Report of the Comptroller and Auditor General of India

for the year ended March 2012

Levy and collection of service tax on import of services

Union Government
Department of Revenue
Indirect Taxes – Service Tax
No. 9 of 2013
(Performance Audit)

Laid on the table of Lok Sabha/Rajya Sabha _____

Table of Contents

Preface

The Report for the year ended March 2012 on the performance audit of levy and collection of service tax on import of services has been prepared for submission to the President of India under Article 151(1) of the Constitution of India.

The audit of Revenue Receipts – Indirect Taxes of the Union Government is conducted under Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The observations included in this Report include findings in audit covering the period upto March 2012. The Report presents the results of our audit along with recommendations.

Executive Summary

- The department does not have a mechanism to arrive at a reliable estimate of value of taxable services imported. The department has however, initiated steps (since November 2011) to utilise primary data available with authorised dealers; the process is ongoing. (Paras 2.7 and 2.8)

- The department did not have any prescribed specific accounting codes or any alternative mechanism to arrive at reliable figures of the taxes collected relating to import of services. (Para 2.7)

- The system was not robust enough to provide information on the gap between the collectible tax and the tax actually collected. (Para 2.7)

- The department did not have a system to utilise data available with the Income Tax department relating to remittances to NRIs. (Para 2.12)

- RBI permits remittances towards import of services irrespective of non-fulfilment of corresponding service tax liability by the service recipient, in the absence of any requirement for submission of an undertaking by remitter/certificate from Accountant on the lines of the prescription in Income Tax.(Para 2.13)

- There was no system of calling for an Annual Information Return from identified parties such as authorised dealers. (Para 2.22)

- Non-fulfilment of liability by export oriented units and associated enterprises indicated the need for strengthening of monitoring on this front. (Paras 3.7 and 3.11)

- The department did not have in place a system to utilise data on high value transactions of specific nature available with certain Central Ministries/RBI to check possible cases of evasion of tax. (Para 3.16)

Chapter 1: Introduction

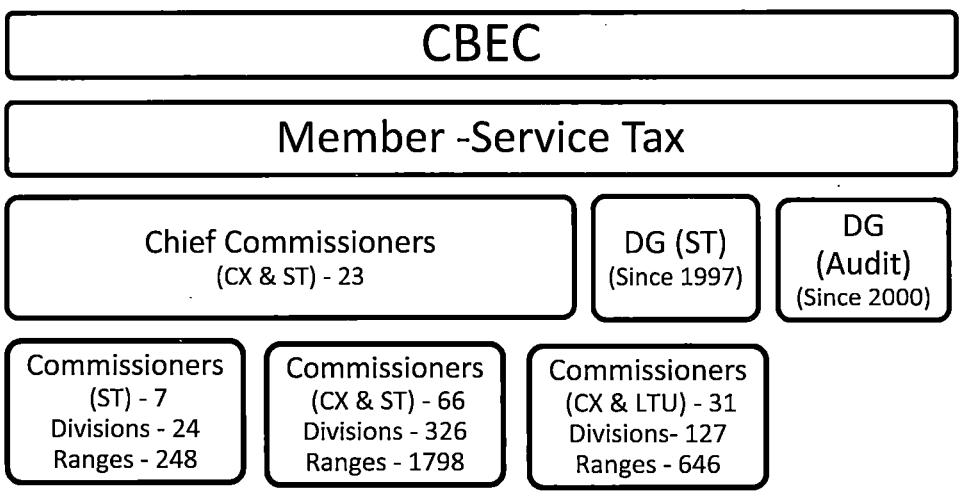
1.1 The essence of indirect (service) taxation is that a service should be taxed in the jurisdiction of its consumption. This principle is more or less universally applied. In terms of this principle, exports are not charged to tax, as the consumption is elsewhere, and services are taxed on their importation into the taxable territory.[1]

1.2 Import of services is one of the specified categories in the Finance Act/Service Tax Rules where liability to pay Service Tax (ST) falls on the service recipient based on the reverse charge mechanism. Under reverse charge method, a legal fiction is created as if the recipient had himself provided the services domestically and accordingly, the recipient of service is treated as deemed service provider.[2] ST liability in respect of import of services is now recognised as effective from 18 April 2006, the date of enactment of section 66A of the Finance Act, 1994.

Organisational set up

1.3 Central Board of Excise and Customs (CBEC) administers the levy, assessment and collection of ST through the field formations under its control. 77 Commissionerates which include 7 exclusive ST Commissionerates, 66 integrated Central excise and ST Commissionerates and 4 Large Taxpayer Unit Commissionerates assess and collect ST across the country. Besides, the Government constituted an office of the Director General (ST) as a subordinate office in 1997 to coordinate ST work. The functions and powers of Director General (ST) include suggesting measures to increase revenue collection, streamlining procedures, study of law and procedures regarding ST to simplify the ST collection and assessment, and monitoring ST collections.

1.4 The following chart depicts the organisational structure under CBEC including subordinate formations, concerned directly or indirectly with the collection of ST revenues and the monitoring of the same.



[1] CBEC's Taxation of Services –An Education Guide.
[2] JS(TRU)'s letter dated 19 April 2006 (F. No. B1 / 4 / 2006-TRU) to CBEC Members and Commissioners

1.5 At the base of the hierarchy, the ranges headed by the Superintendents (Range Officers) are responsible for a variety of tasks including scrutiny of assessments, recovery of arrears of revenue and audit compliance. As part of the compliance verification mechanism, audit parties under the Internal Audit Wing of the Commissionerate conduct audit at assessee premises. The Director General of Audit, who is responsible for institutionalization of a credible audit system, provides functional direction in planning, co-ordination, supervision and conduct of audits by officers at field formations.

1.6 The department carries out most of its functions relating to ST by diverting staff from central excise and customs. The Union Cabinet had sanctioned 2094 posts for ST related functions in 2007. Cadre restructuring proposal (2010) updated in 2012 to seek inter alia, 14990 posts exclusively for ST, has been forwarded to the Department of Personnel and Training.

