

CHAPTER III
SERVICE TAX ON RENT-A-CAB SCHEME OPERATORS’
SERVICES, PHOTOGRAPHY SERVICES AND HEALTH
CLUB AND FITNESS CENTRE SERVICES

Executive Summary

A review of the tax administration and the internal controls relating to three selected services was conducted to evaluate whether these were effective in identifying and bringing into tax net potential assesseees and were efficient in ensuring regular and correct payment of service tax by registered service providers.

Audit review has revealed that the internal control mechanism existing in the department to bring unregistered service providers into tax net were ineffective and inadequate. Key performance indicators (KPIs) like minimum surveys to be conducted by a commissionerate to identify potential assesseees were not prescribed, in the absence of which their performance could not be evaluated. Consequently, a large number of active unregistered service providers were escaping from the service tax net and audit could identify 8,394 of these, with actual loss of service tax of Rs. 34.04 crore and further an estimated service tax leakage of Rs. 27.91 crore. (This is approximately 37 per cent of the total revenue collected from these services).

There was a need for the Board to establish KPIs for a commissionerate which should include minimum number of surveys to be conducted to identify/register assesseees and garner additional revenue. Further, the procedure for conducting survey needs to be streamlined to collect information about potential assesseees from various sources including from income tax department. In all the cases identified by audit, of service providers who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by these service providers and take appropriate action. Additionally, inter-governmental and inter-departmental coordination and control mechanism to ensure that only registered assesseees provide services and pay applicable tax, needs to be strengthened, which would mitigate the risk of evasion of tax by service providers to the Government sector, who do not voluntarily register.

Decline in revenue from selected services in a few commissionerates, despite increase in tax base needs to be investigated and mechanism put in place to ensure that the decline is not due to evasion.

Further, internal controls to detect and take proactive action against ‘stop filers’ were ineffective and resulted in evasion of revenue of Rs. 31.27 crore. The department needs to devise an effective mechanism to detect ‘stop-filers’ in time and collect the Government revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.

Internal control mechanism to verify the correctness of returns filed was inadequate and ineffective and audit noticed several cases of short levy of service tax and evasion of service tax by suppression of value of services. The

short levy worked out to Rs. 43.13 crore. To address the cause of these irregularities, the Board may consider putting in place a mechanism for checking/verification of returns. This checking may be reinforced by detailed scrutiny of a few selected cases. The selection of the cases for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records etc.

Correlation of income tax data and service tax data is an important key factor for correct evaluation of service tax liability. Allotment of PAN based service tax codes (STC) numbers is a step in right direction. However, this aspect of implementation of this scheme has been slow and non-exhaustive, which needs to be corrected.

Specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. All of these have been accepted (December 2007) by the Ministry. The total additional revenue which could come to the Government as a result of this audit intervention (review) is Rs. 158.94 crore.

3.1 Highlights

➤ **Decline in revenue from a particular service, despite increase in tax base needs to be investigated and mechanism put in place to ensure that the decline is not due to evasion.**

(Paragraph 3.6.1)

➤ **Survey is a key activity which helps to identify potential assesseees and thereby augment Government revenues. However, performance indicators for this activity had not been prescribed.**

(Paragraph 3.6.2)

➤ **Measures undertaken by the department to bring unregistered service providers into tax net were ineffective and inadequate. Audit identified 8,394 unregistered service providers in these three services. While actual loss of revenue from 1,040 of these service providers was Rs.78.08 crore, the estimate of the revenue loss from the remaining 7,354 unregistered service providers was Rs. 55.82 crore.**

(Paragraphs 3.6.2.2 and 3.6.2.3)

➤ **Approximately 41 per cent of returns due were not submitted by the registered service providers in these three services, for which no action was initiated by department. Service tax of Rs. 14.36 crore was evaded by 414 registered service providers during the period when they did not file returns. Interest of Rs. 2.55 crore was also leviable, besides penalty of Rs. 14.36 crore.**

(Paragraphs 3.6.3 and 3.6.3.1)

➤ **Verification of returns was ineffective and policy for scrutiny of these returns ambiguous as service tax of Rs. 15.26 crore was short paid by the 398 registered service providers on account of suppression of**

taxable value. Interest of Rs. 5.45 crore was also leviable besides penalty of Rs. 15.26 crore.

(Paragraph 3.6.4)

➤ **Checking of the ST-3 returns on the basis of information furnished by the assesseees was not done properly as irregularities involving service tax to the extent of Rs. 7.16 crore were noticed.**

(Paragraph 3.7.1)

➤ **Correlation of income tax data and service tax data is a key factor for correct evaluation of service tax liability. However, allotment of PAN based STC numbers to enable such correlation has been slow and non-exhaustive.**

(Paragraph 3.7.4)

3.2 Introduction

Service tax on the services of **rent-a-cab scheme operators' services (CAB)** was levied with effect from **1 April 2000**. Section 65(91) of the Finance Act, 1994, defines rent-a-cab scheme operator as 'any person who is engaged in the business of renting of cabs'.

Service tax on the services of **photography services (PGH)** was levied with effect from **16 July 2001**. Section 65(78) of the Finance Act, 1994, defines photography as 'any service by any professional photographer or any person engaged in the business of rendering services relating to photography'.

Service tax on the services of **health club and fitness centre services (HFC)** was levied with effect from **16 August 2002**. Section 65(51) of the Finance Act, 1994, defines health club and fitness centre services as 'any service for physical well being such as sauna and steam bath, turkish bath, solarium, spas, reducing or slimming saloons, gymnasium, yoga, meditation, massage (excluding therapeutic massage) or any other like service.'

3.3 Audit objectives

The audit review was conducted in audit to seek assurance that: -

- the mechanism to identify and bring in potential assesseees in tax net for levy of service tax was effective;
- tax administration was efficient and effective in ensuring compliance with legislations and rules; and
- internal controls were in place and were effective.

3.4 Scope of audit

Records relating to the three selected services, in 66 out of 70 commissionerates dealing with service tax including six exclusive service tax

commissionerates, were test checked. Period covered under audit was from the year 2003-04 to 2005-06.

