

Chapter II

Service Tax liability in Insurance sector

2.1 Introduction

General Insurance Service was one of the three services first covered under the Service Tax net in 1994. Life Insurance Services and Insurance Auxiliary Services were also included in the list of taxable services subsequently. Along with other services such as Banking and other Financial Services, Telecom Services and Business Auxiliary Services, Insurance Services have been a major revenue contributing sector during the past two decades. Service Tax revenues from Insurance sector related services such as General Insurance service, Life Insurance Service, Insurance Auxiliary Services and Management of Investment under Unit Linked Insurance Plan was ₹ 11,034 crore (8.32 per cent of total Service Tax revenue) as per Finance Accounts of 2012-13.

2.2 Audit objectives

We examined the adequacy of the mechanisms in place to ensure that Service Tax due to the Government of India from insurance sector was in fact reaching the Government. Audit was conducted to assess:

- i. the adequacy of rules, regulations, notifications, circulars/instructions/trade notices etc. issued from time to time in relation to levy, assessment and collection of Service Tax relating to services in insurance sector;
- ii. whether the extant provisions of law are being complied with adequately;
- iii. whether there was an adequate mechanism to identify and bring in potential service providers into tax net for levy of Service Tax; and
- iv. whether there was an effective monitoring and internal control mechanism.

2.3 Audit coverage

While coverage of audit examination was generally limited to the period 2010-11 to 2012-13, we have also gone beyond this period in a few specific instances depending on the issues involved. We examined records pertaining to 39 registered insurers in Mumbai, Delhi and Chennai besides relevant records of 31 Insurance Intermediaries including Insurance Brokers, Consultants, Surveyors, Corporate Agents, Individual Agents, etc. Selected

records/returns were also examined in departmental units in the respective selected Commissionerates.

2.4 Audit findings

Scrutiny of assessee records in seven Commissionerates¹³ revealed certain compliance-related as well other issues having financial implication of ₹ 352.55 crore. The Ministry/ department accepted (November 2014) the audit observations having financial implication of ₹ 80.87 crore and recovered ₹ 12.71 crore. The major findings are discussed below:

2.5 System issues

2.5.1 Registration

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 within a period of 30 days from the date on which Service Tax under section 66 of the Act above is levied or from the date of commencement of business of providing taxable service if such business is commenced after introduction of the levy under the Finance Act. Under the system of Automation of Central Excise and Service Tax (ACES), applications for registration or amendments to registrations are to be made online and registration number is also granted online. As per Board's Circular dated 17 September 2002, all temporary registration numbers allotted to the assessee would be converted to PAN based registration number.

We observed the following irregularities in this regard:

i) **Non-conversion of temporary registration into PAN based permanent registration**

Temporary registration numbers are allotted to those registrants who do not possess PAN number issued by the Income Tax department. Once the PAN is obtained, the Service Tax assessee should obtain the 15 digit PAN based Service Tax Registration number. Audit noticed that no time limit for conversion of temporary registration into PAN based permanent registration exist.

Test check through ACES in three Ranges of Service Tax Commissionerate, Delhi, revealed that in the case of following assesseees, temporary registration numbers issued to the assesseees had not been converted into PAN based permanent registration number (as on the date of audit). However, in the

¹³ Delhi Service Tax Commissionerate, LTU Commissionerate at Delhi, Mumbai and Chennai, Service Tax I and II Mumbai Commissionerates and Pune III Commissionerate

absence of date of issue of temporary registration, the actual duration of the continuance of status of temporary registration could not be identified.

Table 2.1 : Status of ST registrations

Sl. No.	Name of Assessee	Temporary ST Regn. No.
1.	Jain Insurance Intermediaries Pvt. Ltd.	TMPRL9067OST001
2.	Amsston Insurance Corp.	TMPRL8326DST001
3.	ASL Insurance Brokers Pvt. Ltd.	TMPAQ7573OST001
4.	G.I. Insurance Services Ltd.	TMPRL8431OST001
5.	Insurance Engineer Corp.	TMPRL8323RST001
6.	4S Insurance	TMPRM3528LST001
7.	Kumra Insurance & Financial Solution	TMPAM7155EST001

When we pointed this out (November 2013) the Ministry intimated (November 2014) that efforts were underway to convert all temporary registration numbers into PAN-based permanent registration.

The reply indicates absence of an effective mechanism to review the status of registrations. In the absence of PAN number in temporary registration number, the department would not be able to link with the Income Tax records of the assessee.

ii) Both temporary and permanent registration active in ACES

After conversion of temporary to permanent number, the temporary registration number should be automatically removed from ACES. Thus, no assessee can have both temporary registration and PAN based permanent registration number live at the same time.

Test check of insurance related service providers in three Ranges of Service Tax Commissionerate, Delhi, revealed that in at least 3 cases, the temporary registration was also shown active on ACES after issuance of permanent registration number to the assessees.

Table 2.2: Status of registration of assessees

Sl. No.	Name of assessee	Temporary ST Regn. No.	Permanent ST Regn. No.
1.	Agile Insurance Brokers Pvt. Ltd.	TMPAQ7265NST001	AAECA1449GST001
2.	Imperial Insurance Brokers (P) Ltd.	TMPRL9075JST001	AABCI0144FST001
3.	Kan Insurance Brokers Private Limited	TMPAH5028YST001	AABCV0952EST001

When we pointed this out (November 2013) the Ministry replied (November 2014) that there is no provision for automatic deletion of temporary registration in ACES. Instructions have been issued to field formations to stop issuing temporary registration and to convert existing temporary registration into PAN based permanent registration in three months.

