Chapter V

Effectiveness of Tax Administration and Internal Controls

(Service Tax)

5.1 Introduction

Internal controls in an organisation are designed to address risks and to provide reasonable assurance that in pursuit of the entity's mission, the following general objectives[46] are being achieved:

- fulfilling accountability obligations;
- complying with applicable laws and regulations;
- safeguarding resources against loss, misuse and damage.

In the era of self-assessment, recognizing the need for a strong compliance verification mechanism, the Board has put in place systems of internal control by way of two functions i.e. Scrutiny of Returns and Internal Audit. With increasing reliance on voluntary compliance and new services regularly brought under the tax net, there were also instructions in place to identify persons who were liable to pay tax, but had avoided to pay, so as to bring them into the tax net thereby broadening the tax base.

5.2 Results of Audit

During the course of examination of 18,000 ST-3 returns submitted by the assessees in audited 744 ranges, we came across several shortcomings in compliance to the Act/Rule provisions, instructions etc. in place. As discussed in paragraph 2.3 and 2.4 of this report regarding audit universe, sample and findings, out of 263 draft paragraphs issued to the Ministry, 168 DAPs pertain to Service Tax on the issues of widening of tax base, scrutiny of returns, internal audit of assessees, anti-evasion cell, disposal of refund claims, adjudication of SCNs and functioning of jurisdictional officers are discussed in this chapter.

Out of above 168 Draft Audit Paragraphs, we communicated our observations to the Ministry through 104 draft audit paragraphs having financial implication of ₹ 206.54 crore in which the lapses of the departmental officials of 43 Commissionerates were pointed out. Out of the above, in 51 cases the Ministry accepted the audit observations, in 42 cases the Ministry partly accepted the audit observations, for revenue loss and taking remedial action for recovery of revenue. In 11 cases, the Ministry did

[46] INTOSAI GOV 9100 – Guidelines for Internal Control Standards for the Public Sector.

not accept the audit observations (September 2018). These cases are included in Appendix-I.

Out of above 168 DAPs, we have also issued 63 draft audit paragraphs having financial implication of ₹ 52.00 crore on the accounts of non/short payment of Service Tax/interest and irregular availing/utilization of CENVAT credit by the assessees in 36 Commissionerates. Out of the above, 55 cases have been accepted by the Ministry and recoveries made/recovery proceedings initiated, in eight cases the Ministry accepted the audit observations but rectificatory action was yet to be initiated (September 2018). These cases are included in Appendix-II.

Apart from the above, during the audit of departmental units in FY18, we had also noticed systemic lapses related to scrutiny of returns, internal audit, adjudication of SCN, refunds etc. in 46 Commissionerates and ADG (Audit), Mumbai, issued to the Ministry through one draft audit paragraph containing 109 observations, out of which in some cases where we could calculate, the money value of audit observations, was ₹ 31.71 crore.

The observations are discussed in the following paragraphs under eight major headings:

- Widening of Tax base
- Scrutiny of Returns
- Internal Audit – Non-furnishing of Information
- Internal Audit – Non-detection of lapse
- Investigation by the Anti-Evasion Cell
- Disposal of Refund claims
- Issuance and Adjudication of SCNs
- Other lapses

5.3 Widening of Tax Base

Widening of tax base and prevention of tax evasion are two important functions of tax administration for optimum tax realisation. With increasing reliance on voluntary compliance by tax payers at large, it becomes important for Department to put in place an effective mechanism for collecting information from various sources in order to bring unscrupulous assessees into tax net. Further, the Board directed its field formations in November 2011 that a Special Cell be created in each Commissionerate to focus on widening of tax base by bringing in potential assessees.

5.3.1 Non Verification of third party data

Scrutiny of records in Mumbai Zone and two Commissionerates revealed that out of 19,168 assessees allotted by the Chief Commissioner Office to the Commissionerates for verification from the CBDT data, the Department did not conduct verification of 17,113 assessees. In 2,055 cases (11 per cent) verified by the Department during FY13 to FY15, revenue liability of ₹ 239.75 crore was detected in 836 cases. This indicates that there was huge revenue potential in the allotted cases and accordingly high priority should have been assigned to the task. However, in 89 per cent of the assessees, the verification was not done as given below:

Table 5.1: Non-verification of third party data

(₹ in crore)

Sl. No.	Field Formation	Total cases	Cases not verified	Cases verified	Duty evasion detected
1	Mumbai Zone	14,568	12,738	1,830	239.11
2	Division IV of Pune ST Commissionerate	3,013	2,842	171	NA
3	Tuticorin Division of Madurai Commissionerate	1,587	1,533	54	0.64
	Total	**19,168**	**17,113**	**2,055**	**239.75**

Considering the huge revenue potential in the cases, non-conducting of the verification would result in considerable escapement of revenue.

The Ministry forwarded (October 2018) replies of two Commissionerates. Bhiwandi Commissionerate (under Mumbai Zone) stated that the work was under process and Mumbai South Commissionerate (under Mumbai Zone) stated that cases pertaining to FY13 had been verified. Further, concrete efforts were being made to liquidate the pendency for FY14 and FY15 also.

Apart from above, we noticed seven other cases and issued two draft paragraphs involving revenue of ₹ 69.60 crore (included in Section A of *Appendix-I*), as detailed below:

5.3.2 Non-registration of local body and consequent non-payment of Service Tax

As per Clause (a) of Section 66D of the Finance Act, 1994, support services provided by the Government or local authority to business entities are liable for payment of Service Tax. Rule 4 of Service Tax Rules, 1994 stipulates that every person liable to pay Service Tax should get registered within 30 days from the date on which Service Tax becomes leviable on the services provided. The Board Circular No. 97/8/2007-ST dated 23 August 2007 specifies that the assessees applying for registration will be granted PAN based registration. Rule 7 of Service Tax Rules prescribes submission of ST-3 Returns by all registered assessees. Section 73A of the Act stipulates that any

amount collected towards Service Tax should be remitted into the Government account.

An assessee, which is an urban local body under the provisions of the relevant Act enacted by the State Legislature, is the local self-government for administering and providing basic civic amenities to the residents of the city. Thus, the assessee qualifies for both as local authority and governmental authority under the provisions of the Finance Act, 1994.

In addition to carrying out the functions entrusted under Article 243W of the Constitution, the assessee provides various taxable services like leasing out the buildings and land owned by it for commercial usage, permitting shooting of films in public parks, allowing telecom companies to use the roads for cable lying work etc. to the business entities located under its jurisdictional area. The assessee disclosed ₹ 10.24 crore as Service Tax under Current Liabilities in the Financial Statements for FY15 and FY16, indicating that said amount was collected as Service Tax by the assessee from its clients but did not remit to the Government account. Verification of the financial records of the assessee revealed that the assessee is liable to pay Service Tax of ₹ 90.07 crore, inclusive of ₹ 10.24 crore referred to above, on consideration received towards the services provided by it during FY14 to FY16.

Verification also revealed that some of the Zonal Offices/Divisions of the assessee were registered under Service Tax authorities and were having temporary registration numbers while other Divisions/Zonal Offices, which also provide taxable services, were not registered. Further, the registered Divisions/Zonal Offices of the assessee had not filed any ST-3 Returns till date (October 2017). The assessee should have taken registration for itself as a whole or for all its Divisions separately from Service Tax authorities within 30 days for the services provided by them becoming taxable with effect from July 2012. Though the Department was aware that the Negative List based taxation regime brought services provided by Government /Local Bodies to business entities in the Service Tax net, it did not take any action either to get the entire units of the assessee registered under Service Tax or to convert the temporary registrations, obtained by some of the Zones/Divisions into PAN-based registrations. The Department also did not take any action for ensuring regular filing of returns by the registered Zonal Offices/Divisions of the assessee.

When we pointed this out (October 2017), the Ministry stated (August 2018) that an SCN had been issued for ₹ 68.81 crore under renting of immovable property service and further stated that other issues regarding non taking permanent registration number or not registering all its divisional units would be taken care by the adjudication proceedings.

The reply of the Ministry is silent on the failure of the departmental officers.

5.3.3 Absence of Provision

According to Section 69 of Finance Act, 1994, as amended, read with Rule 4 of Service Tax Rules 1994, every person liable for paying the Service Tax shall make an application in form ST-1 for registration within a period of 30 days from the date on which the Service Tax under Section 66 (b) of the Finance Act, 1994, is levied. The ST-1 form does not have any column for filling the date of commencement of business or details of financial results of prior-registration period. The Rules also do not provide any checks for gathering this information.