Why we chose the topic

1.7 Significant rise in volume of imported services consequent upon liberalization and global integration would imply that collections of consumption based ST should also rise. During a preliminary study, Audit identified 37 out of 99 purpose codes prescribed by RBI for reporting foreign exchange remittances as being prima facie likely to relate to transactions on which ST liability under section 66A would arise. The list of such purpose codes is annexed **(Appendix 1)**. As per the information reported by authorised dealers to RBI, remittances exceeding ₹ 8 lakh crore categorised under the 37 purpose codes have gone out of the country during the four years 2007-08 to 2010-11. Keeping in view the volume of remittances, we decided to examine the adequacy of statutory provisions, effectiveness of information gathering in the department as well as the adequacy of systems and procedures to minimise tax gap relating to ST liability on import of services.

Audit objectives

1.8 We conducted the performance audit based on the following audit objectives,

a. to evaluate effectiveness of systems in place, if any, to obtain and analyse data on foreign remittances from authorities such as Reserve Bank of India/authorised dealers/income tax department which could facilitate increase in tax collections as well as broadening of the ST base;

b. to evaluate effectiveness of systems and procedures to monitor and update status of taxpayer - as service provider/service recipient/both which would facilitate maintenance of database and monitoring of tax collections relating to import of services;

c. to evaluate adequacy of checks prescribed for scrutiny of returns in relation to import of services and compliance thereof; and

d. to ascertain whether liability to pay ST under reverse charge is taken as a risk parameter for selection of units while conducting audit checks by internal audit and whether the data of foreign remittances is/could be utilised as a key input for selection of units for audit.

Audit scope

1.9 We reviewed ST compliance in respect of cross-border transactions; and, restricted the scope of the review to the ST liability in respect of outward remittances through commercial banks as authorised dealers (among the authorised persons under section 10 of the Foreign Exchange Management Act, 1999). We limited the period of coverage to 2009-12. However, depending on the issues involved, we did look into data up to 2007-08 in some cases.

Audit Methodology

1.10 We carried out examination of records at selected Commissionerates as well as at premises of manufacturers and service providers, selected from the data of remittances through authorised dealers for which we approached RBI as well as the authorised dealers. There were 3 (out of 4) Large Taxpayer Unit (LTU) Commissionerates in 14[3] selected Commissionerates (out of 104) taken up by Audit for its review.

1.11 We also carried out visits to selected premises of service recipients as well as based on samples (registered service providers/manufacturers) selected through stratified sampling from their remittance details (under 37 identified purpose codes) obtained from Authorised Dealers. Fifty three authorised dealers, out of over a hundred approached by Audit furnished data pertaining to the period 2007-11. The data indicated over 11 lakh transactions totaling remittances worth ₹ 3.77 lakh crore over the period 2007-11. We selected fifty five registered manufacturers and 286 registered service providers for audit at their premises. In respect of multi-locational assessees, we scrutinised records at selected premises given our limitation of resources. We also selected 947 remitters possessing ST registration whom we approached through detailed questionnaires. We have also included audit observations from the pilot study. In certain cases where we wanted to lay emphasis on the system issues, we have retained some audit observations raised by CERA as well as by Internal Audit (as informed by the Ministry in its detailed reply dated 22 March 2013).

[3] Ahmedabad ST, Bengaluru ST & LTU, Chennai ST & LTU, Delhi ST, Hyderabad II & IV, Kolkata ST, Mumbai ST-I, ST-II & LTU, Noida & Panchkula

Legal provisions

1.12 An amendment incorporating an explanation (effective from 16 June 2005) to Section 65(105) of Finance Act, 1994 gave statutory recognition to the concept of consumption-based levy on imported services. Section 66A replaced the explanation wef 18 April 2006.The Apex Court later dismissed appeals by the department seeking to give effect to the levy effective from a prior date. The Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 also came into effect almost simultaneously. The Central Government notified that with effect from 1 July 2012, section 66A would be limited in its applicability to things done or omitted to be done prior to this date. Recently introduced provisions sections 66B and 68 of the Finance Act are to be read along with Rule 2(m) of the Place of Provision of Services Rules, 2012 and Notification no. 30/2012 dated 20 June 2012. The person liable to pay the tax under rule 2(1)(d) of the ST Rules, 1994 in respect of any taxable services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory is the service recipient who shall bear 100 per cent of the ST liability.

Acknowledgement

1.13 We acknowledge the cooperation extended by the Department of Revenue and the subordinate formations in providing the necessary records during the conduct of this audit. We discussed the audit objectives and scope of the performance audit in an entry conference with CBEC officers on 10 May 2012. We conducted the exit conference with CBEC on 11 March 2013.

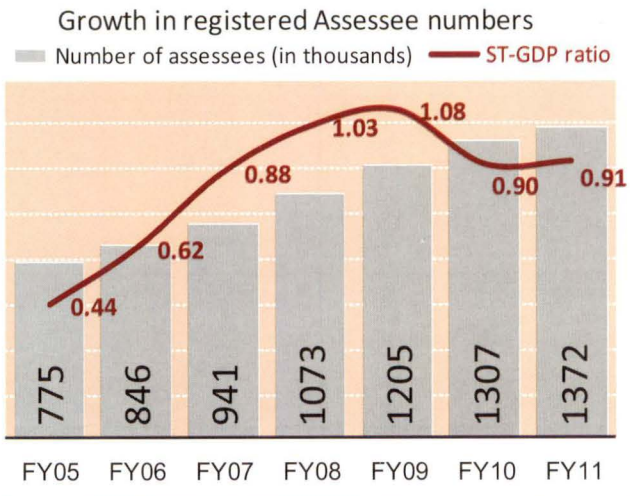
Chapter 2 : Adequacy of existing systems and procedures

2.1 An ideal tax administration system would be one in which all the tax due reaches the Government through voluntary compliance. Tax gap captures the gap between the collectible tax and the tax collected by the Government. Minimising the tax gap would be a goal a good tax administration would strive for.