3.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance in providing the necessary information and records for audit. The draft review was forwarded to the Ministry in November 2007 and an exit conference was conducted with the Ministry officials in November 2007. All the eleven recommendations given by audit in this review were agreed (December 2007) to by the Ministry. The written responses of the Ministry to these recommendations have been incorporated appropriately.

AUDIT FINDINGS AND RECOMMENDATIONS

3.6 System issues

3.6.1 Trend of revenue

Total service tax collected during the year 2005-06 was Rs. 23,053 crore. The three services viz. CAB, PGH and HFC contributed Rs. 68.39 crore, Rs. 58.37 crore and Rs. 39.51 crore during 2005-06, which constituted 0.30, 0.25 and 0.17 per cent respectively of the total revenue collection from all the services during the year 2005-06.

Table nos. 1 to 6 indicate the trends of revenue in respect of 70 commissionerates:-

3.6.1.1 CAB

Table no. 1

(Amounts in crore of rupees)

No. of commissionerates	2001-02		2002-03		2003-04		2004-05		2005-06	
	No. of assesseees	Amt.	No. of assesseees	Amt.	No. of assesseees	Amt.	No. of assesseees	Amt.	No. of assesseees	Amt.
70	1593	10.04	2570	16.53	5658	22.78	10522	47.17	11672	48.72

Figures furnished by commissionerates.

Table no. 2

Percentage growth (+) or (-) over previous year									
No. of commissionerates	2002-03		2003-04		2004-05		2005-06		
	No. of assesseees	Amt.	No. of assesseees	Amt.	No. of assesseees	Amt.	No. of assesseees	Amt.	
70	(+)61.33	(+)64.64	(+)120.16	(+)37.81	(+)85.97	(+)107.07	(+)10.93	(+)3.29	

Audit observed that:-

- There was a sharp decline in the growth rate in terms of both revenue and tax base during the year 2005-06, as compared to the earlier years.

- In Kolkata, Delhi III and Lucknow commissionerates, there was decline of 29.87, 21.24 and 33 per cent in revenue during the year 2005-06 over the year 2004-05, though the number of service providers had increased by 11.53, 66.80 and 29.51 per cent respectively.
- In Surat II commissionerate, there was a 74.51 per cent fall in the revenue collection during the year 2005-06 over the previous year 2004-05 though the assessee base remained the same.

3.6.1.2 PGH

Table no. 3

(Amounts in crore of rupees)

No. of commissionerates	2002-03		2003-04		2004-05		2005-06	
	No. of assessees	Amt.	No. of assessees	Amt.	No. of assessees	Amt.	No. of assessees	Amt.
70	16299	20.34	31751	36.03	40883	48.35	33768	40.98

Figures furnished by commissionerates.

Table no. 4

Percentage growth (+) or (-) over previous year						
No. of commissionerates	2003-04		2004-05		2005-06	
	No. of assessees	Amt.	No. of assessees	Amt.	No. of assessees	Amt.
70	(+)94.80	(+)77.15	(+)28.76	(+)34.20	(-)17.36	(-)15.24

Audit observed that:-

- There was a 15.24 per cent fall in revenue collection during the year 2005-06 over the previous year. The corresponding tax base had also declined by 17.36 per cent.
- In Mumbai ST and Ahmedabad III commissionerates, there was a decline of 17.70 per cent and 54.92 per cent of revenue during the year 2005-06 over the year 2004-05, though the number of service providers had increased significantly by 14.21 per cent and 43.46 per cent respectively during this period.
- In Nasik commissionerate there was a significant fall in the revenue collection by 37.67 per cent during the year 2005-06 over the previous year 2004-05 though the assessee base remained the same.
- In Cochin, Trivandrum and Pondicherry commissionerates, there was decline of 76, 81.75 and 73.20 per cent respectively in the assessee base during the year 2005-06 over the previous year 2004-05. The revenue in these commissionerates had also declined by 35, 28 and 76.25 per cent respectively.

3.6.1.3 HFC

Table no. 5

(Amounts in crore of rupees)

No. of commissionerates	2003-04		2004-05		2005-06	
	No. of assessees	Amt.	No. of assessees	Amt.	No. of assessees	Amt.
70	2501	9.27	4017	18.07	3900	29.66

Figures furnished by commissionerates.

Table no. 6

Percentage growth (+) or (-) over previous year				
No. of commissionerates	2004-05		2005-06	
	No. of assessees	Amt.	No. of assessees	Amt.
70	(+)60.62	(+)95.02	(-)2.91	(+)64.12

Audit observed that:-

- During the year 2005-06, while the revenue from this service grew by 64.12 per cent over the previous year (2004-05), the corresponding tax base declined by 2.91 per cent.
- In Lucknow commissionerate, revenue collection declined sharply by 76.25 per cent during the year 2005-06 over the year 2004-05, though the number of service providers had increased significantly by 73.20 per cent during this period.
- In Ghaziabad commissionerate, the revenue collection fell by 50.40 per cent during the year 2005-06 over the previous year 2004-05 though the assessee base remained the same.

Recommendation

- *The Government needs to continually monitor the data on assessee base and revenues collected and investigate the reasons for decline in revenue from a particular service despite increase in the registered tax base, to ensure that the decline is not due to evasion.*

While agreeing to the recommendation, the Ministry stated (December 2007) that the revenue monitoring and monitoring of assessee base is a priority item and any decline in revenue including sectoral down fall and registered tax base is a significant aspect of the monitoring done by the Government.

3.6.2 Inadequate and ineffective efforts to broaden the tax base

Section 69 of the Finance Act, 1994 read with rule 4 of the Service Tax Rules, 1994, provides that every person liable to pay service tax shall make an application for registration to the concerned central excise officer in form

ST-1, within a period of 30 days from the date on which the service tax under section 66 of the Act above is levied. For registration of eligible service providers and ensuring payment of service tax, the Government has mainly relied on 'voluntary compliance'.

The growth of revenue is directly linked with the growth of the assessee base. With increasing reliance on voluntary compliance, it becomes important for the department to put in place an effective mechanism for collecting information from various sources in order to bring persons evading tax, into the tax net.

As part of the action plan drawn by the Director General of Service Tax, (DGST) and circulated to chief commissioners on 26 May 2003, the department was required to collect intelligence, conduct surveys and to identify unregistered service providers and get these registered. Further, instructions to field formations to carry out 'street to street surveys' to identify tax evaders were issued in August 2004.