Verification of Service Tax registration status of eight works contractors registered with the State VAT Department during audit of Service Tax Range Kottayam (September 2015) in Cochin Commissionerate, revealed that they took Service Tax registration much later than their date of VAT registration. Further, Audit observed from VAT returns and records available in State Commercial Taxes Department that six works contractors had taxable income prior to date of Service Tax registration (registered between June 2011 to February 2014), which was not disclosed by them. This had resulted in non-payment of Service Tax of ₹ 60.30 lakh for the period FY11 to FY13.

No checks have been provided in the Act/Rules to capture date of commencement of business for Service Tax registration. Thus, absence of a system for verification of financial records at the time of registration/filing of first ST-3 return, resulted in non-detection of non-payment of Service Tax by these assessees.

When we pointed this out (September 2015), the Ministry replied (July 2018) that there was short-payment of Service Tax only in four out of the six cases. The rectificatory action was taken in three out of four cases and investigation was going on the fourth case.

The reply of the Ministry is silent on the absence of provisions for checking income of pre-registration period while granting ST registration to the service providers.

The Ministry may consider that at the time of granting of registration details regarding commencement of the business and financial statements of that period may be called for by the Department to check Service Tax liability of the prior period.

5.4 Scrutiny of Service Tax Returns

The Board introduced self-assessment in respect of Service Tax in 2001. With the introduction of self-assessment, the Department also provided for a

strong compliance verification mechanism with scrutiny of returns. Assessment was the primary function of Tax officers who were to scrutinise the Service Tax returns to ensure correctness of tax payment. As per the Manual for the Scrutiny of Service Tax Returns, 2009, a monthly report was to be submitted by the Range Officer to the jurisdictional Assistant/Deputy Commissioner of the Division regarding the number of returns received and scrutinised. Scrutiny was done in two stages i.e. preliminary scrutiny by Automation in Central Excise and Service Tax (ACES) and detailed scrutiny, which was carried out manually on the returns marked by ACES or otherwise.

As per para 1.2B of Manual ibid, preliminary scrutiny of returns was to be conducted on all returns. As per para 4.2A of Manual ibid, only two per cent of returns needed to be examined in detailed scrutiny.

5.5 Preliminary Scrutiny of Returns

The Board had issued revised checklist for scrutiny of Service Tax returns vide circular dated 30th June 2015. As per para 2.1 of the circular, on the basis of the validation checks incorporated in ACES by the Directorate General of Systems & Data Management (DGS&DM), preliminary scrutiny of all returns was to be done online in ACES and the returns having certain errors were marked for Review and Correction (RnC)[47]. These had to be processed accordingly by the Range Officers. The purpose of preliminary scrutiny of returns was to ensure completeness of information, timely submission of return, payment of duty, arithmetical accuracy of the amount computed and identification of non-filers/stop filers. In case any discrepancy was found by the ACES, all such returns were marked for RnC. The returns marked for RnC by ACES should be validated in consultation with the assessee and re-entered into the system. The preliminary scrutiny of returns and RnC was to be completed within three months from the date of receiving the returns.

Despite our best pursuance, the Ministry/Department did not provide data relating to scrutiny of Service Tax returns for FY17 and FY18. Although the preliminary scrutiny of returns and marking the returns for RnC was done online by the ACES still the Department was not able to furnish this information to Audit. The Ministry in its reply stated (May 2018) that all the Chief Commissionerates had been asked to furnish this information to the Board. In self-assessment regime, scrutiny of the returns is one of the tools available with the Department to ensure correctness of tax assessment. Non-maintaining and non-furnishing of the data points towards poor record keeping by the Department.

[47] The process of resolving discrepancies in respect of marked returns is called RnC.

During the test check of scrutiny of records at departmental units during FY18, we noticed 45 instances of non-conducting/non-clearance of returns marked for RnC/detailed scrutiny in 20 Commissionerates[48]. Further, we noticed 420 returns being filed late or not filed in seven Commissionerates[49] on which late fee of ₹ 56 lakh was not levied by the Commissionerates.

Apart from the above, we issued 26 draft paragraphs (included in Section B of *Appendix-I*) involving revenue of ₹ 22.55 crore where due to inadequacies in the system of preliminary scrutiny, short/non-payment of tax liability exhibited in the ST-3 return, non-payment of interest on delayed payment of tax or non/delayed filing of ST-3 returns were not detected by the Department. In 19 cases, the Ministry accepted the audit observations and attributed these lapses to non-availability/shortcomings of the facility in the ACES in 13 cases. In four cases, the Ministry accepted the revenue loss but did not accept the departmental failure while in three cases, the Ministry did not accept the audit observations.

Few illustrative cases are discussed below:

5.5.1 No action taken by the Department on ST-3 Returns marked for RnC by the ACES

5.5.1.1 It was observed in Bengaluru-IV Commissionerate, that the ACES marked the ST-3 Returns filed by an assessee for RnC due to the difference of ₹ 63.82 lakh in the CENVAT account between the closing balance for the month of March 2016 and opening balance for the month of April 2016. The difference occurred as the assessee adopted the closing balance as per the original ST-3 Returns filed for the period from September 2015 to March 2016 instead of the revised ST-3 Returns. Due to non-conducting of RnC, the excess CENVAT credit of ₹ 63.82 lakh could not be recovered.

When we pointed this out (May 2017), the Ministry accepted the facts (October 2018).

5.5.1.2 An assessee in Salem Commissionerate had declared ₹ 3.58 crore as Service Tax payable in the returns filed for FY15 to FY17, whereas no details of payment of tax were shown in the returns. Audit verification revealed that as on 31 December 2017, the assessee had made tax payment of ₹ 2.52 crore beyond the prescribed period but had not paid the interest, which worked

[48] Ahmedabad ST, Ahmedabad-I, Agra, Belapur, Bengaluru-IV, Delhi ST-I, Delhi ST-II, Hyderabad, Kolkata North, Kolkata South, Medchal, Mumbai East, Mumbai West, Nagpur-I, Navi Mumbai, Pune ST, Rajkot, Salem, Tirupati and Visakhapatnam

[49] Bengaluru-I, Bengaluru-IV, Hyderabad, Managalore, Meerut, Secundrabad and Visakhapatnam.

out to ₹ 34.07 lakh. Further, the outstanding dues of ₹ 90.47 lakh, along with interest of ₹ 17.46 lakh (up to the dates of audit) also remained unpaid.

Though the assessee persistently defaulted in payments and ACES had also marked the ST-returns filed for RnC, no action was taken by the jurisdictional officers, resulting in tax dues and interest remaining uncollected until pointed out by Audit.

When we pointed this out (January 2018), the Ministry stated (July 2018) that the audit observation was not accepted as the Department was already aware of the issue and a letter dated January 2016 had been issued to the assessee seeking payment of the dues and the assessee had made part payment of the dues and sought further time till May 2016 for full payment. Now the assessee had paid objected amount of ₹ 1.10 crore alongwith interest of ₹ 5.00 lakh.

The reply of the Ministry is not acceptable as the assessee was a repeat defaulter since 2014 who had short paid the Service Tax in each year. Further, the time limit sought for full payment by the assessee was also upto May 2016 but no coercive action was initiated by the Department even after that. After being pointed out by Audit, a notice for recovery under section 87 (issued to a third party-service recipient) was issued in February 2018. Further, the Department had not taken any action to levy penalty on the repeated short payment of Service Tax by the assessee.

5.5.1.3 An assessee, in Bengaluru ST-II Commissionerate, is a provider of Information Technology Software Services. Verification of the ST-3 returns filed by the assessee revealed that the assessee had declared an opening balance of ₹ 19.96 crore for the month of April 2016 against the closing balance of ₹ 18.85 crore for the month of March 2016 in the CENVAT Account. This resulted in availing of excess CENVAT credit of ₹ 1.11 crore. Even though ACES marked the ST-3 Return for RnC highlighting this error, the Department did not take any action to recover the irregular credit.

When we pointed this out (December 2016), the Ministry stated (May 2018) that the assessee reversed ₹ 1.11 crore in the CENVAT account in April 2017 on the basis of the audit observation. The Ministry admitted that there were certain glitches in the ACES functioning in the pre-GST era. The huge pendency of returns marked for RnC is a matter of concern for the Ministry. The Board had issued D.O. letter (April 2018) to all the field formations for speeding up the disposal of returns marked for RnC to address the huge pendency.

5.5.2 Non-detection of non/stop filer and non-payment of Service Tax

Rule 7 of Service Tax Rules, 1994 envisages that every person liable to pay Service Tax has to submit half-yearly return in Form ST-3 electronically within 25 days of the end of the half-year.

An assessee in Bengaluru ST-I Commissionerate, provides event management services to various clients and collects Service Tax from them. Verification of the Service Tax payment details at the Range Office revealed that the assessee neither paid Service Tax nor filed ST-3 Returns for the period from FY13 onwards. Audit obtained (February 2017) the Financial Statements of the assessee for the period from FY13 to FY15 which revealed that the assessee was liable to pay Service Tax of ₹ 1.04 crore on these services during the said period. The Commissionerate did not initiate any action for best-judgment assessment in this case as per section 72 of the Finance Act, 1994.