2.2 Until 1 July 2012, the department collected ST based on placement of activities under various service categories. Only if taxable value in the hands of a person liable to pay tax exceeded the threshold value, would tax liability generally arise. But in respect of import of services, the law does not recognise such a threshold value. We examined the robustness of the systems and procedures in maximising tax collections relating to import of services.

Importance of information gathering

2.3 Departmental statistics indicate that during the period FY05 to FY11, annual growth rate of assessees showed a declining trend from FY09. The annual growth rates (as percentages) were 9.18, 11.17, 14.08, 12.25, 8.53 and 4.97 during the period FY05 to FY11. The ST to GDP ratio also declined from FY05 to FY11. As the relative slowdown in growth in assessee numbers as well as the declining tax-GDP ratio could be indicative of poor information gathering techniques adopted, we decided to look into the aspect of availability of information relating to potential assessees and the sources of information relied upon, limiting our focus to the area of import of services.



Source: (i) CBEC (for number of assessees) (ii) CSO (for GDP at current market prices) (iii) Finance Accounts (for ST)

2.4 Persons liable to pay ST on import of services would include, besides those already registered with the Central Excise and ST Department on the basis of their being service providers/manufacturers, others liable only under the service recipient category. Even in respect of persons already registered as service providers or manufacturers, the requirement that registration as service recipients should be taken has to be complied with. Reliable information relating to cross-border transactions entered into is crucial for ensuring broadening of the tax base.

Tax Gap Analysis

The department could not arrive at reliable figures of tax gap relating to import of services in the absence of sufficient data on value of taxable services and mechanism to analyse tax collected data.

2.5 Information concerning the remittances made as consideration in respect of taxable services from abroad would be vital for arriving at the taxable value and in turn tax collectible figures. Data available with the authorised dealers licensed by the RBI would be a major source for this. Secondly, for the tax collected, we could refer to the Principal Chief Controller of Accounts' accounts figures, provided the accounts depict service tax collected in respect of import of services under a distinct head.

2.6 We observed that out of the 14 Commissionerates selected for audit coverage, only Chennai ST Commissionerate had initiated action by addressing RBI in connection with remittances to service providers outside India. ST II Commissionerate in Mumbai stated that efforts were being made to collect data from RBI. DGST Mumbai had also not collected data from RBI/authorised dealers until July 2012.

2.7 We also observed that in respect of the 119 service categories listed under section 65(105) of the Finance Act, the Central Government has prescribed accounting heads under which any remittances were to be accounted. We noted that even under the new negative list based comprehensive approach to taxation of services, CBEC vide TRU Circular 165/16/2012-ST dated 20 November 2012 has taken care to restore such service specific accounting codes. So far, however TRU has not prescribed separate accounting heads relating to tax collections in respect of import of services. Hence the authorities would depict ST collected in respect of import of services under the same accounting heads based on the nature of service provided by the foreign service provider. Thus, the department could not utilise data available with the Principal Chief Controller of Accounts to determine actual tax collections. Audit recommended that feasibility of prescribing accounting codes (or other mechanism) specific to payment of ST relating to import of services be considered. Thus Audit observed that as in 2012, the department did not have adequate information on value of taxable services relating to import of services, neither did it have a system in place whereby quantum of tax collections relating to import of services could be determined. In the absence of reliable data with the department on value of services and mechanism to utilize data on revenues collected, the department could not determine the tax gap in respect of ST collections relating to import of services.

2.8 Though the Ministry did not address the concern that data available with the department was insufficient for reliable determination of tax gap in respect of import of services, it stated (March 2013) that the Directorate General of Audit had undertaken an exercise from November 2011 to collect and utilise information available with authorised dealers; 60 out of 101 authorised dealers had so far responded. The

department has forwarded details of 575 cases identified so far as likely to involve ST liability to respective Chief Commissionerates for verification. Besides, DGST had directed the Zonal Chief Commissionerates vide its letter dated 30 July 2012, to approach authorised dealers/banks to identify remitters of foreign exchange and to recover ST on import of services.

2.9 As regards the issue of prescribing accounting codes (or other mechanism) specific to payment of ST relating to import of services in order to facilitate tax gap analysis, the Ministry informed (March 2013) that though creation of additional accounting codes specific to import of services may not be feasible (in order to avoid duplication of accounting codes), the return format has been recently revised vide notification no.1/2013 – ST dated 22 February 2013 to include details relating to this information. The Ministry also stated that the Ministry/department was advising the Commissionerates to factor in analysis of the aspect of import of services while considering any specific service. The Ministry's reply substantiates the Audit observations raised.

Information from other sources

The department did not have a system in place to utilize information on remittances to non-residents available with the Income Tax department.

2.10 We noted that the Income Tax department is another source for information relating to remittances to non-residents. Section 5 of the Income Tax Act, 1961 provides that income which accrues or arises (or is deemed to accrue or arise) in India and income received (or deemed to be received in India) is liable to be taxed in India. The law also provides for deduction of tax at source in respect of such remittances. We observed that payments to non-residents would include cases of provision of service from outside India. ST liability would exist in such cases.

2.11 The Income Tax Rules require that Income tax assessees who deduct tax on payments to non-residents file quarterly TDS returns in Form 27Q . The Department also receives from the authorised dealers, a copy of Form 15CA and Form 15CB (certificate by Chartered Accountant and undertaking by remitter furnished to the authorised dealer as a prerequisite for remittance abroad) in respect of each remitter which include details about nature/purpose of remittance (brokerage fees, engineering services, fees for technical services etc). Remitters are to upload details of foreign remittances in Form 15CA accessing www.tin-nsdl.com.