Audit is of the view that earnest efforts should be made to allot PAN based Permanent registration number as soon as possible.

iii) More than one registration number issued to same assessee

During scrutiny of list of registered assessees obtained from the selected Ranges, we observed that M/s. RIA Insurance Brokers Pvt. Ltd., New Delhi, an Insurance Auxiliary Service provider in Service Tax Commissionerate, Delhi, having been issued PAN based registration number AAACP6072AST002 also had another registration number with a different PAN number i.e. AAACH2654JST001.

When we pointed this out (November 2013) the Ministry intimated (November 2014) that assessee was asked to clarify double registration, who informed that presently only one registration was active and second PAN belonged to some other person. Ministry also stated that double registration to single assessee was a system error and matter was being reviewed.

Audit observed that there is need for a mechanism, in ACES to ensure unique PAN based registration number for every assessee.

2.5.2 Non/delayed payment of Service Tax on reinsurance services

Point of taxation, as per Rule 2 of the Point of Taxation Rules 2011, means the point in time when a service shall be deemed to have been provided. Rule 3 of the Point of Taxation Rules, 2011, envisages, inter alia, that in a case, where the person providing the service, receives a payment before the issue of invoice/completion of service as the case may be, the time when he receives such payment, to the extent of such payment shall be the point of taxation. The explanation to the Rule also provides that wherever any advance by whatever name known, is received by the service provider towards the provision of taxable service, the point of taxation shall be the date of receipt of each such advance.

General Insurance Corporation of India (GIC Re) in Service Tax I Mumbai Commissionerate, being National Reinsurer providing general re-insurance services, was contractually bound with the domestic non-life insurers to accept by way of reinsurance an obligatory cession.¹⁴ As per the reinsurance agreement on obligatory cessions, the liability of the reinsurer (GIC Re) shall commence obligatorily and simultaneously with that of the insurer company which means the service is deemed to be provided as a continuous supply of service when the original policy is issued. For providing this reinsurance

¹⁴ Obligatory cession means every non-life insurer shall re-insure with Indian reinsurers such percentage of the sum assured on each policy (as may be specified by IRDA) issued by the non-life insurer to the original insured.

service, the insurer company pays premium as a consideration which is due to be advised to GIC Re in the form of Statement of Accounts (SOA) only within 45 days after the close of the quarter and paid to GIC only within 60 days after the close of the quarter. Hence, the books of accounts of GIC Re are kept open even 45 days after the end of each quarter and actual figures as advised by the insurer companies are booked thereafter. Thus, for the reinsurance risk assumed by GIC on policies issued earlier, being services provided, the receipt of reinsurance premium from the domestic insurers (date of payment for the services provided) and statement of accounts was only on periodical basis ranging from 45 to 60 days from the close of the quarter. Liability on accrual basis came into force from April 2011.

We observed from the ST-3 returns filed for the period April 2012 to March 2013 that GIC Re had depicted taxable services under re-insurance services valued at ₹ 221.11 crore. The amount related to premium amount on such policies issued by general insurance companies in the financial year 2011-12 and obligatorily ceded to GIC which was booked in the financial year 2012-13 for the reasons stated earlier. As the amount pertained to the year 2011-12 and tax was paid in 2012-13 resulting in delayed payment of Service Tax on which interest of ₹ 58.98 lakh was payable.

When we pointed this out (January 2014) the Ministry admitted the observation and intimated (November 2014) that GIC had paid ₹ 58.98 lakh as interest due on delayed payment.

2.5.3 Non-taxability of charges relating to services on account of ambiguity in the amendment to the provision

The service provided or to be provided to a policy holder, by an insurer carrying on life insurance business, in relation to the management of investment (commonly known as ULIP Scheme) defined under the erstwhile Section 65(105)(zzzzf) of the Finance Act, 1994, was made taxable with effect from 16 May 2008. The value of taxable service i.e. gross amount charged, was the difference between the total premium paid by the policy holder and the sum of the premium attributable to risk cover and the amount segregated for actual investment. Thus, the taxable value, inter alia, was also inclusive of charges levied on account of premium allocation, policy administration, switching, surrender charges etc. Assesseees were paying tax on these items also accordingly.

This method of valuation was modified by amendment to Section 65(105)(zzzzf) of the Act, *ibid*, with effect from 1 July 2010 to provide that the gross amount charged shall be the maximum amount fixed by the Insurance Regulatory and Development Authority (IRDA) as fund management charges or

the actual amount charged by the Insurer, whichever is higher. The effect of this was that insurance companies no longer included (from 1 July 2010) the other elements such as policy administration charges, switching, surrender charges, premium allocation charges etc. in the taxable value.