When we pointed this out (February 2017), the Ministry stated (June 2018) that an SCN demanding Service Tax of ₹ 1.40 crore had been issued. The Ministry further stated that the large number of assessees registered in the Commissionerate makes it difficult to take up every return for scrutiny. However, with the implementation of GST regime, the GST portal was accordingly being modified to capture details of the defaulters/non-filers.

5.6 Detailed Scrutiny of Returns

Revised checklists for detailed scrutiny of Service Tax returns were issued by the Board vide Circular dated 30 June 2015. As per the circular, the purpose of detailed scrutiny of returns is to ensure the correctness of the assessment made by the assessee. This includes checking the taxability of the service, the correctness of the value of taxable services in terms of Section 67 of the Finance Act, 1994, read with the Service Tax (Determination of Value) Rules, 2006 and the effective rate of tax after taking into account the admissibility of an exemption notification, abatement, or exports, if any; ensuring the correct availment/utilization of CENVAT credit on inputs, capital goods, and input services in terms of the CENVAT Credit Rules, 2004, etc. As per para 6.3 of the circular ibid, the Zonal Chief Commissionerates were to submit monthly reports in the format given in Annexure VI to the Directorate General of Service Tax till facilities are developed to enable the Commissionerate to upload the data in the MIS of CBIC.

Despite our best pursuance, the Ministry/Department did not provide data relating to scrutiny of returns for FY16 to FY18. The Ministry in its reply stated (May 2018) that all the Chief Commissionerates had been asked to furnish this information to the Board. In self-assessment regime, scrutiny of the returns is one of the tools available with the Department to ensure

correctness of tax assessment. Non-maintaining and non-furnishing of the data points towards poor record keeping by the Department.

During the test check of records related to detailed scrutiny in departmental units during FY18, we observed six instances of non-conducting of detailed scrutiny in six Commissionerates[50]. Further, we noticed 16 instances of non-clearance of 704 returns marked for detailed scrutiny in seven Commissionerates[51].

Apart from the above, we also issued 10 draft paragraphs (included in Section B of *Appendix-I*) involving revenue of ₹ 6.88 crore where due to non-conducting/ineffective detailed scrutiny of returns, short/non-payment of tax, non-payment of interest on delayed payment of tax etc. were not detected by the Department. In five cases, the Ministry accepted the audit observations, in four cases the Ministry accepted the revenue loss but did not accept the departmental failure and in one case, the Ministry did not accept the audit observation.

A few illustrative cases are given below:

5.6.1 Non-detection of non-levy of Service Tax in Detailed Scrutiny of Returns

As per Serial number 10 of Notification No. 30/2012-ST dated 20 June 2012 (effective from 1 July 2012), when the service provider is in non-taxable territory and service receiver is in taxable territory, Service Tax is payable by the service receiver.

An assessee, in Kutch Commissionerate, was selected for detailed scrutiny of Central Excise returns by the Department. On scrutiny of the relevant documents, we noticed that the assessee had debited ₹ 1.84 crore towards 'royalty payment' (services received from non-taxable territory) during the period FY14 and FY15, on which total Service Tax of ₹ 22.71 lakh was payable but not paid by the assessee.

This information was available in the records submitted to the Range by the assessee for detailed scrutiny of returns but no action was taken by the Jurisdictional Range Officer on this information.

When we pointed this out (August 2016), the Ministry accepted (June 2018) the audit observation and informed that the Department had recovered ₹ 22.71 lakh alongwith interest of ₹ 8.04 lakh. Further, the Ministry stated that the unit was selected only for detailed manual scrutiny of Central Excise returns/records and the same was conducted (March 2016) by the Range

[50] Agra, Delhi ST-I, Mumbai West, Nagpur-I, Navi Mumbai and Salem.

[51] Belapur, Delhi ST-II, Kolkata North, Kolkata South, Mumbai East, Pune ST and Tirupati.

office. Hence, there was no failure/lapse on the part of the Jurisdictional Range Officer.

The reply of the Ministry is not acceptable as the Range Officer should have examined the information available with it prudently to protect the revenue in respect of Service Tax also and not mechanically for the purpose of Central Excise duty only.

5.6.2 Short payment of Service Tax not detected as no detailed scrutiny was conducted

5.6.2.1 Section 65(105)(zo) of the Finance Act, 1994 provides that any service provided or to be provided in relation to any service for repair, reconditioning, restoration or decoration or any other similar services, of any motor vehicle other than three wheeler, scooter, auto-rickshaw and motor vehicle meant for goods carriage, is a taxable service.

Audit examination (October 2016) of Annual Financial Statements, Form 26AS and ST-3 returns of an assessee, of Hajipur Range in Patna-II Commissionerate, revealed that the assessee had received amount of ₹ 1.90 crore during FY14 to FY16, which was received by them from various sources like Hero Motocorp (for free service charge), IndusInd Bank Ltd. (for professional and others) ICICI Lombard General Insurance (for insurance commission) and others. The assessee showed only amount of ₹ 80.17 lakh in ST-3 returns during FY14 to FY16. This resulted in short payment of Service Tax and Cess to the tune of ₹ 14.53 lakh, along with applicable interest thereon, during the said period.

When we pointed this out (October 2016), the Ministry accepted the audit observation and stated (July 2018) that an SCN of ₹ 39.17 lakh (including the objected amount of ₹ 14.53 lakh) had been issued (February 2018) to the assessee covering the period from FY14 to FY17.

The Ministry further stated that the assessee suppressed the actual taxable value in the ST-3 returns filed during the period by them. Non-payment of Service Tax could not have been detected on the basis of scrutiny of returns.

The reply of the Ministry is not acceptable because as per Annexure-III of Circular dated 30 June 2015, the revenue shown in ST-3 returns should be verified with reference to the revenue shown in the financial records i.e. Profit and Loss Account, relevant ITR etc., hence, the shortcoming would have been detected if the scrutiny of returns were conducted by the Department.

5.6.2.2 Section 68(2) of Finance Act, 1994, provides that a person liable to pay tax shall pay the same in prescribed manner. The Service Tax was

payable by an assessee (other than an individual, proprietary firm or partnership firm) by 5th of the month following the month in which payments are received towards value of taxable services (by 6th in case of e-payment) except in March [rule 6(1) of Service Tax Rules]. If the assessee was an individual or proprietary firm or partnership firm, the tax was payable on quarterly basis within 5 days at the end of quarter (within 6 days of e-payment) except in March.

An assessee, in Jaipur Commissionerate, had made payments of Service Tax for the period October 2012 to March 2015 (Audit Period April 2012 to March 2016) with a delay ranging from 1 to 151 days, however interest leviable thereon was not paid/short paid. This resulted in non/short payment of interest ₹ 27.35 lakh on delayed payment of Service Tax.

The ACES had not marked the returns of the assessee for RnC. Further, the Department intimated that Internal Audit of the assessee was not conducted for the period covered in audit observation as detailed scrutiny of the returns was done by the Range Officer, but belated payment of Service Tax was not pointed out in the detailed scrutiny.

When we pointed this out (October 2016), the Ministry stated (July 2018) that the assessee had deposited the interest of ₹ 27.35 lakh. Further, the Ministry stated that as per available records detailed scrutiny of returns was not conducted.

The reply of the Ministry is contradictory as the Commissionerate in its reply to the audit observation had stated (August 2018) that the unit was not covered in internal audit as detailed scrutiny of returns was conducted by the Range.

5.6.2.3 Rule 4(7) of the CENVAT Credit Rules 2004, provides that CENVAT credit in respect of input service shall be allowed, on or after the day on which the invoice, bill or as the case may be, challan was received provided that in respect of input service where whole or part of the Service Tax was liable to be paid by the recipient of the Service, credit of Service Tax payable by the recipient shall be allowed after such Service Tax was paid.

Audit examination (May 2017) of ST-3 returns and GAR-7 Challan of an assessee during audit of Service Tax Range III in Agra Commissionerate, for the period of FY15 to September 2017, revealed that the assessee availed and utilized CENVAT credit of input amounting to ₹ 1.29 crore prior to making payment of Service Tax under Reverse Charge Mechanism (RCM) contrary to the provision of Rule 4(7) of the CENVAT Credit Rules 2004.

When we pointed this out (June 2017), the Ministry accepted the audit observation (August 2018) and intimated that the assessee had reversed the

inadmissible CENVAT credit amounting to ₹ 1.29 crore. The Ministry further stated that the main reason for non-scrutiny of ST-3 returns was reorganisation of the departmental formation.