Status of surveys undertaken by commissionerates during the year 2003-04 to 2005-06 and its impact on revenue is given in the following table:-

Table no. 7

(Amounts in crore of rupees)

Year	No. of commissionerates	No. of surveys	No. of new registrations for all services based on surveys	Total additional revenue realised
2003-04	35	2382	10194	3.42
2004-05	41	3217	7526	2.50
2005-06	58	1153	349	0.97

Figures furnished by commissionerates.

Audit observed that:-

- No target of surveys was fixed for any commissionerate, in the absence of which the performance of the commissionerates could not be evaluated.
- The number of surveys conducted during the year 2005-06 came down significantly from those conducted during 2004-05.
- There was a continued and significant decline in achievement in terms of number of persons registered and additional revenue generated, as a result of surveys, during the years 2004-05 and 2005-06, which is indicative of the fact that the surveys had been largely unfruitful.

Recommendation

- *The Board should establish 'Key Performance Indicators (KPIs)' for a commissionerate which should include minimum number of surveys to be conducted to identify/register assesseees and garner additional revenue.*

Responding to the recommendation, the Ministry informed (December 2007) that the Board prescribes KPIs like revenue collection, recovery of arrears, disposal of pending adjudication, provisional assessment, refunds and performance in audit and anti-evasion work, etc. In relation to the KPI pertaining to 'number of surveys', it further stated that the jurisdictional

commissioner, instead of the Board, would be in the best position to decide the optimal number of surveys keeping in view the available resources.

3.6.2.1 Unregistered service providers escaping from the tax net

The results of the efforts made by the department in terms of widening of the tax base and yielding of extra revenue were largely ineffective as mentioned in the preceding paragraph. The revenue collection in these services also showed a marked downward trend during the year 2005-06 as per the trend analysis given in the earlier paragraph no. 3.6.1. An attempt was, therefore, made by audit on a limited scale to gauge the extent to which the active, though unregistered, service providers escaped the tax net. For this purpose, information from various sources, such as yellow pages, newspapers, websites, income tax returns, departments of State and Central Governments, Public Sector Undertakings and other secondary records etc., was accessed to by audit to the extent possible and analysed.

Preliminary findings of audit indicate that, prima facie, 8,394 service providers (CAB-6,066, PGH-1,773 and HFC-555) in 66 commissionerates had not registered themselves with the central excise department. The additional potential assesseees identified by audit represent approximately 17 per cent of the registered (49,340) assesseees of the three services for the year 2005-06. The leakage of service tax (besides interest and penalty) revenue due to these unregistered service providers could be to the order of magnitude of Rs. 61.95 crore, as pointed out in the succeeding paragraphs. This represents 37 per cent of the total service tax collections from the three services during the year 2005-06. Additionally, penalty of Rs. 61.95 crore and interest of rupees ten crore would also be leviable in these cases.

3.6.2.2 Actual loss of service tax due to unregistered service providers identified by audit

In order to identify unregistered service providers, the income tax records and other connected secondary records, wherever possible, were cross verified. Audit was able to verify income tax records and other related records (such as annual financial statements, departmental/public sector undertaking contracts records, etc.) of 1,040 service providers out of 8,394 such identified unregistered services providers. The service tax evaded by them was to the extent of Rs. 34.04 crore. Additionally, penalty of Rs. 34.04 crore was also payable under section 76 of the Finance Act, 1994, with a further interest liability of rupees ten crore upto 2005-06. The details are mentioned in the following table:-

Table no. 8

(Amounts in crore of rupees)

Name of the service	No. of commissionerates	No. of service providers	Amount of service tax leviable but not levied	Interest payable	Penalty
CAB	26	831	7.65	2.94	7.65
PGH	12	182	20.67	5.66	20.67
HFC	26	27	5.72	1.40	5.72
Grand Total		1040	34.04	10.00	34.04

It is interesting to note that:-

- The evasion of service tax under PGH identified by audit was more than half of the total revenue collections from this service (70 commissionerates) during the year 2005-06.
- The amount of service tax evaded by the unregistered service providers in HFC was almost one fifth of the total revenue from the service during the year 2005-06 (70 commissionerates).

Some illustrative cases are mentioned in the succeeding paragraphs:-

(i) Scrutiny of income tax returns of M/s Trans Specific Travels Pvt. Ltd., in Bangalore (ST) commissionerate, revealed that it had realised Rs. 5.46 crore for rendering 'rent-a-cab scheme operator services' during the period April 2002 to March 2003. The assessee, however, did not register itself with the department, thereby, evading service tax to the extent of Rs. 27.30 lakh. The agency was also liable to pay interest of Rs. 14.97 lakh besides a penalty of Rs. 27.30 lakh.

(ii) From the records of 17 institutions and public sector undertakings, in Bangalore commissionerate, it was observed that these institutions had made a payment of Rs. 4.62 crore to 53 rent-a-cab service providers for services rendered during the period from 2001-02 to 2005-06. It was, however, found on verification that these service providers were not registered with the service tax department. The evasion of service tax by these unregistered service providers for providing rent-a-cab service to these 17 institutions was to the extent of Rs. 39.10 lakh, though the actual evasion by these service providers after taking into consideration possible services to other clients may be higher than the amount worked out by audit.

There is a need for the department to do a detailed scrutiny of the service tax evaded by these service providers and take appropriate action, accordingly.

(iii) Scrutiny of income tax returns of M/s Trends Add Film Makers Pvt. Ltd., in Bangalore (ST) commissionerate, revealed that the assessee had realised Rs. 10.76 crore during the period from April 2003 to March 2005 on account of photography services. But it did not register itself for service tax nor did it pay service tax of Rs. 92.67 lakh. The assessee was also liable to pay interest of Rs. 29.32 lakh besides penalty of Rs. 92.67 lakh.