However, we observed that vide Para 3.4 of Annexure B to the DO letter No. 334/1/2010-TRU dated 26 February 2010 to the field formations of the Department, the Ministry of Finance, in the course of explaining the changes proposed in the Service Tax law in Budget 2010-11, had informed, inter alia, that policy administration charges were chargeable to tax under insurance service. However, while taking advantage of the new definition of 'gross amount charged' in the ULIP context, assesseees did not take cognizance of the fact that policy administration charges were chargeable to tax under insurance service; thus the same remained uncovered under both taxable services, viz. ULIP and Life insurance services notwithstanding the DO cited above. The stand taken by the assesseees was that the definition of taxable service under section 65(105)(zx) of the Act, *ibid*, relating to Life insurance business covered only services provided in relation to the risk cover in life insurance until the statutory provision itself was amended with effect from 1 May 2011. The scope of Life Insurance Service was expanded from 1 May 2011 to cover both risk and management of investment components. Thus, the mismatch between the provisions of sections 65(105)(zx), 65(105)(zzzzf) of the Act, *ibid*, and TRU's DO letter dated 26 February 2010 resulted in loss of revenue during the period 1 July 2010 to April 2011. As amendment to section 65(105)(zzzzf) with effect from July 2010 had not been synchronised with the scope of coverage in section 65(105)(zx), certain elements got excluded from levy under either head of service resulting in loss of revenue.

(i) Audit observed from the records of 5 Life Insurers of Delhi and Mumbai Commissionerates, as given in table below, that during the period 2010-11, the assesseees had excluded from the value of services under ULIP, the amount collected towards policy administration charges, allocation charges, front end load charges, miscellaneous charges, initial fees, policy fees and switch fees on account of the revised definition of taxable services of ULIP u/s 65(105)(zzzzf) of the Act. Service Tax liability on these charges remained uncovered during the period July 2010 to April 2011.

Table 2.3: Amounts excluded from value of taxable services

Sl. No.	Name of the Insurer Co.	Commissionerate	Amount of charges	(₹ in crore)
				Service Tax
1.	M/s. Max Life Insurance Co. Ltd., Delhi	LTU Commissionerate, Delhi	520.43	77.67
2.	M/s. Aviva Life Insurance Co. India Ltd.	ST Commissionerate, Delhi	210.21	31.69
3.	M/s. Canara HSBC Oriental Bank of Commerce Life Insurance Co. Ltd.	ST Commissionerate, Delhi	125.69	18.76
4.	M/s. DLF Pramerica Life Insurance Co. Pvt. Ltd.	ST Commissionerate, Delhi	18.08	2.70
5.	M/s. ICICI Prudential Life Insurance Co. Ltd.	ST-I Commissionerate, Mumbai	0.97	0.10
Total			875.38	130.92

When we pointed this out (January 2014) the Ministry while in case of M/s Max Life Insurance Co. Ltd. stated (November 2014) issue being a policy matter clarification was being sought from higher formation. In respect of M/s Aviva Life Insurance Co. Ltd., SCN was issued to the assessee which was pending adjudication. In respect of M/s. Canara HSBC Oriental Bank of Commerce Life Insurance Co. Ltd. and M/s. DLF Pramerica Life Insurance Co. Pvt. Ltd. matter was under examination by DG (Audit). While in case of M/s. ICICI Prudential Life Insurance Co. Ltd. Ministry did not admit the observation stating that as clarified by Board's letter F. No.334/1/2010-TRU dated 26 February 2010, only fund management charge was chargeable for Service Tax. Thus, Ministry took different views on similar issues.

Ministry's contention is not acceptable as prior to 1 July 2010, all type of administration charges were taxable and para 3.4 (b) of Board's circular in respect of ULIP also stated that policy administration charges were chargeable to Service Tax under Insurance Service. Audit is of the view that ambiguity in the circular resulted in loss of revenue of ₹ 130.92 crore in the reported cases.

(ii) Similarly, during the scrutiny of records of three assesses, as detailed below, audit observed that Service Tax was not paid on the surrender charges during the period 2010-11 to 2012-13, due to ambiguity in Board's circular dated 16 April 2010 which resulted in non-payment of Service Tax of ₹ 121.48 crore including interest.

Table 2.4 : Non-payment of Service Tax on surrender charges

(₹ In lakh)					
Commissionerate	Name of the Assessee	Amount of surrender charges	Service Tax	Interest*	Total amount
Delhi LTU	M/s. Max Life Insurance Co. Ltd., Delhi	26,205.57	2,728.28	1,082.92	3,811.20
Delhi ST	M/s. DLF Pramerica Life Insurance Co. Pvt. Ltd	127.44	12.40	2.76	15.16
Delhi ST	M/s. Aviva Life Insurance Co. India Ltd.	57,936.45	6,055.92	2,266.36	8,322.28
Total		84,269.46	8,796.60	3,352.04	12,148.64

*Interest is calculated at the rate of 18 per cent for delay of period ranging from 31 months to 6 months relating to 2010-11 to 2012-13 respectively upto the date of audit (September/October 2013).

When we pointed this out (October 2013) the Ministry intimated (November 2014) that the case of M/s. Max Life Insurance Co. Ltd. was already under investigation by DGCEI and SCN had been issued to the assessee for ₹ 62.82 crore. The reply of the Ministry is not acceptable as the SCN issued by the DGCEI did not cover the observation, pointed out by Audit. Case of M/s DLF Pramerica was under examination by DG (Audit) and SCN issued to M/s Aviva Life was pending adjudication.

2.5.4 Proportionate reversal of Cenvat credit on account of trading in securities

As per explanation to Rule 2(e) of Cenvat Credit Rules, 2004 (existed prior to 1 July 2012), exempted services includes “trading”. Further, as per amended rule 2 (e) (2) of Cenvat Credit Rules, 2004 (with effect from 1 July 2012), ‘exempted service’ means a service on which no Service Tax is leviable under Section 66B of the Finance Act, 1994. Section 66D of the Finance Act, 1994 specified the services on which no Service Tax is leviable and include ‘trading of goods’. Section 65B (25) of the Act, ibid, specifies that goods includes securities. Hence, Trading of securities is an exempted service.