5.7 Internal Audit

Internal Audit helps to measure the level of compliance by the assessees in light of the provisions of the Central Excise Act and rules made thereunder. The Board had issued detailed procedure of Internal Audit in the form of Central Excise and Service Tax Audit Manual, 2015 (CESTAM, 2015).

After restructuring of the Department in October 2014, the auditable units have been re-organised, into three categories i.e. Large, Medium and Small Units based on centralized risk assessment carried out by DG (Audit). The manpower available with the Audit Commissionerate is allocated in the ratio 40:25:15 among Large, Medium and Small Units and remaining 20 per cent manpower is to be utilised for planning, coordination and follow up.

As per procedure, a list of units will be communicated to the Audit Commissionerates by the DG (Audit) for the purpose of conducting audit for the audit year. The Audit Commissionerate may select the units to be audited in a particular year after reviewing the list forwarded by the DG (Audit), in the context of local risk perceptions and parameters. The Audit Commissionerate may also select an assessee with low risk score but reasons for such selection should be indicated which would be used as feedback by the DG (Audit).

The information related to internal audit is contained in monthly performance reports (MPR) and is maintained in the Directorate of Data Management's (DDM) website. The MPRs are uploaded by field formations and contain information on Audits, Revenue, Adjudication, Refunds, Arrears, Appeals etc.

Despite our best pursuance, the Ministry/Department did not provide data related to units due for internal audit during FY18.

When we asked reasons for the non-furnishing of this information, the DG (Audit) stated (September 2018) that figures of units change every month for the reason that Audit Commissionerates change the scheduling of audits as per manpower available and the spillover of units remains to be audited.

The DG (Audit) further stated that DDM had been requested to provide for a facility in the system to enable generating information for the selected period and they are working on it.

The failure of the Department to furnish this data reveals major shortcoming in data keeping of the Department.

The result of the audit conducted by the Department is shown in table 5.2.

Table 5.2: Total detection made vis-à-vis units audited by Internal Audit

(₹ in crore)

Year	Category	Total units audited	Short levy detected	Total recovery	Recovery as % of Total detection
FY18	Large Units	2,521	2,441	581	23.80
	Medium Units	4,473	994	319	32.09
	Small Units	9,173	643	302	46.97
	Total	**16,167**	**4,078**	**1,202**	**29.48**

Source: Figures furnished by the Ministry.

It is observed that amount of short levy detected and recovered in Large units is significantly higher than other units but the total amount recovered in comparison to detected amount is higher in the Small and Medium units. The Department may look into the reasons for less recovery in Large units.

During the test check of records in departmental units during FY18, we noticed 16 instances of non-coverage of due units for audit, non-preparation of assessee master file, delay in issuance of Quality Assurance Report (QAR), delay in follow-up action etc. in eight Commissionerates[52] and Office of the Additional Director General of Audit, Mumbai. The revenue involved in these cases was ₹ 22.33 crore.

Apart from the above, we also issued 51 draft paragraphs (included in Section C of *Appendix-I*) involving revenue of ₹ 94.17 crore where due to inadequacies in the system of internal audit, short/non-payment of tax, non-payment of interest on delayed payment of tax etc. were not detected. In 19 cases, the Ministry accepted the audit observations, in 26 cases the Ministry accepted the revenue loss but did not accept the departmental failure and in six cases, the Ministry did not accept the audit observations.

A few illustrative cases are given below:

5.7.1 Non Coverage by Internal Audit

During scrutiny of records relating to Internal Audit of the Department we observed, in five Commissionerates[53] that out of 4,540 units planned for audit during FY16, FY17 and FY18, 3,641 units (80 per cent) were not audited by the Department.

When we pointed this out (May 2017), the Ministry stated (October 2018) that the observations of audit had been noted and the audit officers had been sensitized in this regard.

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[52] Hyderabad Audit, Mumbai Audit-I, Pune ST Audit, Lucknow Audit, Chennai Audit-I, Kolkata Audit-I, Kolkata Audit-II and Mumbai West.

[53] Chennai Audit-I, Coimbatore Audit, Kolkata Audit-I, Kolkata Audit-II and Pune ST Audit.

5.7.2 The failure to audit may also be due to lack of proper execution of audit planning and monitoring. On scrutiny of records of Pune ST Audit Commissionerate it was observed (May 2017) that in respect of audit of Large and Medium category units, the Department took 18 days to 9 months for audit which is in violation of para no. 4.3.1 of Central Excise and Service Tax Audit Manual (CESTAM), 2015 which provided duration of six to eight, four to six and two to four working days for audit of units under the Large, Medium, and Small categories, respectively.

When we pointed this out (May 2017), the Pune ST Audit Commissionerate stated (May 2018) that more number of days than time framed were taken because the assessees did not submit the required information in time.

The reply is not acceptable as the number of days taken were abnormally high which indicates inadequacy in the functioning of the Department.

5.7.3 During the test check of records we observed, in four Commissionerates, one Division and DG (Audit) Mumbai that

- Quality Assurance Review Reports of DG Audit were communicated to the higher authorities with delay ranging from 12 days to 131 days in the ADG (DG Audit) Mumbai.
- No monthly scoring for audit reports was done in 24 cases in the Mumbai Audit-I Commissionerate.
- The Assessee Master Files were not being prepared/updated in two Commissionerates which would result in selection of assessees for audit without applying the norms.
- In Mumbai Audit-I Commissionerate, in 13 cases the audit was pending even though the intimations were sent to the assessees before one year. Out of these, in two cases audit plan was approved and in five cases records were already received by the audit groups.
- In 13 cases of Mumbai Audit-I Commissionerate and eight cases in Lucknow Audit Commissionerate, there was delay in finalization of Final Audit Report (FAR) beyond 15 days of Monitoring Committee Meeting (MCM). In three Commissionerates, there was delay ranging from 14 days to 148 days in issuance of FAR and Draft Audit Report (DAR).
- On scrutiny of FAR of Mumbai Audit-I Commissionerate, it was observed that in 52 cases there were no verification reports as required in the Para 4.6.1 and Para 7.6.2 Central Excise and Service Tax Audit Manuals respectively and thus, there was non-monitoring of

submission or receipts of the information required for the evaluation of the performance of the audit groups.

- It was observed in Mumbai Audit-I Commissionerate that 45 Paras involving revenue of ₹ 22.33 crore were pending for further action as prescribed in the CESTAM after finalisation of internal audit and acceptance in the MCM. The delay ranged from two to six months in 28 cases and more than six months in 17 cases.
- In Division–VI of Mumbai West Commissionerate, we observed that internal audit detected that an assessee had provided Business Support service to a related company but Service Tax of ₹ 4.92 lakh was not paid. This observation was incorrectly dropped stating that there was no service provider-receiver relationship though both were legally different entities. This indicates that no proper follow up action was taken despite the fact that the objection was accepted in MCM and SCN was issued.
- Scrutiny of QAR files of Additional Director General (ADG Audit) Mumbai Zone revealed that revenue profile of the Commissionerates was not available.

It appears from the audit observations that the various provisions of Service Tax Audit Manual 2011 and CESTAM 2015 were not being followed by various field formations. Since internal audit is one of the main functions of the Department to ensure compliance to various provisions and procedures, its effectiveness needs to be ensured.

The Ministry in its reply stated (October 2018) that concerned Commissionerate had already been informed to take necessary steps in future.

5.7.4 Ineffective Mechanism to keep records related to Internal Audit Reports

As per Para No. 8.2.2 of CESTAM 2015, Monitoring Committee Meeting (MCM) should be convened by the Audit Commissionerate, to which the Executive Commissioner or his representative shall be invited to attend. The decision taken by the Audit Commissioner, with regard to settlement of audit observations after recovery of all dues or dropping of the unsustainable audit observations, shall be final. Approved audit observations, including those in which show cause notices are proposed to be issued, should be conveyed to the Executive Commissioner in the form of Minutes of the MCMs, who shall respond to these objections conveying his agreement/disagreement within 15 days of the receipt of the minutes of the MCM.

In view of the above, the Executive Commissionerates should have full information regarding the internal audit of the units falling under its jurisdiction.

We noticed that in case of 21 assessee units, the Executive Commissionerate could not furnish the information whether the assessees were audited by the Department or not. Of these, in 20 cases the Ministry accepted the audit observations for revenue involved but regarding information pertaining to internal audit, it stated that the same may be collected from the Audit Commissionerates and in one case the Ministry's reply was silent on information regarding internal audit of the unit.

One illustrative case is given below:

5.7.4.1 As per Section 67(3) of the Finance Act, 1994 the gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such services. Further, as per Rule 3(b) of Point of Taxation Rules, 2011 with regard to the receipt of payment for the taxable services provided or advance payment received towards taxable services to be provided in future, the point of taxation is date of receipt of payments. In terms of Section 75 of the Act, delay in payment of Service Tax, including a part thereof, attracts simple interest.