[4] Delhi ST, Bengaluru ST, Chennai ST, Bangalore LTU, Hyderabad II & IV, Kolkata ST, Noida, Ahmedabad ST and Panchkula

2.12 We enquired from the selected 14 Commissionerates whether the department accesses information available with Income Tax authorities regarding remittance to foreign service providers. Ten[4] Commissionerates informed in the negative. Mumbai ST-II Commissionerate stated that efforts were on to collect data from the Income Tax department. Mumbai LTU indicated that it would collect such data henceforth. Barring Hyderabad-II which indicated conducting surveys for the purpose of identifying potential assessees, no other Commissionerate indicated any other specific procedures having been resorted to identify unregistered service recipients. DGST is yet to provide information relating to accessing of information from sources such as the Income Tax Department.The Ministry informed (March 2013) Audit about the constitution of a committee consisting of representatives of both departments to work out modalities for sharing of information. Further, the department was examining the possibility of a system in which the Income Tax server can be linked to CBEC's server for secure data transfer.

Comparison with systems in Income Tax Department

RBI permits remittances towards import of services irrespective of non-fulfilment of corresponding service tax liability by the service recipient, in the absence of any requirement for submission of an undertaking by remitter/certificate from Accountant on the lines of the prescription in Income Tax.

2.13 Section 195 of the Income Tax Act, 1961 mandates deduction of income tax from payments made or credit given to non-residents at the rates in force. The RBI requirement that no remittance be made to a non-resident unless a no objection certificate has been obtained from the Income Tax Department, was modified in 2002 to allow such remittances without insisting on such no objection certificate, if the person making the remittance furnishes (in form 15CA) an undertaking (addressed to the Assessing Officer) accompanied by a certificate (in form 15CB) from an Accountant. The certificate and undertaking are to be submitted (in duplicate) to the RBI/authorised dealers who in turn are required to forward a copy to the Assessing Officer concerned. The purpose of the undertaking and the certificate is to collect taxes at the stage when the remittance is made as it may not be possible to recover the tax at a later stage from non-residents. Audit observed that no such control has been introduced as yet in respect of fulfillment of liability of ST before release of remittance by the authorised dealer. We have sought to illustrate the risk of tax evasion through the following cases.

Box 2.1: Illustrations depicting risk of tax evasion

A. M/s Zoom Developers Ltd in Mumbai ST-I Commissionerate (with registrations in four other Commissionerates of India) remitted foreign currency equivalent at least to ₹ 513.15 crore during 2007-08 to 2010-11, under the purpose codes which can primarily be considered as towards import of services, to persons located outside India as per the PAN wise data received from various Authorised Dealers during the years 2007-08 to 2010-11. The assessee could not be located at its registered premises. The Commissionerate could not provide its ST Returns for the above period or any prior period. The Ministry informed (March 2013) that the Anti-Evasion wing had initiated action for non-payment of ST through show cause notices dated 24 October 2011 and 9 April 2012 for over ₹ 900 crore covering the period 1.4.2006 to 31.3.2011. Show cause notices were issued by pasting at the known address of the assessee, by registered post acknowledgment due and by delivery at the registered office. The Commissionerate has also written to other field formations to take further action to safeguard Government revenue. The Commissionerate has also addressed the RBI Foreign Exchange Department in December 2012 requesting the Reserve Bank to monitor the remittances by the said party and to inform their whereabouts.

B. M/s Tulsiyat Tek Pvt Ltd., in Mumbai ST-II Commissionerate also remitted foreign currency amounting to ₹ 64.87 crore during 2010-11, under the purpose codes which could primarily be considered as towards import of services, to persons located outside India as per the PAN wise data received from various Authorised Dealers. This assessee could also not be located at its registered premises. The Commissionerate also could not provide their ST Returns for the above period. The copies of returns for any prior period are also awaited from the Commissionerate. The assessee had no other registration in any of the Commissionerates of India as per ACES data on registrations. The Ministry informed (March 2013) that though the assessee took registration on 15 March 2011, it did not file ST-3 returns. The assessee did not respond to the Commissionerate's request to pay ST dues as well as to summons subsequently issued. Governmental authorities have sealed the premises. The Ministry added that Show cause notice has been issued for non-filing of ST-3 returns.

2.14 Had there been a provision for coverage of ST liability at the time of remittance, at par with the Income Tax Rules, the revenue authorities possibly could have recovered the ST dues, at that stage itself.

2.15 The Ministry replied (March 2013) that confirmation of payment of ST by authorised dealers at the point of remittance is not feasible since the service recipient under reverse charge pays ST in a lump sum at the end of the month/quarter and not with respect to each transaction, unlike Income Tax. Further, unlike deduction of tax at source which is a simple computation at flat rates, there would be interpretational issues involved in ST, which would be beyond the scope of the authorised dealer to verify. It would be difficult for authorised dealers to assess legal issues such as relating to exemption, whether the activity conforms to the definition of service, taxable service etc. The assessee making a self-assessment by way of payment of tax and filing of return

has to consider all these aspects before paying tax. This task cannot be performed by the bank facilitating the remittance and legal liability remains with the recipient of service. The Ministry however added that the objective can be achieved alternatively by getting the required data (Forms 15CA and 15 CB) from the Income Tax authorities as detailed in para 2.12 above.

2.16 On examination, Audit opines that getting the required 15CA and 15CB documents from the Income Tax department though a positive initiative, would not be adequate to ensure revenue is protected particularly, if obtained after the remittance has been permitted. (Prescribed norm for detailed scrutiny of ST returns is only 5 percent of filed returns and departmental figures for coverage of assessees (A and B categories) by internal audit indicates a shortfall of approximately 50 percent). The Ministry may consider the possibility of reinforcing the proposed initiative by expanding the scope of Form 15 CA (undertaking by remitter)/ Form 15 CB (certificate by Accountant) to ensure coverage of ST liability also. Establishing such a mechanism would not result in additional responsibilities to authorised dealers concerning possible issues of interpretation in law since the undertaking concerned would be from the remitter and the certificate is of the Accountant. Besides, the ST Rules which provide that ST is to be paid by the prescribed dates are enabling Rules and the same could be amended, if found necessary, to provide for the payment with respect to each transaction in the specific situation of import of services. Further, even in Income Tax, tax deducted at source is to be remitted to Government account only by the dates prescribed for the purpose. The other point to be noted is that import of services is probably one of the few situations where it may be possible to ensure almost total coverage by the department on account of a) data being available at a single source category (i.e. with the authorised dealers) and b) the compulsory reliance by the remitters on the prescribed channels for remittance.