We observed during the audit of M/s. Star Union Dai-ichi Life Insurance Company, under the jurisdiction of Service Tax II Mumbai Commissionerate that the assessee was considering trading in securities as exempted service for proportionate reversal under Rule 6(3A) of Cenvat Credit Rules, 2004, which aspect was also informed to the Department. However, during our detailed audit examination of records of other Insurance companies within the jurisdiction of Service Tax I Mumbai Commissionerate, we observed that none of the companies had disclosed any such calculation in order to effect proportionate reversal on this account. Assessee contended that

'investment' is one of their core activities and that trading done by them is not with any intention to earn any profit per se, but only to carry out their day-to-day business needs. However, the extant provision of Cenvat credit specifically requires such reversal if there is a trading activity in securities by the Insurance companies. The fact that at least one assessee has been carrying out reversals of Cenvat credit availed in respect of trading activities indicates the need for the department to examine the issue and provide clarification.

When we pointed this out (January 2014) the Ministry did not admit the audit observation (November 2014) stating that in endowment policies as well as in ULIP, the services provided by insurance companies with regard to investment of premium is subject to Service Tax. In the case of ULIP or endowment policy, the activity of investing the fund of the policy holder is neither exempted by a notification nor is non-taxable. Therefore, the services provided by the insurance companies does not fall in the definition of 'exempted services', hence the provisions of Rule 6(3) would not be applicable in the present case. It was further stated that the taxability of the service provided by the insurance company being in nature of composite/bundled service, is determined on the criterion that a single service (out of all the services forming part of the composite service) which gives the service its essential character would be treated as the main taxable service. The activity of investing is only an ancillary activity while the essential character is provided by the coverage of risk of life of the policy holder.

The reply is not acceptable as trading in securities is covered in negative list under section 66D of the Finance Act and as per amended definition of exempted service under sub-rule 2 (e) (ii) of Cenvat Credit Rules 2004, all services on which no tax is leviable under section 66B of the Act, are exempted. Hence, rule 6(3) is applicable in the present case and credit proportionate to the value of trading in securities is to be reversed.

However, on Audit recommendation (June 2014) that, CBEC may consider issuing a clarification on the correct treatment in respect of trading as part of investment activities carried out by insurance service providers, then Ministry admitted (November 2014) the issue stating that trading of security is exempted service and Cenvat credit is required to be reversed, which is contrary to the views expressed in reply of the para above. Audit re-iterates that Ministry should issue clarification to ensure consistency by departmental authorities and reversal of Cenvat credit may be ensured from all service providers as per the applicable provisions.

2.5.5 Incorrect finalisation of Provisional Assessment not pointed out in review

Section 65(55) of the Finance Act, 1994, (as applicable prior to 1 July 2012) defined 'Insurance Auxiliary service' as any service provided by an actuary, an intermediary or insurance intermediary or insurance agent in relation to general insurance business or life insurance business and includes risk assessment, claim settlement, survey and loss assessment.

Rule 6(4) of the Service Tax Rules, 1994, provides for option to pay Service Tax provisionally where an assessee is, for any reason, unable to correctly estimate on the date of deposit, the actual amount payable for any month or quarter as the case may be. Orders of final assessment shall be passed under Rule 7(3) of Central Excise Rules, 2002.

M/s United India Insurance Company Ltd, Chennai in LTU Commissionerate, Chennai had opted for provisional assessment for the financial years 2008-09 to 2010-11 as they could not finalise their tax liability before the due dates on account of data not reaching them on time from 1430 branches. We observed that the credit of entire Service Tax paid on agency commission under insurance auxiliary service on provisional basis was taken as input service credit every month. However, this fact was not taken into account during finalization of the said provisional assessments. Accordingly, the Orders-in-Original stated that the Service Tax and Cess amounts paid in excess, relating to agency commission may be utilised by the assessee in subsequent months. The assessee utilised the same for adjustment towards output Service Tax during the months of April 2009, April 2010 and April 2011 respectively. Since entire Service Tax/cess paid provisionally was taken as credit every month, the question of refund of excess paid Service Tax did not arise. This resulted in incorrect grant of refund of ₹ 10.31 crore. Appropriate interest was also recoverable.

When we pointed this out (September 2012) the Ministry stated (November 2014) that demand for excess amount claimed and refunded to service provider was confirmed with interest and equal penalty.

The fact remains that Orders-in-Original dated 26 May 2011 and 30 May 2012 were reviewed and had been accepted by the Commissioner. The error was not noticed in review also in two consecutive years, is indicative of the weakness of the systems in place in the Commissionerate.

Recommendation No. 1

The department may consider introduction of a checklist for finalisation of high value provisional assessment cases.

The Ministry stated (November 2014) that suggestion has been noted.

2.6 Compliance issues

CBEC introduced self-assessment in respect of Service Tax in 2001. With the introduction of self-assessment, the department also provided for a strong compliance verification mechanism through Scrutiny of Returns, internal audit and the anti-evasion/ preventive wing. Audit observed that notwithstanding the above, we came across certain cases during examination of assessee records which indicate the need for strengthening of the department's compliance verification mechanisms.

2.6.1 Non-payment of Service Tax under reverse charge for import of services

Rule 2 (1)(d)(iv) of the Service Tax Rules, 1994, stipulates that in respect of taxable service provided by a person, who is a non-resident or is from outside India and does not have an office in India, the person receiving the taxable service in India is liable to pay Service Tax under reverse charge mechanism.