An assessee in Hyderabad GST Commissionerate (erstwhile Hyderabad II Commissionerate), received advances amounting to ₹ 6.01 crore at the rate of 25 per cent of the total sanction fee for setting up Wind Power Projects at various sites in Andhra Pradesh from different firms during FY15 and FY16. However, the assessee had not paid Service Tax on such advances received which was in contravention of the Rules mentioned above. This had resulted in non-payment of Service Tax of ₹ 74.24 lakh which was required to be recovered along with interest.

When we pointed this out (March 2017), the Ministry accepted (July 2018) the audit observation and intimated that the assessee paid Service Tax of ₹ 74.24 lakh along with interest of ₹ 42.02 lakh in September 2017. The Ministry further stated that the CAG Audit may seek details of internal audit from the concerned Audit Commissionerate.

The reply of the Ministry regarding furnishing of details of internal audit is not acceptable in view of the provisions cited above regarding sharing of the information regarding result of internal audit with Executive Commissionerate by the Audit Commissionerate as per the mechanism provided in CESTAM 2015. Thus, the inability of Executive Commissionerates to furnish the information about internal audit shows improper maintenance

of important data by the Department and ineffectiveness of monitoring mechanism.

5.7.5 Non-detection of lapses by Internal Audit Parties (IAP)

The IAPs carry out the audit of assessee units in accordance with the Audit Plan and as per the procedures outlined in the Service Tax Audit Manual, 2011 replaced with Central Excise and Service Tax Audit Manual, 2015 (CESTAM 2015).

During the course of audit, we examined the quality of audits undertaken by the IAPs by auditing a sample of assessees audited by the IAP. Of the 30 instances (Section C of *Appendix-I)* involving revenue of ₹ 86.20 crore where we pointed out omission of IAPs to detect certain significant issues of non-compliance by assessees, the Ministry accepted 19 cases. Of the remaining 11 cases, the Ministry accepted the revenue loss in five cases but did not accept the departmental failure and in six cases, it did not accept the audit observations.

A few instances are illustrated below:

5.7.5.1 Non-payment of Service Tax

As per section 66B of The Finance Act 1994, there shall be levied a tax (hereinafter referred to as the Service Tax) at the rate of fourteen per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed. Further, as per Section 66E(e) of Finance Act 1994,'agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act' is a declared service.

An assessee in Mumbai South Commissionerate, has been in the business of providing finance to the customers purchasing vehicles manufactured by its parent company. With regard to this business activity, the assessee had entered into an agreement with its parent company. For seamless financing to the customers purchasing vehicles manufactured by it, the parent company had agreed to compensate the losses which might arise out of default of loan repayment by its customers to the assessee and other expenses. Since the assessee was not providing any loan to the parent company directly, the compensation received from it could not be treated as interest income. Instead, this was a business income directly related to its business activity pertained to the service provided in accordance with the agreement with the parent company. During FY16 and FY17, the assessee received an amount of ₹ 295.81 crore and ₹ 148.28 crore respectively as

as shown in the Profit and Loss Account. No Service Tax was paid by the assessee on this amount. This resulted in non-payment of Service Tax of ₹ 62.91 crore.

When we pointed this out (October 2017), the Ministry stated (August 2018) that no service was provided by the assessee and the transaction is merely a monetary transaction. No nexus of service provided and consideration received exists in the transaction. Terms and nomenclature of the agreement is not the conclusive factor to be considered in determining the nature of the transaction. No toleration of any act is involved in the issue. The amount received is principal and interest, which was not paid by the customers. Hence, this amount is not liable to Service Tax. The reply of the Ministry is not acceptable due to the fact that the assessee had provided the loans to the customers of the parent company on agreed terms in lieu of compensation for its loss. This activity is covered under the declared service as per the provision cited above.

5.7.5.2 Non-payment of Service Tax on recovery of liquidated damages

As per clause (e) of Section 66E of the Finance Act, 1994 (inserted with effect from 01 July 2012), 'agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act' will constitute a declared service.

An assessee in Kochi Commissionerate had recovered/claimed liquidated damages amounting to ₹ 10.07 crore, ₹ 33.46 lakh and ₹ 20.66 lakh in FY14, FY15 and FY16 respectively, from various works/supply contractors. Even though the assessee had recognized the liquidated damages as income in accounts, no Service Tax was paid. This had resulted in non-payment of Service Tax ₹ 1.32 crore during FY14 to FY16.

When we pointed this out in consecutive audits (September 2015 and September 2016), the Ministry stated (July 2018) that the audit observation was acceptable and SCN demanding Service Tax of ₹ 1.32 crore was being issued.

5.7.5.3 Short-reversal of CENVAT credit

The provider of service, opting not to maintain separate accounts for receipt and use of inputs/input services utilised for provision of both taxable and exempted services, has to reverse the CENVAT credit pertaining to the input services utilised for provision of exempted services by opting any one of the methods under Rule 6(3) or 6(3A) of CENVAT Credit Rules, 2004.

An assessee in Bengaluru North Commissionerate, is engaged in provision of taxable services of maintenance and repair services and information technology software services. The assessee was engaged in providing certain exempted services under both the categories and was also in trading activity, which was also an exempted service. The assessee availed CENVAT credit in full on all the input services utilised for providing both the exempted and taxable services. Verification of the Service Tax records revealed that the assessee short-reversed CENVAT credit under Rule 6 ibid to the extent of ₹ 2.43 crore for FY15 to FY16 due to error in calculation.

Two internal audits carried out by the Department covering the period from April 2014 to June 2017 failed to detect this short-reversal resulting in error remaining undetected until pointed out by CAG Audit.

When we pointed this out (December 2017), the Ministry stated (August 2018) that the CAG Audit had not furnished the documents along with the objection.

The reply of the Ministry is not acceptable as we mentioned the source of information[54] in respect of each of the figures adopted for calculation of objected amount alongwith audit observation. The Department could have collected these documents from the assessee.

5.7.5.4 Short-payment of Service Tax

Section 67 of the Finance Act, 1994 provides that Service Tax has to be paid on the gross amount charged by the Service Tax provider.

An assessee in Bengaluru South Commissionerate, a statutory corporation owned by the Government of Karnataka, is engaged in operation of the public transportation system in Bengaluru. In addition to providing transportation to the public, the assessee earns income by leasing out the buses and the buildings owned by it and also by allowing its premises and buses for displaying advertisements of various entities. The assessee was paying Service Tax on these services. A verification of the Service Tax records of the assessee revealed that the assessable value of these services declared by the assessee in the ST-3 Returns was less than the service charges collected as per the ledger accounts during the period from April 2014 to September 2016. This resulted in short-payment of Service Tax of ₹ 1.26 crore during the said period.

The internal audit carried out (January 2015) by the Department detected the non/short-payment of Service Tax in respect of renting of immovable

[54] Financial Statements and ST-3 returns of the assessee.

properties for the period upto September 2014. Even though the assessee paid the amounts as per the internal audit observation, similar short-payment persisted for the subsequent period from October 2014 onwards. However, the Department did not issue any SCN for the subsequent period as part of the follow-up action. Subsequent internal audit carried out (March 2017) by the Department also failed to detect this short-payment. Further, the short-payment of Service Tax on renting of motor vehicles and allowing space for advertisements was not detected during both the internal audits.

When we pointed this out (July 2017), the Ministry accepted the audit observation and stated (August 2018) that the assessee had paid Service Tax of ₹ 0.52 crore in respect of renting of immovable property.

For the failure of IAP, the Ministry stated that the Commissionerate had been requested to call for an explanation from the concerned audit officers and take appropriate action accordingly.

5.7.5.5 Irregular availing of CENVAT credit

Rule 9(1) of CENVAT Credit Rules, 2004, prescribes the documents on the basis of which CENVAT credit can be taken by a provider of output service. As per clause (bb) of the said rule, CENVAT credit is not allowed on the basis of a supplementary invoice, bill or challan issued by a provider of output service, where the additional amount of tax became recoverable from the provider of output service, on account of non-levy or non-payment or short-levy by reason of fraud or collusion or willful mis-statement or suppression of facts or contravention of any of the provisions of the Finance Act or of the rules made thereunder with the intent to evade payment of Service Tax.