2.17 DGCEI's issuing show cause notices for over ₹ 900 crore in the single case illustrated above only reiterates the urgent requirement to cover this gap in the prescribed Rules/ procedures.

2.18 The information available on the net also indicates that some countries have incorporated such controls in their taxation systems. For instance, an imported service paid through a regular bank transfer from a Brazilian bank account requires the Brazilian party to demonstrate a taxation document named DARF (Documento de Arrecadação de Receitas Federais or Document for Receipt of Collection of Federal Income) and a tax payment confirmation before release of money out of the country. If the Brazilian party chooses to pay for the service using a credit card or other payment method not directly controlled by Banco Central, the DARF document and tax payment are still required in order to document trace of the money.

2.19 We also observed that the department does not have a structured system of following up on potential information sources unlike Direct Taxes-possibly attributable to the fact that the ST wing is the one most recently introduced among major Central tax wings. Besides, there is the felt need for posts commensurate to the volume of work.

2.20 When we pointed this out, the Ministry stated (March 2013) that a Committee has been set up to work out the modalities of sharing data with CBDT. As of now, CBEC is accessing information available with the Ministry of Corporate Affairs. Independent of this, Commissionerates conduct surveys based on information about potential assessees, available in the public domain. The Ministry informed (March 2013) that the cadre restructuring proposal of the department envisages enhanced strength for ST functioning.

2.21 Audit recommends that the Ministry may pursue the matter of extending the access to data on Ministry of Corporate Affairs portal to more officers of the department. The Ministry has informed that access in field formations is currently restricted to Chief Commissioner level.

Need for systematic information gathering mechanisms

The department lacked a mechanism for systematic collection of information such as provision requiring filing of Annual Information Return by identified parties.

2.22 The systems in the Income Tax Department include collection and collation of information by the Central Information Branch (CIB) functioning under the investigation wing. Based on the recommendation of the Task Force on Direct Taxes, the Income Tax department has also set up a Tax Information Network which is the gateway hosted by NSDL for electronic information coming to the department from other agencies. It serves as a repository for important tax related information such as information on tax deduction at source. There is also a system of submission by certain identified persons of Annual Information Return (AIR) capturing high value transactions which could be a useful source of information as evidenced by the continuance of the system in Income Tax wing since its inception in 2004. For instance, an authorised officer of the RBI is to file this return giving details in respect of receipts exceeding ₹ 5 lakh on RBI bonds. Besides, tax authorities may source information from different agencies such as banks, mutual funds and credit card companies if they need it for any inquiry or proceedings. This source of gathering information (mandatory and optional source codes have been determined) is independent of the details collected through the annual information returns (AIR). The CIB has a separate code for each transaction - there are around 36 CIB codes and value limits have been set for many transactions. Audit observed that no such mechanism for collection of information on regular basis exists in the ST sector. Being the fastest growing revenue sector, it is imperative that efforts to collect information are systematised and given adequate recognition in law.

2.23 The Ministry replied (March 2013) that the feasibility of the same would be examined. During the Exit Conference, CBEC members also expressed their apprehension that introduction of an Annual Information Return system would result in burdening of taxpayers and other stakeholders with excessive reporting. However recognizing the need for controls to be in place without burdening the assessee, CBEC mooted the possibility of authorised dealers/assessees enclosing with the return, an attachment providing number of cases and details of foreign remittances.

2.24 Audit examined the apprehensions raised during the exit conference and reiterates the felt need for putting in place a robust system of information gathering without which the department may be able to discharge only to a limited extent its envisaged role as authority responsible for collection of ST revenues due to the Government. CBEC's stated Mission inter alia, is to achieve excellence in the implementation of ST laws and procedures aimed at realizing the revenues in a fair, equitable, transparent and efficient manner, ensuring control on cross border movement of goods, services, intellectual property etc. During the exit conference, DG (Audit) informed that despite efforts since November 2011 to collect data from 101 authorised dealers in the country, they have been able to collect data only from 60 dealers. Such feedback strengthens the case for introduction of a system of furnishing of Annual Information Return inter alia, by authorised dealers, all of whom would be ST assessees (under banking and financial services category).

Compliance verification Mechanism

2.25 Audit considered the utilisation of import of services related information by two important prongs of the compliance verification system viz returns scrutiny and audit. We looked into the adequacy of provisions prescribed as also the actual position of implementation in field.

Scrutiny of returns

The department had not identified data on remittances relating to import of services as a parameter for selection of returns for scrutiny.

2.26 Audit observed that there are two occasions where data on value of remittances towards import of services could come in handy during the scrutiny process at ranges; firstly, during selection of returns for scrutiny. Departmental officers carry out selection of returns based on prescribed risk norms. Audit observed that these risk parameters prescribed(Annexure 2.2) in respect of both Central Excise and ST Scrutiny Manuals do not include consideration of data on import of services. We further observed that the details furnished in the return filed by the assessee form the basis of the risk parameters for scrutiny prescribed. However, we also noted that there is scope for consideration of external parameters given the fact that one of the local factors suggested (apart from the five prescribed parameters) is - units not audited in the last five years. We however, observed that in the absence of data relating to value of

remittances relating to import of services, at the selected Commissionerates, this was not a factor considered during selection of returns for scrutiny. The Ministry informed (March 2013) that the department would consider this aspect along with others during the development of risk parameters.