(iv) The chief electoral officers of the states/union territories engaged various agencies for preparation and issue of electoral photo identity cards (EPICs) to the voters. The EPICs were prepared using digital photography by close circuit devices (CCD) or digital cameras alongwith data management, printing and lamination at developing and processing laboratory (DPL). All these services were in the nature of 'photography services'. The records of only 16 out of 35 chief electoral officers of the states/union territories indicated that an amount of Rs. 79.03 crore was paid to 101 such agencies for preparation of EPICs. These agencies, however, had not registered themselves with the department and had not paid estimated service tax of Rs. 6.36 crore. Penalty of Rs. 6.36 crore and interest of Rs. 2.13 crore was also leviable. The actual evasion of service tax on this account would be much higher, if the payment made by the remaining chief electoral officers to the service providers is taken into account.

(v) In the context of health club and fitness centre services, the CBEC in their circular dated 1 August 2002 clarified that ‘therapeutic massage’ would mean a massage performed by qualified professionals under medical supervision for curing diseases such as arthritis, chronic low back pain and sciatica, etc. Ayurvedic massage, acupressure therapy, etc. given by qualified professionals under medical supervision for curing diseases/disorders would come under the category of therapeutic massages. It was also clarified that if a massage is without any medical supervision or advice but for the general wellbeing of a person, it would not come under the purview of ‘therapeutic massage’ and would be liable to service tax. In Kerala, many hotels and resorts have opened ayurvedic centres offering packages for rejuvenation of body (body massage, steam bath, dhara, etc.). From the literature of eight such ayurvedic health resorts/centres, in Calicut, Trivandrum and Cochin commissionerates, it was observed that these resorts were offering packages at pre-determined rates, which include programmes for “relaxation, refreshing massage, rejuvenation, life style, de-toxification, anti-obesity etc.” and not for any specific illness/disorder. These services were, therefore, in the nature of health club and fitness centre services. These service providers, however, did not register themselves with the department. Nor did these assesseees pay any service tax. From the information collected from the Tourism department of Kerala and Registrar of Companies, it was observed that these eight service providers had realised Rs. 54.89 crore during the period from 2003 to 2005 on these services, on which an estimated service tax of Rs. 4.88 crore was payable. Besides, interest of Rs. 1.08 crore and penalty of Rs. 4.88 crore was also payable.

The above indicates that conditional exemption granted to therapeutic massage from service tax is prone to misuse leading to avoidance of service tax. There are 48 ayurvedic centres certified (upto March, 2005) by the Tourism department of Kerala, itself.

Recommendations

- *The department should verify the nature of the services being rendered by the service providers of HFC including therapeutic massage on an all India basis and recover the applicable service tax.*
- *The department should also review the exemption granted to therapeutic massage in view of the widespread misuse pointed out by audit.*

Agreeing to the first recommendation, the Ministry informed (December 2007) that the nature of services is verified through (i) surveys, (ii) audit and (iii) enforcement measures, deploying available resources in an optimal manner.

The Ministry noted (December 2007) the second recommendation above for further necessary action.

(vi) Scrutiny of income tax returns of M/s India Realistic Health Centre, Bangalore commissionerate revealed that the service provider had realised Rs. 4.84 crore from their customers on account of health and fitness centre services during the period 2002-03 to 2004-05. The service provider, however, did not register itself with the department thereby evading service

tax to the extent of Rs. 38.11 lakh. The service provider also liable to pay interest of Rs. 13.16 lakh and penalty of Rs. 38.11 lakh.

3.6.2.3 *Estimated loss of service tax in respect of other unregistered service providers identified by audit*

In the absence of related records, audit attempted to estimate the quantum of evasion of service tax in respect of 7,354 out of 8,394 number of identified unregistered service providers by applying the parameter of average revenue yield from registered assesseees from same services. This indicated evasion of an estimated service tax of Rs. 27.91 crore by these unregistered service providers during the year 2005-06 alone. Penalty of Rs. 27.91 crore is also leviable. The details are mentioned in the following table:-

Table no. 9

(Amounts in crore of rupees)

Name of service	No. of commissionerates	No. of other unregistered service providers identified by audit	No. of registered service providers	Total revenue	Revenue yield per service provider	Estimate of revenue loss	Penalty
CAB	25	5235	11622	48.72	0.0042	21.99	21.99
PGH		1591	33786	40.98	0.0012	1.91	1.91
HFC		528	3900	29.66	0.0076	4.01	4.01
Total		7354				27.91	27.91

The projections have been made on the basis of the details of registered service providers furnished by 70 commissionerates.

Recommendations

- *The procedure for conducting surveys needs to be streamlined and strengthened in the commissionerates to collect information about potential assesseees from various sources including from income tax department. The surveys should be conducted in a professional manner after collection, collation and analysis of information.*
- *In all cases of service providers identified by audit, who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by not only these service providers but also by service providers in these categories not covered by audit and take appropriate action to recover the tax due together with interest and penalty.*
- *Inter-governmental and inter-departmental coordination and control mechanism needs to be strengthened to ensure that only registered assesseees provide services and pay applicable tax. This would mitigate the risk of evasion of tax by service providers to the Government sector, who may have the penchant of not registering voluntarily.*

Accepting the recommendations above, the Ministry stated (December 2007) that it is continuously striving to make the surveys more scientific and professional including collection of information from third party sources.

3.6.3 Ineffective monitoring of service tax returns

Section 70 of the Finance Act, 1994, read with rules 7(1) and (2) of Service Tax Rules, 1994, provides that every person liable to pay service tax should itself assess the tax, furnish half yearly return in form ST-3 or ST-3A by the 25th of the month following the half year. Under the amended section 77 of the said Finance Act, a person failing to furnish the returns in due time was liable to a penalty subject to a maximum of one thousand rupees.

This return is one of the critical tools with the department for effective administration of service tax and to combat evasion of service tax by registered service providers. It is, therefore, important for the department to watch and ensure that the returns are regularly submitted by all active registered service providers.

The position of submission of returns by registered service providers, during the period from 2000-01 to 2005-06 has been mentioned in the following table:-

Table no. 10

(Amount in lakh of rupees)

Name of the service	No. of commissionerates	No. of returns due	No. of returns received	Returns received by due date	Returns received late	No. of returns not received	Penalty levied	Penalty not levied
CAB	44	29484	19038	17498	1540	10446	2.27	106.28
PGH		69926	38026	33795	4231	31900	3.34	348.51
HFC		9102	6623	6021	602	2479	0.38	28.21
Total		108512	63687	57314	6373	44825	5.99	483.00

Figures furnished by commissionerates.