Audit of Range-III (erstwhile Range-II of BBD Bag-II Division) of BBD Bag II Division under Kolkata North GST Commissionerate (erstwhile Kolkata ST-I Commissionerate) was conducted in January 2017. During audit of accounts relating to Service Tax of the said Range and subsequent verification of documents of an assessee, we found that the assessee had taken CENVAT credit on input services on the basis of supplementary invoices issued by two service providers who had not discharged their Service Tax liability from FY11 to FY15 in contravention of the provisions of the Finance Act, 1994 and discharged their Service Tax liability only after the pursuance of an investigation by anti-evasion unit of Kolkata ST-I Commissionerate in February 2016. Subsequently the said two service providers issued supplementary invoices for passing the CENVAT credit and the assessee

availed the same. This had resulted in irregular availing of CENVAT credit of ₹ 94.61 lakh during FY16.

The internal audit party had audited the assessee in January 2017 for the period upto FY16 but this lapse was not detected, resulting in error remaining undetected until pointed out by CAG audit.

When we pointed this out (June 2017), the Ministry admitted the audit observation (August 2018) and reported that the demand had been confirmed alongwith penalty.

5.8 Investigation by the Anti-Evasion Cell

As per the provisions under Preventive & Investigation Manual, senior officials are required to be involved in the investigations and review the cases for their focused, effective and expeditious completion. Though no specific time limit was prescribed for the completion, it is expected that even a complicated case should not take more than six to nine months to investigate. Section 11 of Central Excise Act, 1944 and Section 87 Finance Act, 1994 provides for various modes of recovery of duty/tax and any other sums of any kind payable to the Central Government under any of the provisions of the Act or of the Rules made there under.

During the test check of records in FY18, we noticed 36 instances of tardy investigation in anti-evasion cases in four Commissionerates[55] due to which investigation of routine verification of data was not completed even after lapse of more than one year. The revenue involved in these cases was ₹ 2.50 crore. Some illustrative cases are as follows:

5.8.1 During the course of audit of Anti Evasion Cell in Mumbai ST-IV Commissionerate, it was noticed that an investigation in case of an assessee was initiated in November 2013. However, till August 2016 no action was taken. It was further seen that the investigation had not been concluded till date (July 2018).

Similarly, during the course of audit of Anti Evasion Cell in Mumbai ST-V Commissionerate, an investigation was initiated against an assessee for the period FY14 to FY17 for non/stop filing of returns in December 2016. Documents submitted by the assessee revealed Service Tax liability of ₹ 46.58 lakh and interest liability of ₹ 35.62 lakh. However, investigation was not completed even after one year.

The Ministry stated (October 2018) that the reply would follow.

[55] Mumbai East, Mumbai ST-II, Mumbai ST-IV and Mumbai ST-V.

5.9 Disposal of Refund Claims

Section 11B of the Central Excise Act, 1944 provides the legal authority for claim and grant of refund. Further, section 11BB of the Act stipulates that interest is to be paid on refund amount if it is not refunded within three months of the date of application of refund. The Central Excise Manual prescribed that the Department should accept refund claims only when accompanied with all supporting documents as refund claims without requisite documents may lead to delay in sanction of refunds. The Central Excise Act provisions regarding refund claims apply to Service Tax also.

Table 5.3 depicts the status of disposal of refund claims by the Department. The delay depicted is in terms of time taken from the date of receipt of refund application till the final processing of the claims.

Table 5.3: Disposal of refund claims in Service Tax

(₹ in crore)

Year	Opening Balance		Receipt (during the year)		Disposal (during the year)				Cases where interest has been paid		No. of Cases Disposed within 3 Months
					Sanctioned		Rejected				
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Interest paid	
FY16	20,740	12,370	26,230	10,633	23,860	6,598	7,973	6,302	0	0	1,131
FY17	12,243	8,319	33,343	14,792	28,154	9,953	7,165	5,954	4	6	1,632
FY18	10,089	6,904	22,065	10,469	16,412	5,567	4,014	3,485	11	0.01	13,020

Source: Figures furnished by the Ministry.

It is observed that both number of refund cases disposed-off as well as amount sanctioned had decreased substantially in FY18 as compared to FY17. Out of a total of 20,426 cases disposed in FY18, 13,020 cases *(63.74 per cent) were processed within the stipulated three months period.* This is a steep increase as compared to disposal of 5.80 per cent cases within three months in FY17. The Department had paid interest only in 11 cases for delay in sanctioning the refund. Though there was a delay in around 36 per cent of disposals but interest was not paid in almost all the cases of delayed refunds, both of which were in violation of provisions of the Act.

Table 5.4 depicts an age-wise analysis of pendency of refund claims during last three years.

Table 5.4: Age-wise pendency of Service Tax refund cases as on 31 March

(₹ in crore)

Year	OB plus claims received in the year	Total number of refund claims pending as on 31 March		Refund claims pending for			
				Less than one year		Over 1 year	
		Number	Amount	Number	Amount	Number	Amount
FY16	46,970	12,243	8,319	9,403	5,146	2,840	3,173
FY17	45,586	10,089	6,994	9,063	6,035	1,026	959
FY18	32,154	9,266	7,207	8,266	5,674	1,000	1,533

Source: Figures furnished by the Ministry.

It is observed that the number of refund claims pending, including those pending for over one year had decreased slightly, but amount involved had increased substantially in FY18 as compared to FY17. Closing balance figure of FY18 does not appears to be correct. The correct figure, arrived by opening balance plus addition during the year minus disposal during the year, as provided by the Ministry, should be 11,728. But the closing balance furnished by the Ministry is 9,266. The Ministry may look into the reasons for this discrepancy.

The Department did not maintain the age-wise breakup of the cases pending for more than one year. These details would help the Department to keep watch on cases pending for too long. The Ministry may revise its MPRs format to capture the age-wise break up.

During the test check of records in departmental units in FY18, we noticed seven instances of delay in sanctioning of refunds, irregular sanctioning of refunds etc. in six Commissionerates[56]. The revenue involved in these cases was ₹ 87.39 crore.

Apart from the above, we also issued two draft paragraphs (included in Section D of *Appendix-I*) where shortcomings in disposal of refund claims by departmental officers were noticed that would have remained undetected if not pointed out by CAG Audit. The Ministry accepted the revenue loss in both cases but did not accept the departmental failure.

A few illustrative cases are given below:

5.9.1 We observed (April 2017) during scrutiny of refunds sanctioned by the Division-II of Ahmedabad-I Commissionerate during FY13 to FY17 that in one case, the claim was rejected due to unjust enrichment. The refund of ₹ 7.76 lakh claimed by an assessee was ordered to be credited to the Consumer Welfare Fund by the Assistant Commissioner vide OIO dated 30 October 2013 and a copy of the OIO was also marked to the PAO, Ahmedabad for credit of refund amount in Consumer Welfare Fund.

Commissioner (Appeals) Ahmedabad remanded the case back to the adjudicating authority on appeal filed by the refund claimant against which Department filed appeal (challenging remand authority of Commissioner-Appeals) in CESTAT and entered the case in Call Book which was subsequently withdrawn by the Department. Accordingly, the refund claim was retrieved from the Call Book and the Assistant Commissioner again ordered the claim of ₹ 7.76 lakh to be credited to the Consumer Welfare

[56] Delhi ST-II, Mumbai Central, Mumbai South, Ahmedabad-I, Ahmedabad ST and Bengaluru ST-II

Fund vide OIO dated 10 November 2016 and a copy of the OIO was again marked to the PAO, Ahmedabad. Thus, it was noticed that through two different OIOs (October 2013 and November 2016), refund of ₹ 7.76 lakh were ordered to be credited in Consumer Welfare Fund. The PAO, Ahmedabad also confirmed (April 2017) the double credit of refund amount.

When we pointed this out (April 2017), the Ministry stated (October 2018) that PAO, Ahmedabad had requested (July 2017) Principal CCA, the Board, New Delhi to revert the duplicate sanction of refund.

5.9.2 As per Paragraph 2.2 of the Board's Circular No.869/07/2008-CX, dated 16 May 2008, all refund/rebate claims involving an amount of ₹ 5 lakh or above should be subjected to pre-audit at the level of Deputy/Assistant Commissioner (Audit) in the Commissionerate Headquarters Office.

During test check of the refund claims sanctioned in the Division-II of Ahmedabad ST Commissionerate (now GST Division.-VI, Ahmedabad-South), it was noticed that one refund claim of an assessee of ₹ 69.05 lakh was sent by the Division office for pre-audit to Commissionerate Audit, Service Tax. This was returned (January 2017) by the Assistant Commissioner (Audit), Service Tax without conducting pre-audit stating that the claimant was not registered with Service Tax Ahmedabad Commissionerate. It was noticed that the refund of ₹ 69.05 lakh was sanctioned (February 2017) by the Department without pre-audit which was in violation of the Board's instructions above.

When we pointed this out (January 2018), the Ministry stated (October 2018) that the adjudicating authority sanctioned the refund as time limit for it was elapsing immediately.