Box 2.2 : Illustrative cases of exemptions taken incorrectly

A. ST on Business Auxiliary Services (BAS) is leviable wef July 2003. Notification No. 18/2009-ST dated 7 July 2009 read with Circular No.118 /12/2009-ST dated 23 November 2009ST permits exemption of ST on commission paid to the agent located outside India upto one per cent of the FOB value of export goods for which the service has been used subject to the fulfilment of conditions. These conditions include registration under section 69 of the Finance Act as ST assessees, intimation to the Assistant Commissioner in form EXPI form and submission of six -monthly returns in form EXP2.

Seven assessee[5] exporters in Mumbai I ST, Mumbai II ST and Thane I Commissionerates remitted ₹ 12.57 crore towards export commission depicting charges under BAS. The assessees could not produce evidence concerning fulfilment of the conditions prescribed. Six PAN holders did not fulfil even the basic requirement of registration under section 69 of the Finance Act. Non-fulfilment of the conditions implies liability to pay ST amounting to ₹ 1.29 crore on such services received from outside India. The Ministry reported (March 2013) that in respect of four of these assessees, the cases are under investigation of the Anti-Evasion wing and further progress will be informed. One assessee exporter has subsequently taken registration under section 69 and another has taken ST registration in June 2012.

2.27 Secondly, during the actual scrutiny process, the departmental auditors are to follow the checks as prescribed in the Scrutiny Manual. These checks include checks relating to fulfilment of liability as ST recipient under section 66A. Though we sought information from the selected Commissionerates about undertaking of scrutiny of returns for units falling under their respective jurisdictions from Audit's selected sample, response received in respect of the Commissionerates has only been in the negative so far. This could be owing to the fact that the prescribed norm for detailed scrutiny of ST returns is only 2 percent of the returns filed.

Internal Audit

2.28 The recently revised (2011) ST Audit Manual lists among the local risk parameters for selection of units for audit, a newly introduced parameter based on liability under section 66A. Effectiveness of selection based on such parameter among others would be dependent on regular updating of assessee master files maintained by the Commissionerates. Audit observed non-updating/irregular updating of assessee master files (including information concerning registration status of assessee as

[5] Sequent Scientific Ltd., Rainbow Silks, Ramka Silks, Annet Technologies, Vora Exports, Goyal Garb and Firestar International Pvt. Ltd

recipient) in 10[6] Commissionerates. Some of the Commissionerates (Hyderabad IV and Noida) have since responded as indicated in the Ministry's reply (March 2013) that they are maintaining assessee master files and updating the same with data relating to reverse charge. Audit recommends that among other parameters for examination at Commissionerates, DG (Audit) may check the satisfactory maintenance and updating of assessee master files. We further noted that in audits conducted at premises of ST assessees, one of the checks departmental auditors carry out at ST assessee premises related to section 66A liability. This was in compliance with the prescriptions listed in the ST Audit Manual provisions.

Role of the Directorate

2.29 As the premier body responsible for looking after the implementation of ST administration in the country, the Directorate of ST should assume a proactive role in ensuring availability of data in respect of key area such as import of services. Audit sought information from DGST relating to action taken if any, in utilising data on remittances made in respect of import of services available with sources such as the RBI/authorised dealers and Income Tax department. We also sought details(November 2012) of steps initiated regarding streamlining of procedures and improving tax collections, recommendations for changes in the law if any, suggestions made to Director General(Systems) concerning requirements for improvements in the ACES system, other suggestions made to CBEC/TRU etc.

We are awaiting DGST's reply(March 2013). Audit suggested that the department might review and if required, consider strengthening of the DGST setup so that the office may fulfil the pivotal role expected of it in ST related matters. The Ministry stated (March 2013) that strengthening of the Directorate of ST is under examination by a Committee; the first step is to ensure better coordination, if need be, by relocating the office.

Recommendations.

We recommended that

a. the department may explore the feasibility of setting in place a mechanism to utilise data available with authorised dealers, in order to assess the extent of voluntary compliance in respect of ST liability relating to import of services.

Agreeing with the recommendation, the Ministry stated that Special Cells have been set up in DGST and DG (Audit) to collect the information from authorised dealers for import of services. DG (Audit) had initiated an exercise in November 2011 for collecting and utilising information available with Authorised dealers relating to foreign exchange remittances; so far it has collected data from 60 authorised dealers.

Audit reiterates the need for a reliable system (with inter se roles of DGST, DG (Audit) etc clearly defined) of data collection from authorised dealers and its utilization in order

[6] Mumbai ST-I,II, LTU, Hyderabad II & IV, Kolkata ST, Noida, Ahmedabad ST, Panchkula and Delhi ST.

to ensure adequacy of data to evaluate extent of voluntary compliance and to facilitate tax gap analysis.

b. CBEC may consider the feasibility of prescribing accounting codes (or other mechanism) specific to payment of ST relating to import of services in order to facilitate tax gap /statistical analysis. Accepting the recommendation for prescription of a suitable mechanism, the Ministry stated that format of ST-3 return has been revised to provide field for data on import of services.

c. the Ministry may consider initiating steps to enable access by officers of the Central Excise and ST department to electronic data available with the Income Tax department in order to maximise revenue collections through optimal use of available resources.

Agreeing with the recommendation, the Ministry stated, that a committee has been set up to work out the modalities for sharing information with CBDT and the work had been started in this regard.

d. the rapid growth in import of services points to the necessity of having a control requiring evidence of fulfilment of liability of ST by remitter as a prerequisite before release of remittance by the authorised dealer.

The Ministry stated that it is not feasible to introduce TDS for ST or even confirmation of payment of ST by Authorised Dealer due to complexities involved in computation and interpretation issues involved in ST. The Ministry further informed that the desired objective could be achieved alternatively by getting data from income tax authorities.