Audit observed that:-

- Action for levy of penalty of Rs. 4.83 crore on defaulting assesseees was not taken.
- Forty one per cent of the returns due were not received in respect of these three services.
- Ten per cent of the returns received, were late.
- All the photography and health club and fitness centre service providers, in Dera Bassi division of Chandigarh commissionerate, stopped filing returns after introduction of threshold exemption limit of rupees four lakh. The department did not take any action to ascertain/verify whether these service providers were eligible for exemption.

3.6.3.1 No mechanism to detect and take proactive action for 'stop filers', leading to evasion

Audit assessed the number of service providers not filing returns as significantly high for want of proper watch by department over the submission

of returns and inaction by department by way of imposition of penalty in cases of default. Audit, therefore, attempted to ascertain whether these registered service providers were actually rendering services and thereby evading tax during the period when they had not furnished the returns. An independent verification of income tax returns and other connected records of a few of such defaulters, on a very limited scale, indicated that 414 assessees (226 of CAB, 168 of PGH and 20 of HFC) in 20 commissionerates had continued providing services, on which no service tax was paid during the period when they had not filed the returns. The department did not take any action for non-submission of returns by these defaulters. Nor did it verify whether the defaulters were actively engaged in providing services during the period of default. This resulted in evasion of service tax to the extent of Rs. 14.36 crore. Interest of Rs. 2.55 crore and penalty of Rs. 14.36 crore was also leviable, as shown in the following table:-

Table no. 11

(Amounts in crore of rupees)

Name of the service	No. of commissionerates	No. of service providers	Service tax payable	Interest payable	Penalty payable
CAB	9	226	6.10	1.96	6.10
PGH	20	168	1.83	0.51	1.83
HFC	8	20	6.43	0.08	6.43
Total		414	14.36	2.55	14.36

Some illustrative cases are mentioned in the succeeding paragraphs:-

(i) M/s S.V. Large Format Digital Imaging Pvt. Ltd., in Hyderabad II commissionerate, engaged in providing photography service had not filed any ST-3 returns during the period from 2002-03 to 2004-05. Verification of its income tax returns, however, revealed that it continued to render photography services during the above period with gross value of service being Rs. 3.28 crore. This resulted in evasion of service tax to the extent of Rs. 27.24 lakh. Interest of Rs. 9.46 lakh and penalty of Rs. 27.24 lakh were also leviable.

(ii) Verification of income tax returns of M/s Mahalakshmi Travel, in Visakhapatnam I commissionerate, revealed that the assessee had realised Rs. 2.20 crore for rendering rent-a-cab service during the period 2004-05 and 2005-06. However, no returns were filed by the assessee during this period. Applicable service tax was neither paid nor was it demanded by the department. This resulted in non-payment of service tax to the extent of Rs. 21.90 lakh. Interest of Rs. 5.69 lakh and penalty of Rs. 21.90 lakh was leviable, additionally.

(iii) M/s Kumarakom Lakes Resorts Kottayam, in Cochin commissionerate, engaged in health club and fitness centre services had not furnished returns during the period 2003-04 and 2004-05. But from the records of the Tourism department of the Government of Kerala, it was observed that the assessee had rendered service during the above period for a value of Rs. 1.22 crore. This resulted in evasion of service tax of Rs. 10.45 lakh, in addition to interest liability of Rs. 3.25 lakh and penalty of Rs. 10.45 lakh.

Recommendation

- *The department needs to devise an appropriate and effective mechanism to detect in time 'stop-filers' of returns and collect the Government revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.*

The Ministry agreed with the recommendation and stated (December 2007) that an appropriate and effective mechanism to identify the 'stop filers' in an automated environment will be implemented through the ACES (automation of Central Excise and Service Tax) project.

3.6.4 Taxable value suppressed

The power vested in superintendent of central excise to call for any records from the assessee for verification was withdrawn, when section 71 of the Finance Act, 1994 was omitted with effect from 10 September 2004. This power was, however, seldom exercised by the department for verification purpose even prior to 10 September 2004, as had been pointed out in the reviews on various services contained in the Audit Reports of earlier years. Since no mechanism to check the correctness of the assessment made by the service providers as a deterrent has been put in place, the risk of suppression of assessable value in ST-3 returns to evade payment of service tax, remains un-mitigated. Attempt was, therefore, made by audit to ascertain the extent of correctness of tax paid by assessees by cross verification of ST-3 returns with income tax returns and other related records of a few assessees. Audit noticed deliberate attempts by assessees to suppress the value of services and consequently evade service tax, in a few cases.

The service tax evaded by 398 assessees by suppression of their assessable value was Rs. 15.26 crore during the period from 2000-01 to 2004-05. Additionally, interest of Rs. 5.45 crore and penalty of Rs. 15.26 crore was also leviable in these cases, as has been mentioned in the following table:-

Table no. 12

(Amounts in crore of rupees)

Name of the service	No. of commissionerates	No. of assessees	Service tax payable	Interest	Penalty
CAB	28	181	8.25	3.16	8.25
PGH	30	173	6.64	2.17	6.64
HFC	20	44	0.37	0.12	0.37
Total		398	15.26	5.45	15.26

Figures furnished by commissionerates.

Further, the suppression of value with consequent short payment of service tax noticed by audit by cross verification of income tax returns of 181 and 173 assessees in rent-a-cab scheme operator and photography services, respectively was more than one sixth of the total revenue generated from these services (from 70 commissionerates) during the year 2005-06.

Some illustrative cases are mentioned in the succeeding paragraphs:-

- (i) Cross verification of the income tax returns of M/s Cosy Cab's, in Hyderabad II commissionerate, providing rent-a-cab scheme operator service revealed that the assessee had undervalued services to the extent of

Rs. 6.51 crore in ST-3 returns during the period from 1 April 1997 to 31 March 1999 and from 1 April 2000 to 31 March 2005. This resulted in short payment of service tax to the extent Rs. 38.52 lakh besides applicable interest of Rs. 26.95 lakh and penalty of Rs. 38.52 lakh.

