percent Export Oriented Unit, in Alwar Commissionerate, made payments/incurred expenditure on account of the services received from foreign service provider. Scrutiny of Balance Sheet for the period 2012-13 and 2013-14 revealed that the assessee made payments/incurred expenditure of ₹ 2.87 crore on account of Travelling expenses, Bank charges, Exhibition charges, Material testing charges and CandF charges for various services received from foreign service providers, but Service Tax as required under provisions mentioned above was not paid on this amount. This has resulted in non-payment of Service Tax of ₹ 33.82 lakh including cess.

When we pointed this out (March 2015), the Ministry stated (October 2015) that an appeal of the Department in a similar case was pending before Honourable Supreme Court on which no stay had been granted. Therefore, no action could be taken contrary to the said judgement at this stage. However, protective show cause notice was issued (June 2015) for recovery of Service Tax of ₹ 43.51 lakh.

The reply of the Ministry was not accepted as even if the similar issue was pending in higher courts, an SCN to protect the revenue should have been issued by the department suo-moto, which was done only after being pointed out by us.

3.3 Availing of CENVAT credit

3.3.1 Non-reversal / Short reversal of CENVAT credit

As per Rule 6 of the CENVAT Credit Rules, 2004, 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. As per Rule 2(e), 'exempted service' means taxable services which are exempt from the whole of the Service Tax leviable thereon, and includes services on which no Service Tax is leviable under section 66B of the Finance Act. Notification No. 03/2011-CE (NT) dated 1 March 2011 clarified that 'exempted services' includes 'trading'. Further, as per Board's Circular No.943/04/2011-CX, dated 29 April 2011, trading is an exempted service, even prior to 1 April 2008.

M/s L and T Limited (Heavy Engg. Division), Powai in Mumbai Commissionerate, also engaged in trading activities, was eligible for availing proportionate CENVAT credit of input service. Accordingly the assessee exercised the option to reverse proportionate Service Tax credit with respect

to common services as per Rule 6(3)(ii) read with Rule 6(3A) for the financial years 2010-11, 2011-12 and 2012-13.

(i) Audit observed that for arriving at proportionate credit to be reversed in respect of exempted services, trading activities were not considered during the financial year FY11. The proportionate CENVAT credit attributable to trading activities worked out to ₹ 22.03 lakh was required to be reversed along with interest amounting to ₹ 14.49 lakh. Similar exercise was required to be done for financial years FY09 and FY10 also.

(ii) Audit also observed that for FY12 and FY13, the assessee was calculating and paying the Service Tax credit attributable to exempted output services including 'trading activities' on provisional-basis for each month; and had determined 8.23 per cent[39] (for FY12) and 9.28 percent (for FY13) as the final attributable Service Tax credit for the whole year.

However, audit scrutiny of the calculations vis-à-vis ER-1 returns filed by the assessee revealed that the assessee was not considering 'the total CENVAT credit taken on input services during the financial year' as stipulated in the provisions of Rule 6(3A)(c)(iii) of CENVAT Credit Rules, 2004. While reversing, the assessee was adopting only the 'CENVAT credit in respect of common input services', in contravention of the formula.

This omission resulted in incorrect calculation and short-reversal of amount of ₹ 65.49 lakh (for FY12) and ₹ 78.08 (for FY13). This was required to be reversed along with interest.

(iii) Internal audit covering the period pointed out non-compliance to Rule 6 of the CENVAT Credit Rules, 2004 in respect of exempted goods and that the assessee was liable to pay an amount of Five percent (Six percent with effect from 1 April 2012) of the value of exempted goods. But Internal Audit did not point out any lapse in respect of exempted services (including 'trading') as pointed out by CERA.

When we pointed this out (April, 2014), the Ministry accepted the audit objection and stated (December 2015) that SCN was issued for FY10 to FY13 amounting to ₹ 1.41 crore and another SCN for the period FY14 amounting to ₹ 4 lakh was issued. It appeared that due to late issue of SCN, demand for FY09 had been time-barred.

[39] as per the formula prescribed under Rule 6(3A)(c)(iii) of the CENVAT Credit Rules, 2004