Audit reiterates that getting the required 15CA and 15CB documents from the Income Tax department though a positive initiative, may not be adequate to ensure adequate protection of revenue without adequate strengthening of the department's compliance verification mechanisms. The Ministry may consider the feasibility of a) expanding the scope of Form 15 CA (undertaking by remitter) / Form 15 CB (certificate by Accountant) to cover ST liability also and b) amending the ST Rules, if necessary, to provide for transaction based payment of ST in the specific contingency of import of services.

e. the department may consider the need for introduction of an AIR system with authorised dealers as one of the categories of persons obliged to submit such return; the department may also explore possibility of empowering tax administrators to call for information based on specific identified source codes.

The Ministry expressed apprehensions concerning excessive burdening of the taxpayer. It however informed that the department would examine the feasibility of implementation.

f. the department may consider the possibility of inclusion of a risk parameter based on remittances in respect of import of services for the purpose of returns' selection for scrutiny.

The Ministry accepted the recommendation stating that the department would consider the feasibility of inclusion of a risk parameter based on remittance in respect of import of services while fixing the risk parameters for scrutiny of ST-3 return.

g. the Commissionerates may ensure that Internal Audit cells maintain updated assessee master files containing all relevant information relating to import of services so as to enable consideration of this parameter while selecting units for audit.

Agreeing with the recommendation, the Ministry stated that the existing ST Audit Manual already envisages the same. However, Audit recommendation is concerning the strengthening of implementation of the existing mechanism so that data on import of services may be useful as a parameter for selection of units for audit. The selected Commissionerates did not have a mechanism in place to collect data on import of services. Audit recommends that among other parameters for examination at Commissionerates, DG (Audit) may check the satisfactory maintenance and updating of assessee master files.

h. the department may review and if required, consider strengthening of the DGST setup so that the office may fulfil the pivotal role expected of it in ST related matters.

Agreeing with the recommendation, the Ministry stated that issue of strengthening of the DGST is already under examination by a Committee.

i. the department should initiate action to establish a mechanism for accessing information such as accounts of companies available with the Registrar of Companies in order to systematically minimize possibility of evasion in international transactions.

The Ministry stated that the system exists as the Ministry of Corporate Affairs had provided access to Chief Commissioners and DG (Audit) for accessing the MCA-21 Portal. Audit recommends that the Ministry may pursue the matter of extending the access to data on Ministry of Corporate Affairs portal to more officers in the field.

Chapter 3: Issues relating to fulfilment of tax liability

3.1 The Finance Act, 1994 requires that where a person or business from a country other than India provides a service specified in clause (105) of section 65, the recipient has to pay ST on the service provided. A crucial requirement is that the recipient must receive the taxable service in India.

3.2 During the course of audit, we came across several instances where the assessee had not fulfilled its ST liability by the time of audit. While in some instances we observed that the assessee had not registered itself as service recipient which it was supposed to under Rule 4 of the Taxation of Services (Provided from Outside India and received in India) Rules, 2006, in others either the tax/ interest/both had not been paid. We also observed that there were possibilities of collecting information from other sources such as Central Ministries, which the Department could have harnessed. We also observed instances of incorrect determination of value of taxable service under the ST (Determination of Value) Rules, 2006. We have also brought out certain issues where we felt the need for a consistent stand on the part of the department while issuing notifications.

Requirement of registration

In the absence of any mechanism in the field formations to systematically track the non-registered import of service recipients, several assessees were yet to take registration (as per data available in ACES) under Rule 4 of Taxation of Services(Provided from outside India and received in India) Rules 2006 .

3.3 Rule 4 of the Taxation of Services (Provided from outside India and received in India) Rules, 2006 requires that the recipient of taxable services provided from outside India and received in India shall make an application for registration. However, from the ACES data as furnished by DG (Systems), we observed that among the samples scrutinised in audit, 132 assessees were yet to take registration under Rule 4 though they were liable to pay ST under section 66A of the Finance Act. Further, there was no system in the field offices of ensuring compliance with registration related provisions. Existence of such a system would depend on the availability of information relating to the outward flow of remittances in respect of taxable services. Though the Ministry replied (March 2013) that seminars are being held from time to time in Commissionerates to educate the trade on this aspect and the website updated, Audit observed that as of July 2012, there was no mechanism in the field formations to systematically track the non-registered service recipients of import of services. Though DG (Audit) stated during the exit conference (March 2013) that his office had obtained data on remittances from 60 out of 101 authorised dealers since November 2011 (efforts included a demi-official letter from Secretary (Revenue) to Secretary (Banking) in 2012), such a one-time effort though very positive does not imply existence of a system. That 41 authorised dealers including bigger ones were yet to respond highlights the

need for introduction of a mandatory system (such as through Annual Information Return) for flow of information.

ACES did not flag such cases where data in ACES returns revealed need for updation of category of ST remitter in database.

3.4 We also observed from the returns filed that some assessees remitted ST relating to import of services though they had no registration in their capacity as service recipients. ACES system does not flag such cases or provide for automatic updation of the database. DG (Systems) confirmed that the ACES system does not provide for generation of exception reports in such cases. During the exit conference, Director General (Systems) stated that the assessee has to initiate any modification in the ST-1 Registration form. He added that while it may not be possible to adopt the suggestion for auto-populating registration form based on entries in the ACES return, the best approach would be to make it mandatory for assessees to amend the data in their registration forms by making it a mandatory process before filing returns. The Ministry may examine the same for incorporation in the system.