Besides, Rule 9 of Place of Provision of Services Rules, 2012 provides that place of provision of services shall be the location of the service providers in the following cases: (a) services provided by a banking company, or a financial institution, or a non-banking financial company, to account holders; (b) online information and database access or retrieval services; (c) Intermediary services; and (d) service consisting of hiring of means of transport. As per Rule 2 (f) of Place of Provision of Services Rules, 2012, "intermediary" means a broker, an agent or any other person, by whatever name called, who arranges or facilitates provision of service (main service) between two or more persons.

Audit scrutiny revealed that 5 assesseees did not fulfill Service Tax liability amounting to ₹ 7.05 crore under reverse charge on insurance auxiliary services received from foreign service providers during the period covered by Audit.

Table 2.5 : Non-payment of Service Tax under reverse charge

					(₹ in lakh)	
Commiss ionerate	Assessee	Description of service	Value of services received/ expenditure incurred	Service Tax amount*		
LTU Delhi	M/s. The Oriental Insurance Co. Ltd.	Reinsurance premium ceded to foreign reinsurers	4,227.78	566.10		
ST, Delhi	M/s. Ace Insurance Brokers Pvt. Ltd.	Insurance Brokers located abroad	697.30	105.06		
		Business promotion expenses	62.66	9.35		
		Sponsorship expenses paid by the sponsor**	17.96	2.45		
ST, Delhi	M/s. Corporate Warranties India Pvt. Ltd., Insurance Broker	Software subscription fee paid to above foreign party	136.06	19.21		
ST, Delhi	M/s. Aviva Life Insurance Co. (India) Ltd.	Foreign payments for survey	8.15	1.00		
ST, Delhi	M/s Bajaj Capital Insurance Broking Ltd.	Commission for reinsurance business	14.68	2.27		
Total			5,164.59	705.44		

*inclusive of interest upto date of Audit

** vide circular dated 28 February, 2006, Service Tax is to be collected under reverse charge method from the service recipient viz. the sponsor - body corporate/firm.

When we pointed this out (December 2013) the Ministry intimated (November 2014) that in respect of Oriental Insurance Co. Ltd., the facts were under examination and SCN had been issued. M/s Corporate Warranties India Pvt. Ltd. and M/s Bajaj Capital Insurance Broking Ltd. had paid the Service Tax. SCN had been issued to M/s. Aviva Life Insurance Co. (India) Ltd. which was pending adjudication. In respect of M/s Ace Insurance Brokers Pvt. Ltd., Ministry intimated partial recovery of ₹ 4.67 lakh in respect of sponsorship expenses paid by the sponsor. Reply for the remaining two services was awaited.

2.6.2 Terrorism Premium

The Indian Market Terrorism Risk Insurance Pool was formed as an initiative by all the non-life insurance companies in India in April 2002. It functions as a multilateral reinsurance arrangement of terrorism risks insured by any of the Members with M/s General Insurance Corporation (GIC Re) and all other members as reinsurers, in agreed proportions. The Pool is administered by GIC and is applicable to all insurances of terrorism risk insured along with the insurances of property. The maximum limit of liability for insurance of terrorism risk shall be as decided by the Pool Underwriting Committee and as filed with the Insurance Regulatory and Development Authority from time to time. Presently, the Pool offers a capacity of ₹ 1000 crore per location. The

Pool itself is protected by an Excess of Loss (XOL) reinsurance cover to protect itself against claims beyond normal ranges/catastrophic losses. Any claims exceeding the underlying limit will be recovered from the Reinsurers. Pool Members interested in participating as Reinsurers on the XOL cover are given share on priority basis and balance is placed with Foreign Reinsurers (foreign cession).

2.6.2.1 Non-payment of Service Tax on retrocession premium relating to Terrorism Pool

Section 66 read with Section 65(105)(zx) of the Finance Act, 1994, (as applicable prior to 1 July 2012) envisage that any service provided or to be provided to a policy holder or any person, by an insurer including reinsurer carrying on life insurance business is a taxable service. In the case of foreign reinsurers, the liability was to be borne by the service recipient under reverse charge under the provision of Section 66A of Finance Act, 1994. With effect from 1 July 2012, all services other than those specified in the Negative List, provided or agreed to be provided will attract levy of Service Tax.

By virtue of the pooling agreement, GIC Re, the National Re-insurer, functions as Pool Manager. The total premium transferred to the Pool by all the members, within 45 days after the close of each quarter, is apportioned by GIC Re to each of the Pool members at the rate of their respective predetermined share percentages and informed to them at the end of the financial year, in the form of a matrix. Thus, retrocession which involves the transaction whereby a reinsurer cedes to another insurer or reinsurer all or part of the reinsurance it has previously assumed is carried out by this process. The own share premium is, however, not considered for retrocession. Thus, any amount insured for terrorism risks is reinsured in this manner through participation of all the pool members as reinsurers.

Since the activity described above is clearly in the nature of reinsurance, Service Tax liability would arise which is to be discharged by each reinsurer-member based on its respective apportioned shares. We observed that while Service Tax liability of GIC's share as reinsurer is discharged by GIC, Service Tax liability of each of the other members on their portion of the retroceded premium amounts is also worked out in the matrix and communicated by GIC. Each member company shall discharge their Service Tax liability on the amount of terrorism premium retroceded in their name.