(ii) Cross verification of ST-3 returns with the records of M/s Oil and Natural Gas Corporation revealed that 15 rent-a-cab service providers, in Visakhapatnam I and Visakhapatnam II commissionerates, had realised Rs. 5.56 crore during the period from 2002-03 to 2004-05 on which service tax to the extent of Rs. 43.39 lakh was not paid. Interest of Rs. 15.59 lakh was also liable to be paid besides the penalty of Rs. 43.39 lakh.

On the mistake being pointed out (September 2006) in audit, the department in the case of M/s Raja Taxi Service, in Visakhapatnam I commissionerate, issued (December 2006) a show cause notice for Rs. 19.42 lakh.

(iii) Cross verification of returns filed by M/s R.K. Foto Plaza and Studio, in Tirupathi commissionerate, with commercial tax department revealed undervaluation of photography services by the assessee in its ST-3 return to the extent of Rs. 3.03 crore during the period 1 April 2003 to 23 September 2006. This resulted in short payment of service tax to the extent of Rs. 38.74 lakh. Additionally, interest of Rs. 8.62 lakh and penalty of Rs. 38.74 lakh were also leviable.

(iv) Cross verification of income tax returns of M/s Goyal Colour Lab, in Jaipur I commissionerate, providing service under photography services revealed that the assessee had undervalued services to the extent of Rs. 20.65 crore during the period 2003-04 and 2005-06 in ST-3 returns. During the year 2003-04, the assessee did not pay any service tax, although the gross receipt as per his income tax return during that period was Rs. 6.72 crore. This resulted in short payment of service tax amounting to Rs. 1.96 crore. Additionally, interest of Rs. 51.10 lakh and penalty of Rs. 1.96 crore were also leviable.

(v) Scrutiny of IT records of M/s Ovira Logistics Pvt. Ltd., in Mumbai II commissionerate, revealed that the assessee had shown receipt of Rs. 16.44 crore on account of rent-a-cab scheme operators' services during the period 2000-01. But in ST-3 returns, gross receipt was shown only as Rs. 5.58 crore. This resulted in undervaluation of the taxable amount and short payment of service tax of Rs. 54.31 lakh during the year 2000-01. Additionally, interest of Rs. 31.77 lakh and penalty of Rs. 54.31 lakh were also leviable.

Recommendations

➤ *To address the root cause of the irregularities pointed out through paragraph 3.6.4 of this report, the Board may consider putting in place a mechanism for checking/verification of returns on regular basis. This checking may be reinforced by detailed scrutiny. The selection of cases for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records etc.*

- *The department should investigate all cases identified by audit where suppression of taxable value was done wilfully and take appropriate action.*

The Ministry while agreeing to the above recommendations informed (December 2007) that the RMS (risk management system) under preparation in their department would enable selection of returns on a scientific basis for detailed scrutiny.

3.7 Compliance issues:

3.7.1 Ineffective verification and scrutiny of returns

The scrutiny of returns filed by the service providers is the most important element of the enforcement strategy of tax administration. The overriding aim of such verification/scrutiny is to provide a credible deterrence to wilful suppression of assessable value as well as to realise appropriate Government revenues. The verification/scrutiny broadly would consist of checking on the basis of: (i) the information contained in the ST-3 returns; and (ii) scrutiny of other supporting records such as commercial records, income tax returns, etc. of the assessee for ascertaining the correctness of the tax paid.

Prior to 10 September 2004, section 71 of the Finance Act, 1994, provided for the verification of the correctness of the tax assessed by the assessee, on the basis of information contained in the returns filed by the assessee. This section also empowered the superintendent of central excise to call for any accounts, documents or other evidence in connection with such verification, though this power was sparingly exercised by range offices. After withdrawal of section 71 above (with effect from 10 September 2004), no departmental instructions were issued for verification/scrutiny of returns till 8 February 2007. The Board issued instructions on 8 February 2007 for scrutiny of ST-3 returns filed by large service tax payers on a selective basis.

The verification with reference to the information available in ST-3 returns has assumed greater significance because of the following factors: (i) grant of value based threshold exemption with effect from 1 April 2005; (ii) grant of specific and conditional exemption (service tax on specified percentage of gross value) to certain services; (iii) the introduction of Cenvat Credit Rules, 2004 with effect from 10 September 2004, allowing cenvat credit of excise duty paid on inputs or capital goods or cenvat credit on input service (an overall cenvat credit of Rs. 3,502.64 crore was utilised during the year 2005-06 while paying service tax) and (iv) grant of exemption of service tax on export of service.

The succeeding paragraphs of this audit review report on the three selected services bring out that scrutiny of the returns has not been effective. The status of verification/checking of ST-3 returns furnished by 21 such commissionerates for the period for 2005-06 is given in the following table:-

Table no. 13

Name of the service	No. of commissionerate	No. of returns received	No. of returns verified	Pending verification
CAB	21	4189	3540	649
PGH		6521	6214	307
HFC		1743	1520	223
Total		12453	11274	1179

Figures furnished by commissionerates.

Audit attempted to check some of the ST-3 returns including those verified/checked by department on the basis of the information furnished by the assesseees. Records of ST-3 returns were not maintained properly and service-wise in the department, making it difficult for audit to obtain ST-3 returns of these three services selected in audit. On scrutiny of some of the ST-3 returns with reference to information contained in those which audit could obtain, it was noticed that service tax of Rs. 7.16 crore had been short paid. This indicated that basic checks with reference to the available information in ST-3 return were not exercised. This resulted in even mistakes apparent from records going undetected by the department.

These cases are mentioned in the succeeding paragraphs:-

3.7.1.1 Incorrect availing of exemption on goods and material consumed by assessee

Notification dated 20 June 2003 allows exemption from service tax on the value of goods and material sold by the photography service provider to the recipient of the service on the condition that there is documentary proof in support of the value of goods and material sold.

Scrutiny of ST-3 returns in audit revealed that 28 assesseees, in Bangalore, Hyderabad, Chandigarh, Ludhiana and Meerut I commissionerate, engaged in photography service had claimed exemption on value of goods and material which was actually consumed by them and not sold to the recipient of the service. This resulted in incorrect availing of exemption from payment of service tax to the extent of Rs. 1.11 crore. Interest of Rs. 7.58 lakh and penalty of Rs. 1.11 crore was also leviable.