Reply of the Ministry is not acceptable as the Commissionerate where the assessee was registered should have been identified to follow the procedure before sanctioning the refund. Thus, sanctioning of refund without conducting pre-audit was in violation of the Board's instructions above.

5.9.3 Ineffective follow up action on refund order

Rule 5 of CENVAT Credit Rules, 2004, allows an exporter of service to avail refund of CENVAT credit of input or input services utilized towards the output services exported where such credit remains unutilized. Such refunds were subject to the conditions prescribed vide Notification No. 5/2006-CE(NT) dated 14 March 2006 and the sanctioning authority should ensure reversal of the said amount in the CENVAT Account after sanction of refund.

5.9.3.1 An assessee in Bengaluru ST-II Commissionerate, filed (March 2012) a refund claim of unutilized CENVAT credit for the period from April 2011 to September 2011 in terms of the above notification. The Divisional Officer, while sanctioning (March 2016) the refund of ₹ 6.05 crore, ordered the assessee to reverse the said amount in the CENVAT Credit Account and submit documentary evidence of such reversal within one week from the date of receipt of the refund. However, the assessee did not carry out reversals in the CENVAT Credit Account. Although the assessee filed ST-3 Returns to the Range Officer without making such reversal in the CEVNAT Credit Account, the Department did not take any action thereon.

When we pointed this out (December 2016), the Ministry stated (June 2018) that the assessee had reversed (May 2017) ₹ 6.05 crore and exhibited the same in the ST-3 Returns for the period April 2017 to June 2017. The reply of the Ministry was silent on the failure of the jurisdictional officers.

5.9.3.2 An assessee in Bengaluru ST-II Commissionerate, filed (September 2012) a refund claim of unutilized CENVAT credit of ₹ 47.88 lakh covering the period from October 2011 to December 2011 in terms of the above notification. Refund of ₹ 40.85 lakh was sanctioned (June 2015) while the claim of ₹ 7.03 lakh was rejected as ineligible CENVAT credit by the Divisional Officer. The sanctioning authority ordered the assessee to reverse the entire amount of the refund claim in the CENVAT Credit Account and submit documentary evidence of such reversal within one week from the date of receipt of the refund. However, the assessee did not reverse the said amount in the CEVNAT account even after receipt of the refund. Although the assessee filed ST-3 Returns to the Range Officer exhibiting the refunded amount as part of the closing balance of CENVAT credit, the Commissionerate did not take any action to ensure the said reversal.

When we pointed this out (December 2016), the Ministry admitted (June 2018) the audit observation and stated that the assessee had reversed (March 2017) ₹ 47.88 lakh. The reply of the Ministry was silent on the failure of the jurisdictional officers.

5.10 SCN and Adjudication

Adjudication is the process through which departmental officers determine issues relating to tax liability of the assessees. Such process may involve consideration of aspects relating to, inter-alia, CENVAT credit, valuation, refund claims, provisional assessment etc. A decision of the adjudicatory authority may be challenged in an appellate forum as per the prescribed procedures.

Table 5.5: Disposal of SCN in Service Tax

(₹ in crore)

Year	Opening Balance		Receipt (during the year)		Disposal (during the year)		Closing Balance		Cases pending for more than 1 year
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	
FY16	33,136	78,529	34,613	76,592	37,296	78,997	30,453	76,124	8,587
FY17	30,453	76,124	54,310	67,413	65,710	74,596	19,053	68,941	6,919
FY18	19,053	68,941	35,173	70,918	34,180	57,220	22,208	81,280	5,789

Source: Figures furnished by the Ministry.

The total cases pending for adjudication increased by 16.56 per cent in FY18 as compared to FY17. However, the cases pending for more than one year decreased by 16.33 per cent. The total closing balance involved in these cases increased by 17.90 per cent in FY18 as compared to FY17. Closing balance figure (No. of cases) of FY18 does not appear to be correct. The correct figure should be total cases of the year minus total disposal which, as per the figures provided by the Ministry, works out to 20,046 but the figure furnished by the Ministry is 22,208. The Ministry may look into the reasons for this discrepancy.

During the scrutiny of records related to SCN and adjudication during FY18, we noticed delay in adjudication of 2,500 SCNs out of which 1,783 SCNs (71 per cent) were pending for more than one year, six instances of non-issuance of SCN and one instance of short demand in 15 Commissionerates[57]. The revenue involved in these cases was ₹ 8,295.98 crore.

Apart from the above, we also issued two draft paragraphs (included in Section E of *Appendix-I*) where late issuance of SCN by the departmental officers had resulted in demands being declared time-barred in adjudication order. The Ministry accepted the audit observation in one case and did not accept the audit observation in the other case although the issue involved and Commissionerate were same in both the cases.

A few illustrative cases are given below:

5.10.1 Division III of Mumbai East Commissionerate had issued SCN to an assessee for ₹ 57.72 crore for the period FY11 to FY12 and for ₹ 46.60 crore for the period FY13 on non-payment of Service Tax on service provided for the upkeep and maintenance of three 747-400 Aircrafts for VVIP operations. The Department did not issue periodical SCN for the subsequent period i.e. for FY14 on the ground that the assessee had made payment.

It was noticed (April 2018) from the records that budgetary provision of ₹ 84.06 crore had been made by Ministry of Defence, of ₹ 56.04 crore by

[57] Ahmedabad ST, Bharuch, Bolpur, Chandigarh-II, Gurugram, Haldia, Jamshedpur, Mumbai Audit-I, Mumbai Central, Mumbai West, Mumbai East, Navi Mumbai, Panchkula, Salem and Sonepat.

Ministry of External Affairs and of ₹ 196.14 crore by Ministry of Home Affairs for the maintenance cost to be paid to the assessee for FY14. Out of this, the assessee had received the entire amount from Ministry of Defence, whereas Ministry of Home Affairs had made part payment of ₹ 163.14 crore as against ₹ 196.14 crore and Ministry of External Affairs had not paid any amount. Thus, the assessee had received reimbursement of ₹ 247.20 crore for FY14 and paid Service Tax of ₹ 30.55 crore as against the Service Tax of ₹ 44.03 crore payable on ₹ 336.24 crore.

Thus, the assessee had not paid Service Tax of ₹ 13.48 crore on balance maintenance cost of ₹ 109.04 crore for FY14. However, the Department had neither issued periodical SCN for the same nor the assessee had clarified on non-payment of Service Tax on balance maintenance cost. This resulted in loss of revenue of ₹ 13.48 crore due to non-issue of periodical SCN within the prescribed time limit of 18 months.

The Ministry stated (October 2018) that the reply would follow.

5.10.2 Adjudication records of Division IV of Mumbai East Commissionerate revealed that an assessee was issued two SCNs in October 2011 and October 2012 for non-payment of Service Tax of ₹ 12.16 crore and ₹ 2.70 crore for the period upto FY11 and FY12 respectively on the various services. The same were adjudicated and demand was confirmed (May 2014) against which the assessee filed an appeal in the Tribunal. However, for the subsequent period the assessee paid the tax finally in all services except Business Auxiliary Service (BAS), which was made under protest. Thus, the assessee had paid Service Tax of ₹ 6.49 crore for the period FY14 & FY15 and out of this, payment against BAS was still disputed by the assessee. Service Tax payment details for FY13 were not available on record. As such, Department should have continued to issue SCN for further period on BAS in order to protect the Government revenue. However, the Department had discontinued issuing SCNs from FY13 onwards in respect of all the services including BAS, which was not in order as the revenue to the extent of ₹ 6.49 crore (for FY14 & FY15) remained legally unprotected.

The Ministry stated (October 2018) that the reply would follow.

5.10.3 During the scrutiny of records of Division-V of Navi Mumbai Commissionerate, it was observed that an assessee was issued SCN for the period from 2007 to 2011 in 2012 and for FY12 in 2013 on differential amount between Financial Accounts and ST-3 returns. Thereafter, periodical SCN was issued on 27 September 2017 for FY14. However, periodical SCN for FY13 could not be issued due to elapse of last date of issue of periodical SCN.

It was observed (April 2018) in audit that as per the Profit and Loss Accounts for FY13 the total revenue was ₹ 8.96 crore (including sale of services of ₹ 8.75 crore), against which the assessee had declared ₹ 6.45 crore in the ST-3 return, resulting in undischarged liability of Service Tax on differential amount of ₹ 2.51 crore (₹ 8.96 crore – ₹ 6.45 crore). The Service Tax liability on this amount works out to ₹ 30.17 lakh. Thus, non-issue of periodical SCN resulted in loss of revenue of ₹ 30.17 lakh besides penalty and interest.

The Ministry stated (October 2018) that the reply would follow.