However, we observed that the matrix for 2010-11 and 2011-12 was still under preparation at GIC while the matrix for 2012-13 was ready. As the members are yet to be informed of their share of the retroceded amounts by GIC for the years covered by CERA (2010-11 to 2012-13), the matrix for which

was ready as at the time of CERA examination, liability on the same has not been discharged. It is observed that there is a non-payment of Service Tax payment on account of the prolonged process of finalization of preparation of retrocession matrix due to the procedure laid down by IRDA. Service Tax provisions on accrual basis of valuation of services is not complied with the procedure/ mechanism adopted by the non-life insurance sector.

Audit scrutiny of the matrices¹⁵ prepared by GIC Re revealed the non-payment of Service Tax liability amounting to ₹ 47.38 crore relating to all member non-Life Insurer companies other than GIC as depicted in the following table which needs to be recovered with interest.

Table 2.6 : ST liability on retroceded amounts

Particulars of Premium	Year	Total Service Tax payable	(₹ in lakh)	
			GIC Re's liability of Service Tax (already paid)	Service Tax to be recovered from Insurance Cos. other than GIC
Retrocession premium	2012-13	5,014.26	886.44	4,127.82
Retrocession premium (XOL)	2012-13	156.08	51.98	104.11
	2011-12	43.00	13.71	29.29
Retrocession premium (foreign cession)	2012-13	461.99	73.92	388.07
	2011-12	109.77	21.30	88.48
Total		5,785.10	1,047.35	4,737.77

When we pointed this out (January 2014) the Ministry stated (November 2014) that assessee under LTU-Delhi Commissionerate has been asked to deposit the Service Tax. In respect of LTU-Chennai Commissionerate, Ministry intimated that Matrix have been prepared and sent to member companies for discharging Service Tax liabilities. Two assesseees under LTU Chennai Commissionerate had paid the Service Tax. In respect of Mumbai ST-I Commissionerate the ministry admitted the observation and stated that there was delay on part of GIC in submitting matrix due to various technical issues and the procedure has been streamlined now.

2.6.2.2 Non-payment of Service Tax on service charges received on managing specific insurance pool

i) Scrutiny of the terms of agreement on Indian Market Terrorism Risk Insurance Pool dated 25 July 2007 between M/s General Insurance

¹⁵ Source document: Matrix on Retrocession premium on Retrocession Premium on domestic cession, Excess of Loss (XOL) premium and foreign cession of the Excess of Loss (XOL) premium for the year 2012-13 and 2011-12 to Pool Members prepared by GIC and Service Tax liability thereon obtained from GIC Re.

Corporation (GIC Re) i.e. Pool Manager and each of the non-life insurers named in the schedule to the agreement revealed the following facts:

The constituents of Indian Terrorism Pool (Pool) are all general insurance companies who write premium for policies of terrorism risks and the National Reinsurer, M/s General Insurance Corporation (GIC Re). Though GIC does not write direct premium, it is nevertheless, a member of the Pool with a definite share from the premium amounts transferred into the Pool by other member companies. The other member companies also have their respective shares in the Pool. GIC is the Pool Manager, as the management and administration of the Pool is vested with it and for this activity, it charges a fee called management commission at one per cent of the original premium for insurance of terrorism risk.

Audit scrutiny of the accounts of GIC Re and Terrorism Pool Quarterly Retro Account statement for revealed that GIC Re had charged fee at the rate of 1 per cent as service charges. However, scrutiny of ST-3 returns for the period 2011-12 and 2012-13 revealed that GIC Re was not paying Service Tax on service charges which form the value of taxable services. The Matrix for Retrocession Premium which is prepared by the GIC Re on the basis of Statement of Accounts received from the members of the Pool showed that the Pool received a total net premium of ₹ 145.52 crore and ₹ 448.24 crore for the years 2011-12 and 2012-13 respectively. GIC Re, being the Pool Manager received service charges as per the agreement at the rate of 1 per cent of the original premium aggregating to ₹ 6.60 crore on which they had not paid Service Tax of ₹ 78.21 lakh which was recoverable alongwith interest.

When we pointed this out (January 2014) the Ministry did not admit the objection (November 2014) stating that issue is clarified vide circular dated 16 April 2010. GIC Re is only sharing the expenses with other insurers and the activity will not attract Service Tax. As both the insurance company and reinsurer pay Service Tax as entire amount, question of charging Service Tax under any other service does not arise.

Ministry reply is not acceptable as Clauses 10 and 16 of the Terrorism Pool Agreement reveals that the fee due from other Pool members is a remuneration charged by the Pool Manager for management of the administration of the pooling arrangement. Thus, this is clearly a situation where service is provided by GIC Re as pool manager to the other members of the pool as service recipients and is not covered by CBEC's Circular cited above, as the circular speaks about sharing of expenses by the insurer with the re-insurer. In this case policy is not written by GIC and he had not incurred any expense which is needed to be recovered from other insurer. GIC is

managing the pool which is a separate service, other than re-insurance hence, and charging an amount from all members for this service. Therefore, Service Tax is leviable for consideration received to manage the pool.

ii) Non-payment of Service Tax on service charges on motor third party pool

GIC as national Reinsurer was entrusted with the management of Indian Motor Third Party Insurance Pool (IMTPIP) with effect from April 2007 exclusively for commercial vehicles on the directives of IRDA under a multilateral reinsurance arrangement among the underwriting non-life insurer companies and GIC Re.