3.7.1.2 Incorrect availing of exemption by rent-a-cab scheme operators

Notification dated 1 March 2006 allows exemption on taxable service provided by a rent-a-cab scheme operator from so much of the service tax leviable, as is in excess of the service tax calculated on a value which is equivalent to 40 per cent of the gross amount, provided that no cenvat credit of duty on inputs or capital goods or the cenvat credit of service tax on input services was taken.

Scrutiny of ST-3 returns in audit indicated that 49 assesseees, in eight commissionerates, had availed the benefit of this abatement as well as cenvat credit on inputs/capital goods/input services. This resulted in short payment of service tax to the extent of Rs. 3.61 crore. Interest of Rs. 46.89 lakh was also leviable in these cases besides penalty of Rs. 3.61 crore.

A case is illustrated in the following paragraph:-

M/s Ovira logistic India Pvt. Ltd., in Mumbai III commissionerate, engaged in photography service simultaneously availed of cenvat credit and exemption upto 60 per cent on the value of services, while discharging service tax liability for the month of March 2006. This resulted in short payment of service tax to the extent of Rs. 17.24 lakh besides short levy of interest and penalty.

On the mistake being pointed out in audit (March 2007), the department issued (April 2007) a show cause notice to the assessee.

3.7.1.3 Irregular benefit under Export of Service Rules, 2005

Under rule 3(2) of the Export of Service Rules, 2005, any taxable service shall be treated as export of service, which is exempt from the levy of service tax, when the following conditions are satisfied, namely:-

- (i) such service is delivered outside India and used outside India; and
- (ii) payment for such service provided is received by the service provider in convertible foreign exchange.

M/s Super Shuttle, M/s Orix Auto and Business Solutions and M/s Ovira Logistics engaged in rent-a-cab scheme operators service, in Mumbai (ST) commissionerate, did not pay service tax of Rs. 54.03 lakh by declaring their services as 'export of service' during the period from October 2005 to March 2006. Since one of the above two conditions viz. such service was delivered outside India and used outside India was not met by these service providers, their services could not be treated as 'export of service'. Exemption from payment of service tax of Rs. 54.03 lakh was, therefore, inadmissible.

On this being pointed out in audit (March 2007), the department replied (May 2007) that show cause notices have been issued to all the three assessees.

3.7.1.4 Excess utilisation of cenvat credit

Rule 6(3)(c) of the Cenvat Credit Rules, 2004 stipulates that the provider of output service, opting not to maintain separate account for input service intended to be used for taxable services as well as exempted services, shall utilise credit only to the extent of an amount not exceeding 20 per cent of the amount of service tax payable on taxable output service.

Test check of the service tax records of four assessees engaged in rent-a-cab scheme operator services and 24 assessees engaged in photography services, in Mumbai, Allahabad and Trivandrum commissionerates, revealed that though the assessees were utilising cenvat credit on inputs/input services for providing taxable as well as non-taxable services, they had not maintained separate accounts of inputs. The assessees, however, utilised cenvat credit exceeding 20 per cent of their tax liability towards taxable output service.

This resulted in short payment of service tax to the extent of Rs. 1.76 crore (Rs. 98.18 lakh in respect of rent-a-cab scheme operator service and Rs. 77.62 lakh in respect of photography service), which is required to be paid in cash. The assessees were also liable to pay interest of Rs. 9.33 lakh.

3.7.1.5 Irregular availing of cenvat credit on basic customs duty

Rule 3 of the Cenvat Credit Rules, 2004, provides that any output service provider shall be allowed to take credit of excise duty/service tax paid on any inputs, capital goods or any input service received in his premises. The basic customs duty paid on inputs is, however, not eligible for credit under the above rules.

A scrutiny of ST-3 returns of M/s Fitness One India Ltd. (health club and fitness centre services) and M/s One Touch Micro Computerised Colour Lab (photography service), in Bangalore and Patna commissionerates, revealed that these service providers had availed of credit on basic customs duty to the extent of Rs. 8.09 lakh and Rs. 3.21 lakh respectively. This was incorrect.

On this being pointed out in audit (April 2007), the department intimated the reversal of credit of Rs. 3.21 lakh in the case of M/s One Touch Micro Computerised Colour Lab.

3.7.1.6 Non-levy of interest and penalty

Section 75 of the Finance Act, 1994, stipulates that if a person fails to credit the tax due or any part thereof within prescribed period, it shall have to pay simple interest at prevalent rate. Section 76 of the Finance Act, provides for levy of penalty due for failure to pay service tax.

Scrutiny of ST-3 returns of 312 assesseees (CAB-155, PGH-127 and HFC-30), in Mumbai and Meerut commissionerates, revealed that these assesseees did not pay the applicable interest and penalty due to delayed payment of tax to the extent of Rs. 16.19 lakh.

3.7.1.7 Other cases

Short levy of service tax of Rs. 3.08 lakh in seven other cases was noticed in audit.

3.7.2 Service tax collected but not remitted to the Government

Section 73 A of the Finance Act, 1994 (as amended with effect from 18 April 2006), provides that any person who is liable to pay service tax and has collected any amount in excess of the service tax assessed shall forthwith pay the amount so collected to the credit of the Central Government.

Twenty assesseees providing rent-a-cab scheme operator service and 13 assesseees providing photography services, in nine commissionerates, did not remit to the Government account Rs. 33.73 lakh and Rs. 8.87 lakh respectively service tax collected by them from the customers in excess of what was paid by them to the Government.

3.7.3 Cenvat credit

In terms of rule 4 of the Cenvat Credit Rules, 2004, credit is allowed to a provider of taxable service of excise duty or service tax paid on any input or capital goods or any input service. Credit can be utilised towards payment of

service tax subject to the fulfilment of certain conditions. A few cases of incorrect availing of cenvat credit noticed in audit have been mentioned in the following paragraphs:-

3.7.3.1 Irregular availing of cenvat credit on capital goods

(i) Rule 4 (2) (a) of the Cenvat Credit Rules, 2004, stipulates that 50 per cent of the cenvat credit can be taken in respect of capital goods received in the premises of the provider of output service at any point of time in a given financial year and the balance 50 per cent in the subsequent financial year. Eight assessees providing photography service in Chennai, Trivandrum, Jalandhar, Calicut and Bhubaneswar commissionerates, availed of, in the same year, cenvat credit of Rs. 44.24 lakh during the period 2004-05 on capital goods. The credit so availed of was 100 per cent of the duty paid on those capital goods as against the permissible 50 per cent. This resulted in excess use of cenvat credit of Rs. 22.12 lakh, which needs to be recovered.