5.10.4 During the test check of records of Division-III of Mumbai East Commissionerate, it was observed that an assessee was issued SCN of ₹ 11.83 Crore for the period from April 2009 to June 2012. Subsequently, periodical SCNs were issued for the period from July 2012 to March 2015. However, for FY15, Department had incorrectly worked out non-payment of Service Tax of ₹ 7.15 crore instead of ₹ 7.58 crore, which resulted in short demand of ₹ 43.60 lakh.

The Ministry stated (October 2018) that the reply would follow.

5.10.5 Section 73 (I) of the Finance Act, 1994 states, inter alia, that where Service Tax has not been paid or short paid, SCN is to be served within one year from the relevant date in normal case (with effect from 28 May 2012, within eighteen months) and within five years from the relevant date in case of fraud, collusion, wilful suppression of facts etc. with the intent to evade payment or to get erroneous refund.

5.10.5.1 During audit of the Dibrugarh Commissionerate, in February 2018, it was observed that Department had issued SCN to an assessee on 28 September 2015 showing demand of ₹ 32.86 lakh (alongwith interest and penalty) for the period FY12 to FY15 (upto November 2014) invoking extended period of time limit for issue of non-payment of Service Tax under "Supply of Tangible Goods" service and the said demand was confirmed by the Adjudicating Authority vide his order dated 18 March 2016. Subsequently, the Appellate Authority vide his order dated 15 February 2017 had dropped the demand partially (demand pertaining to period prior to 24 October 2013) on the ground that the portion of the demand in SCN was barred by limitation of time. Thus, non-issue of SCN in time had resulted in loss of revenue of ₹ 14.76 lakh.

Similar irregularities were also observed in the same Commissionerate in respect of three assessees for which loss of revenue of ₹ 13.71 lakh, ₹ 12.45 lakh and ₹ 15.45 lakh respectively had occurred. Total revenue loss due to delay in issue of SCN was of ₹ 56.37 lakh.

Thus, incorrect invocation of extended period of time for issuance of SCN by the Commissionerate resulted in demand being held time barred by the Appellate Authority resulting in loss of revenue.

When we pointed this out (February 2018), the Ministry stated (August 2018) that the issue was already in the knowledge of the Department.

The reply of the Ministry is not relevant to the audit observation regarding failure to issue SCN within time by the Department due to which demands had been declared time barred in adjudication.

5.10.5.2 The same Commissionerate (Dibrugarh Commissionerate) had issued (April 2014) an SCN to an assessee showing demand of ₹ 21.70 lakh for the period FY11 and FY12 invoking extended period of time limit for issue. The SCN was issued on the basis of the observation raised by the Internal Audit in February 2013.

The Adjudicating Authority vide order dated 27 November 2014 had dropped the said demand on the ground that earlier SCN covering period October 2008 to June 2010 on the same issue and same contract was issued to the assessee on 14 March 2013 invoking extended period of time and the Department was quite aware of the activities performed by the assessee since 2008. Hence, the allegation of suppression of fact by the assessee in the second SCN was not sustainable as the activity performed by the assessee was a continuous process and the Department could have issued the SCN periodically within normal time limit. Thus, non-issue of SCN within time limit had resulted in loss of revenue of ₹ 21.70 lakh.

When we pointed this out (February 2018), the Ministry accepted (August 2018) the audit observation and stated that responsibility was being fixed on the concerned officers for such lapse.

5.11 Other Lapses

We noticed 11 cases (included in Section F of *Appendix-I*) involving revenue of ₹ 6.10 crore indicating shortcomings in functioning of jurisdictional Commissionerates. The Ministry accepted the audit observations in seven cases and in four cases, the Ministry accepted the revenue loss but did not accept the departmental lapse.

A few instances are illustrated below:

5.11.1 Shortcomings in follow-up action

The internal control mechanisms in the Department like scrutiny of returns or Internal Audit would have the required impact only if the jurisdictional officers take proper follow up action on the lapses noticed earlier.

An assessee in Ahmedabad North Commissionerate, had persistently delayed the payment of Service Tax due during the period covered by Audit i.e. FY13 to FY17, without paying any interest under Section 75 of the Finance Act, 1994. Preventive wing of the Department had commented upon (July 2016) the interest liability and penalty of the assessee upto December 2015 despite which the assessee kept on delaying payment of Service Tax for the further period without discharging its interest liability. Interest payable on delayed payment of Service Tax for the period January 2016 to February 2017 amounted to ₹ 33.31 lakh.

When we pointed this out (May 2017), the Ministry accepted (October 2017) the audit observation and informed that the assessee had paid (May to October 2017) the objected interest amount of ₹ 33.31 lakh. Further, the Ministry stated that as the assessee had been penalized to pay the interest as per the law, no action was warranted against the Range Officer.

The reply of the Ministry is not acceptable as despite being a habitual offender and pointed out by the Preventive Wing, no coercive measure was taken by the Range Officer against the assessee until pointed out by CAG Audit.

5.11.2 Persistent Irregular availing of CENVAT credit on the basis of invalid documents

According to Rule 9(I) of CENVAT Credit Rules, 2004, CENVAT credit shall be taken on the basis of an invoice/bill/challan issued by a provider of output service. As per rule 4(A1) of Service Tax Rules, 1994, every person providing taxable service shall issue an invoice/bill/challan duly signed, serially numbered and containing name, address and the registration number of such person; the name and address of the person receiving taxable service; description, classification and value of taxable service provided or to be provided; and the Service Tax payable thereon. As per proviso to this sub-rule, in the case of banking company, invoice/bill/challan shall include any document, by whatever name called, whether or not serially numbered, and whether or not containing address of the person receiving taxable service but containing other information as required under Rule 4 (A)(1).

A Service Tax assessee under Calicut Commissionerate, providing banking and other financial services, availed and utilized CENVAT credit of ₹ 38.75 lakh without invoices, during the period May 2013 to March 2014. The credit was availed based on e-statements of transactions in relation to National Financial Switch (NFS) operations, a shared Automated Teller Machine (ATM) network which inter-connected different Bank's ATM switches and was operated by a service provider as authorized by Reserve Bank of India.

In September 2010, same issue was pointed out vide para no. 6.1 of the CAG's Audit Report No. 4 of 2015 in respect of another assessee in the same Commissionerate, on which the Department issued SCN in the year 2012. But action was not taken to identify similar irregular availing of credit on NFS operations by the assessee.

When we pointed this out (January 2015), the Ministry accepted the audit observation and stated (August 2018) that SCN dated 11 April 2016 was issued to the assessee demanding ineligible CENVAT credit of ₹ 1.66 crore taken and utilized during the period April 2011 to March 2015 alongwith interest and penalty. The Ministry further stated that the concerned Commissioner had been asked to sensitize the jurisdictional and internal audit officers to be more careful in dealing with potential revenue risk cases.

5.11.3 No action taken by the Range Officer regarding belated filing of revised ST-3 return

Rule 7B of the Service Tax Rules, 1994, stipulated that an assessee may submit a revised return, in Form ST-3, to correct a mistake or omission, within a period of ninety days from the date of submission of the return under Rule 7 (i.e. the date of filing of original return).

An assessee falling under the jurisdiction of Range-II, Division-Anjar (Bhachau), Kutch Commissionerate (Gandhidham) had made short payment of Service Tax amounting to ₹ 11.75 lakh during the period October 2013 to March 2014, which was revealed from its ST-3 return of the given period.

The assessee, subsequently, submitted revised ST-3 return for the half year April 2013 to September 2013 (i.e. period prior to the given period of default) on 27 May 2015 in which it showed that it had made excess payment of duty against the Service Tax actually due. It appeared from the departmental correspondence that the assessee intended to adjust the excess payment (shown in revised return) of the prior period to cover the short payment made during the subsequent half year (i.e. October 2013 to March 2014).

However, since the assessee had filed the revised return for the period April-September 2013 on 27 May 2015 (i.e. after 19 months from the date of original return filed on 23 October 2013) after the period of 90 days allowed under Rule 7B ibid, it had become time-barred and no amount claimed under revised return could be allowed to be adjusted in the subsequent return.

No action was taken by the range officer to disallow the belated filing of ST-3 returns to adjust the excess Service Tax paid earlier.

This resulted in short-payment of Service Tax amounting to ₹ 11.75 lakh which was required to be recovered along with applicable interest.

When we pointed this out (September 2016), the Ministry accepted (June 2018) the audit observation and stated that the assessee had deposited ₹ 11.75 lakh. The Ministry further stated that the assessee had not filed revised return online for the period April 2013 to September 2013 which was mandated by the law. Therefore, there was no lapse on the part of the jurisdictional range officer.

The reply of the Ministry is not acceptable as if the revised return was not filed by the assessee then the Range Officer should have taken rectificatory action to recover the short paid amount which was apparent from the original returns filed by the assessee for the relevant period.