Scrutiny of the accounts and annual reports of GIC Re revealed that the assessee earned administration fees/ service charges of ₹ 27.19 crore and ₹ 27.75 crore for the years 2010-11 and 2011-12 respectively which was netted off with the expenses relating to the Motor Pool/ included in other income. These amounts were to be included in the taxable value of services as they would form part of the 'gross amount charged' as per section 67 of the Finance Act. We observed that as these amounts were not included in the value of taxable services, Service Tax amounting to ₹ 2.80 crore and ₹ 2.86 crore for 2010-11 and 2011-12 respectively, is recoverable with interest.

When we pointed this out (January 2014) the Ministry did not admit (November 2014) the objection stating that circular dated 16 April 2010 was also applicable in the case.

Ministry reply is not acceptable as per section 67 of the Finance Act, 1994, the value of taxable service would be 'gross amount charged' by the service provider. Circular dated 16 April 2010 is not applicable in the instant case.

2.6.3 Short payment of Service Tax

Audit scrutiny exercised on the basis of reconciliation of the gross income reflected in the annual accounts (Balance Sheet and Trial Balance) with the taxable income reflected in the ST-3 returns revealed short payment of Service Tax of ₹ 14.73 crore in the following 4 cases:

Table 2.7: Short payment of Service Tax

(₹ in lakh)				
Assessee (Period covered in observation)	Audit Observation	Service Tax	Interest (delay period worked upto the date of audit)	Short payment of Service Tax including interest
M/s Oriental Insurance Co. Ltd, LTU Commissionerate, Delhi (2011-12)	There was a difference of ₹ 105.39 crore in the premium income as per the reconciliation statement of gross premium income in the accounts and ST-3 returns.	1,085.49	325.65 (20 months from April 2012 to November 2013)	1,411.14
(2012-13)	Service Tax was paid on Insurance/rental services etc. at the rate of 10.3 per cent as against the enhanced rate of 12.36 per cent with effect from 1 April 2012	29.52	7.22 (delay by 18 to 12 months upto November 2013)	36.74
M/s Ace Insurance Brokers Ltd., ST Commissionerate, Delhi (2011-12)	Gross taxable income as per Balance Sheet was ₹ 31.56 crore whereas gross income as per the return was ₹ 30.31 resulting in undervaluation of ₹ 1.26 crore.	12.96	3.89 (delay of 20 months from April 2012 to Nov. 13)	16.85
M/s Sridhar Insurance Brokers, ST Commissionerate, Delhi. (January 2013 to March 2013)	During the year 2012-13, out of the brokerage income of ₹ 9.31 crore, Service Tax was paid on ₹ 8.02 crore and ₹ 0.55 crore was declared under VCES, however, on the remaining ₹ 0.47 crore tax was not paid.	5.22	0.71 (9 months delay from April 2013 to December 2013)	5.93
M/s Hawk Vision Ltd., ST Commissionerate, Delhi. (2010-11 to 2012-13)	There was a difference of ₹ 18.42 lakh in the gross receipts shown in the TDS statement and that of ST-3 returns.	1.90	0.43 (delay by 32 to 8 months till November 2013)	2.33
Total				1,472.99

When we pointed this out (December 2013) the Ministry intimated (November 2014) that M/s. Oriental paid the Service Tax of ₹ 10.85 crore and SCN had been issued for interest and penalty. Case of M/s. Ace Insurance Brokers Ltd. and M/s. Hawk Vision Ltd. are under investigation and SCN will be issue if demand arise. M/s. Sridhar Ltd. has also paid the Service Tax of ₹ 5.93 lakh.

2.6.4 Non-payment of interest on delayed payment of Service Tax

The assessee is liable to pay interest at the prescribed rate on the delayed payment of Service Tax as per section 75 of the Finance Act. The rate prescribed has been increased from 13 per cent to 18 per cent with effect from 1 April 2011.

We came across instances of delayed payment of Service Tax in 6 cases in ST Commissionerate, Delhi on which interest of ₹ 13.23 lakh was recoverable.

Table 2.8: Non-payment of interest due

Assessee	(₹ in lakh)
M/s Corporate Warranties Ltd.	10.69
M/s Bajaj Capital Insurance Broking Ltd.	1.74
M/s Almondz Insurance Brokers Pvt. Ltd.	0.34
M/s Unison Insurance Broking Services Ltd.	0.24
M/s Fair deal Insurance Brokers Ltd.	0.15
M/s DLF Pramerica Life Insurance Company Ltd.	0.07
Total	13.23

When we pointed this out (November 2013) the Ministry intimated (November 2014) that all the assesseees had paid the interest.

2.6.5 Cenvat credit

2.6.5.1 Incorrect utilisation of Cenvat credit

Under the provisions of rule 3 of the Cenvat Credit Rules, 2004, a service provider is allowed to take credit of Service Tax paid on any 'input service' used in providing taxable output service. Credit availed on Education Cess and Secondary and Higher Education Cess cannot be utilised for the payment of basic Service Tax.

Scrutiny of returns for the period 2011-12 of M/s Bajaj Allianz General Insurance Co. Ltd. in Pune III Commissionerate revealed a discrepancy in carrying forward Cenvat credit of ₹ 14.30 lakh for the month of October 2011 which was on account of an incorrect adjustment of basic tax and Education Cess, inadmissible as per the Cenvat Credit Rules. This resulted in excess credit availed of ₹ 14.30 lakh and utilised subsequently in the following months which needs to be recovered.