(ii) Rule 3 (1) of the Cenvat Credit Rules, 2004 provides that a provider of taxable service shall be allowed to take cenvat credit on the duty of excise paid on any input received in the premises of provider of output service on or after 10th day of September 2004. Further, rule 9(1) of the Cenvat Credit Rules, 2004 provides that cenvat credit can be taken by the provider of output service on the basis of an invoice issued by first stage dealer or second stage dealer.

M/s PR Combines, in Calicut commissionerate, is a registered dealer dealing with the inputs which are used for photography services. A scrutiny of the return filed by the dealer in the Calicut commissionerate revealed that it had a cenvat credit of Rs. 10.35 lakh in its account as on 30 September 2006 for distribution by sale of inputs relating to photography service providers. A cross reference with the returns filed by the seven photography service providers in the same commissionerate who had purchased inputs from this dealer revealed that the dealer had distributed Rs. 21.68 lakh to these service providers as against Rs. 10.35 lakh available in its account for distribution. This resulted in excess utilisation of cenvat credit by seven output service providers to the extent of Rs. 11.33 lakh and consequential loss of service tax to the Government.

(iii) Twenty six other cases involving irregular availing of cenvat credit on inputs/capital goods in these services to the extent of Rs. 17.39 lakh were also noticed in audit.

3.7.4 Service tax code (STC) number based on permanent account number (PAN) not allotted

The Board in their letter dated 27 August 2001 issued instructions for allotment of service tax code numbers based on PAN allotted by income tax department to all service providers. The work was to be completed latest by 15 November 2001. The progress was to be monitored by the DGST on a weekly basis. The Board, vide circular dated 21 February 2002, had issued further instructions for allotment of PAN based service tax code numbers. As a part of electronic tax administration programme, the department has also

developed allotment of service tax payer code number programme. Audit, however, found that the progress made in this regard was not encouraging and was indicative of lack of monitoring and appropriate corrective action by the department.

Position of allotment of PAN based service tax code number as on 31 March 2006 in 46 commissionerates is given in the following table:-

Table no. 14

Name of service	No. of commissionerates	No. of service providers	No. of service tax providers not allotted STCNs	Percentage
CAB	46	8628	3290	38.13
PGH		19297	11221	58.15
HFC		2139	930	43.48
Total		30064	15441	

Audit observed that:-

- The work of allotment of service tax code numbers, which is crucial from the point of view of cross verification of value of services, was yet to be completed even after a lapse of more than five years.
- In Tirupathi commissionerate, 98 per cent of assessees in respect of photography services were not allotted service tax code numbers.
- Information furnished by Nagpur commissionerate revealed that no service provider in these services was allotted service tax code number.
- In Hyderabad I and Patna commissionerates, no service provider was allotted service tax code number in HFC service.
- In Panchkula commissionerate, no service provider was allotted service tax code number in CAB service.

Recommendation

- *Correlation of income tax data and service tax data is a key factor for correct evaluation of service tax liability. Allotment of PAN based STC numbers is a step in right direction. However, this aspect of implementation of this scheme has been slow and non-exhaustive, which needs to be corrected.*

The Ministry noted (December 2007) the above recommendation for further necessary action.

3.8 Conclusions

Audit review has revealed certain risk areas owing to weaknesses in the systems as well as other compliance issues. The irregularities discussed in the report can easily go undetected due to ineffective internal control mechanism relating to (i) correspondence functionality (relationship) between the assessee base and revenue, (ii) surveys and registration, (iii) scrutiny of returns,

(iv) detection of non-filers and stop-filers, (v) detection of evasion/suppression of taxable value, (vi) certain other compliance issues like cenvat and ineffective internal audit (as none of these irregularities pointed out by the external audit were detected by internal audit).

The Government, therefore, needs to take appropriate steps in respect of the existing internal control mechanism in order to ensure that the Government dues are realised efficiently and revenue evasion are dealt with effectively.

3.9 Summary of recommendations

- *The Government needs to continually monitor the data on assessee base and revenues collected and investigate the reasons for decline in revenue from a particular service despite increase in the registered tax base, to ensure that the decline is not due to evasion.*
- *The Board should establish 'Key Performance Indicators (KPIs)' for a commissionerate which should include minimum number of surveys to be conducted to identify/register assessees and garner additional revenue.*
- *The department should verify the nature of the services being rendered by the service providers of HFC including therapeutic massage on an all India basis and recover the applicable service tax.*
- *The department should also review the exemption granted to therapeutic massage in view of the widespread misuse pointed out by audit.*
- *The procedure for conducting surveys needs to be streamlined and strengthened in the commissionerates to collect information about potential assessees from various sources including from income tax department. The surveys should be conducted in a professional manner after collection, collation and analysis of information.*
- *In all cases of service providers identified by audit, who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by not only these service providers but also by service providers in these categories not covered by audit and take appropriate action to recover the tax due together with interest and penalty.*
- *Inter-governmental and inter-departmental coordination and control mechanism needs to be strengthened to ensure that only registered assessees provide services and pay applicable tax. This would mitigate the risk of evasion of tax by service providers to the Government sector, who may have the penchant of not registering voluntarily.*
- *The department needs to devise an appropriate and effective mechanism to detect in time 'stop-filers' of returns and collect the Government revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.*
- *To address the root cause of the irregularities pointed out through paragraph 3.6.4 of this report, the Board may consider putting in place a mechanism for checking/verification of returns on regular basis. This checking may be reinforced by detailed scrutiny. The selection of cases*

for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records etc.

- *The department should investigate all cases identified by audit where suppression of taxable value was done wilfully and take appropriate action.*
- *Correlation of income tax data and service tax data is a key factor for correct evaluation of service tax liability. Allotment of PAN based STC numbers is a step in right direction. However, this aspect of implementation of this scheme has been slow and non-exhaustive, which needs to be corrected.*

All of the above eleven recommendations were agreed (December 2007) to by the Ministry.