When we pointed this out (September 2013) the Ministry intimated (November 2014) that assessee rectified the error and SCN had been issued for interest and penalty.

2.6.5.2 Cenvat credit on input services used in non-taxable/exempted output services

Under rule 3 of Cenvat Credit Rules, 2004, a service provider is allowed to take credit of Service Tax leviable under section 66/66A (section 66B with effect from 1 July 2012) of the Finance Act 1994, paid on any input service.

Section 64 of Chapter V of Finance Act, 1994 excludes the applicability of Service Tax to the State of Jammu and Kashmir. Hence, if Service Tax not due to be paid in respect of commission paid to insurance agents for sourcing business in Jammu and Kashmir has been paid under reverse charge, credit of the same should not be availed.

a) We observed the following instances where assessee had availed Cenvat credit of ₹ 64.26 lakh on commission paid to the insurance agents for sourcing business in Jammu and Kashmir (which are non-taxable services) which were inadmissible in view of the aforesaid provision and needs to be recovered with interest.

Table 2.9: Cenvat credit on input services used in non-taxable output services

		(₹ in lakh)
Name of the assessee	Commissionerate	Service Tax paid on Commission paid to Insurance Agents
M/s Bajaj Allianz Life Insurance Co. Ltd.	Pune III	38.40
M/s HDFC ERGO General Insurance Co. Ltd.	ST- I, Mumbai	1.53
M/s Reliance Life Insurance Co. Ltd.	ST-II, Mumbai	24.33
Total		64.26

When we pointed this out (January 2014) the Ministry in case of M/s. Bajaj Allianz Life Insurance and M/s Reliance Life Insurance Co. Ltd admitted (November 2014) the objection and intimated that M/s Bajaj Allianz had reversed Cenvat credit of ₹ 60.77 lakh alongwith interest of ₹ 14.23 lakh and SCN for penalty was being issued while case of M/s Reliance was being verified and SCN would be issued shortly. However, in case of M/s. HDFC Ergo Ministry did not admitted the objection and stated that as provision of Service Tax are not applicable in J&K, no tax is payable for such services and assessee first paid the tax and then availed Cenvat credit of the same and the exercise is revenue neutral.

Ministry has taken two different stands for similar issue. Ministry need to take a common stand for the issue and clarify the same to its field formations. However, contention of the Ministry in case of M/s HDFC Ergo is not acceptable because as per rule 3 of Cenvat Credit Rules, 2004, credit is admissible for Service Tax paid under section 66,66A or 66B and Service Tax

paid for J&K policies does not fall under the purview of any section of the Act. Further, though the exercise of paying Service Tax for J&K policies and then availing credit is revenue neutral, the tax paid on non-taxable policies, is passed on to J&K clients which is defying the intention of the legislation of not extending Service Tax to J&K.

b) We also observed that insurers did not maintain separate account for input services used in provision of taxable output services and non-taxable output services (relating to Jammu and Kashmir) on the lines of the requirement in Rule 6(3) of Cenvat Credit Rules, 2004 regarding taxable and exempted services. Prior to 1 July 2012, there was no requirement in the law or Rules for maintenance of such separate accounts. However, we note that absence of such requirement results in a vitiation of the logic behind the introduction of Cenvat since it means allowing the utilization of input services for provision of services not contributing to the revenues of the Central Government.

During examination of records of 3 assesseees in Service Tax-1 Mumbai Commissionerate, Audit observed that the assesseees did not maintain separate account for input services used in the provision of taxable and non-taxable services during the period covered in audit. If we applied the analogy of Rule 6(3) of Cenvat Credit Rules, 2004, the required reversal of Cenvat credit would work out to ₹ 2.31 crore.

Table 2.10 : Cenvat attributable to input services used for provision of Jammu and Kashmir related services

			(₹ in lakh)
Commissi- onerate	Name of Assessee	Period	Cenvat attributable to input services used for provision of J & K related services
ST I Commission erate, Mumbai	M/s HDFC Ergo General Insurance Co. Ltd.	2011-12	5.27
	M/s ICIC Prudential Life Insurance Co. Ltd.	2010-11	76.46
	M/s New India Assurance Co. Ltd.	2012-13	150.18
	Total		231.91

When we pointed this out (January 2014) the Ministry did not admit the objection (November 2014) stating that as provision of Service Tax are not applicable to J&K. Rule 6(3) of Cenvat Credit Rules, 2004 which require reversal of proportionate Cenvat credit, is also not applicable.

The reply is not acceptable as the issue is not related to leviability of Service Tax in J&K but availing of irregular Cenvat credit in taxable territory other than J&K, for services which are not taxable. Non-reversal of credit on services pertaining to J&K which are non-taxable would defy the basic logic of Cenvat Credit Scheme. The issue has also been decided in respect of Central

Excise by Supreme Court in case of Maruti Suzuki Ltd. where apex court held that credit is not eligible for the electricity, a non-dutiable product, to the extent it is not used in manufacturing of dutiable products. Suitable amendment/clarification may also be made, if required, in respect of Service Tax.

2.7 Other cases

In addition to the above, we noticed 4 other cases of non-compliance by the assessee involving tax effect of ₹ 9.04 lakh out of which ₹ 8.11 lakh had been recovered.

2.8 Conclusion

While services in insurance sector continue to contribute very significantly to the Service Tax revenues, at least some portion of the revenue due to reach the Government fails to reach the Government owing to various factors such as limitations in our compliance verification mechanisms and lacunae/ambiguity in provisions.