Need to analyse data relating to remittances by unregistered persons

3.5 In the samples selected by Audit, we covered units registered either as service providers or as manufacturers with the department. However from the data obtained from the RBI/authorised dealers, we observed that there could be several such instances where tax payable on account of the party being a recipient of services from abroad had not been remitted. Data for the years 2007-11 from over 50 authorised dealers indicated over 20000 service recipients who made remittances under the 37 purpose codes identified but did not possess registration under ACES. The selected Commissionerates did not collect/analyse data available with the authorised dealers. Audit noted that this could be a source of information for departmental officers including Directorate General of Central Excise Intelligence to check evasion of tax in respect of import of services. The Ministry informed Audit about forwarding of the data to DGCEI. The Ministry also informed during the exit conference that Director General (Audit) had come across approximately 450 unregistered service recipients in a similar exercise. In many cases, remitters had indicated wrong purpose codes, or remittance had been for purchase of goods or authorized dealers had wrongly captured data. Audit recommends that the department may seek to impress upon RBI the need for enhancement in quality of data capture by authorized dealers. Audit further recommends that the department may consider the allocation of responsibilities among different offices such as DGST, DG (Audit) and DGCEI in connection with collection of data from authorised dealers, its analysis and subsequent follow-up. For instance, follow-up in respect of non-registered service recipients may not be termed the responsibility of the Director General (Audit).

Non-fulfilment of liability by registered manufacturers

Certain manufacturers who were liable to pay tax under import of services category, failed to pay ST.

3.6 During scrutiny of records of selected central excise assessees (manufacturers registered with the department), we found non/short levy of ST in 19 cases involving ST of ₹ 2.52 crore excluding interest and penalty. We have illustrated a few cases below.

Box 3.1: Illustrative cases of non-fulfilment of ST liability by manufacturers

A. M/s Hydro Building Systems Pvt. Ltd., in Bengaluru ST Commissionerate, registered with Central Excise as a dealer of excisable goods such as aluminum extrusions, profiles and accessories did not take registration either as a recipient or as a provider of service. The assessee had entered into an agreement with its parent company M/s. Hydro Aluminum SA having head office in Switzerland for the provision of Information Technology Software Services, Technical Assistance, Management Services etc and paid ₹ 3.51 crore during the period 2009-10 to 2011-12 for the above services. We observed that the assessee had not paid the applicable ST of ₹ 36.23 lakh (excluding interest).The Ministry intimated (March 2013) issue of show cause notice dated 6 December 2012 by the Commissionerate on the basis of the Audit observation.

B. M/s Ashimori India Pvt. Ltd. in Jaipur I Commissionerate, paid ST of ₹ 76.79 lakh on technical testing, inspection and certification services as against the ST of ₹ 91.15 lakh payable. This resulted in short payment of ST ₹ 19.82 lakh including interest. The Ministry intimated (March 2013) that the assessee deposited the amount of ₹ 19.82 lakh including interest on this being pointed out.

ST liability of Export oriented units

The department did not have a system to utilize information available with Development Commissioners relating to import of services by EOUs.

3.7 There is no exemption from ST liability in respect of Export Oriented units importing services. Under the Foreign Trade Policy, it is obligatory on the part of every EOU to furnish an Annual Performance Report to the concerned Development Commissioner's office. The Annual Performance Report system requires the EOUs inter alia, to provide details of foreign exchange outflow on import of services (royalty, technological, commission etc). Response from the Division at Bengaluru dealing exclusively with EOUs on whether it had a system in place to utilise the information available with the Development Commissioner's office in the form of Annual Performance Reports furnished by EOUs as an aid to assess the liability of EOUs in respect of import of services is awaited.

Audit observed that in the following case, the EOU had not fulfilled the ST liability.

Box 3.2 : Illustrative case of non-fulfilment of liability by EOU

M/s. Katra Phytochem (India) Pvt. Ltd., in Bangalore ST Commissionerate, a 100 per cent export oriented unit, had entered into an agreement with Mabriba GMBH, a company registered in Switzerland for services relating to improvement of the business and paid ₹ 2.22 crore between 2009-10 and 11-12. Mabriba, a tax resident of Switzerland exporting its services was not subject to Swiss VAT under the Agreement. We observed that the company did not have ST registration either as a recipient or as a provider of service. The manufacturing company did not pay the applicable ST of ₹ 22.85 lakh excluding interest and the same was not pointed out by the department either through scrutiny or audit processes. The Ministry intimated (March 2013) recovery of ₹ 34.57 lakh (including interest).

3.8 Audit recommended that the department might consider tapping data relating to Export Oriented Units available with the Development Commissioner's office as a lead for assessing ST liability. The Ministry stated (March 2013) that this would be examined.

3.9 In our audit scrutiny in respect of assessees registered as service providers/recipients) we found non/short levy of tax in 236 cases involving ST of ₹ 194.11 crore (excluding interest).

Valuation of taxable services

3.10 Section 67(1) of the Finance Act envisages that ST chargeable on any taxable service with reference to its value shall be the gross amount charged by the service provider for such service provided. Audit observed non-compliance in certain cases; we have discussed one such instance below.

Box 3.3: Illustrative case of incorrect valuation of taxable services

The amount paid by M/s. Dhamra Port Company Ltd., in Bhubaneswar I Commissionerate, towards dredging services provided by a foreign service provider included an amount of ₹ 24.85 crore for bunkering charges during 2011-12 on which the applicable ST of ₹ 2.56 crore was not paid. The contract entered into by the company with Chellchart (UK) Ltd was for carrying out dredging works in specified areas, using a specific Trailing suction hopper dredger (TSHD). The contract envisaged that the owner would supply fuel at the owner's cost. The charterer would pay a fixed amount of USD 18000 prorata per day for the supply of fuel subject to fuel price adjustment. As value of taxable services would be the gross amount charged, Audit pointed out the ST liability on payments for bunkering included in the dredging contract. The Ministry accepted the audit objection.

3.11 We observed that remittances to associated companies as royalty though common, ST liability in several cases remained either unfulfilled or partially fulfilled owing to non-inclusion of a portion of the consideration. Explanation to section 67 of Finance Act clarifies that gross amount charged in respect of transactions involving associated enterprises would include any amount credited or debited, as the case may be, to any account, whether called "suspense account" or by any other name, in the

books of account of a person liable to pay ST. Explanation to Rule 6(1) of ST Rules, further clarifies that any payment received towards the value of taxable service, in such case shall include any amount credited or debited, as the case may be, to any account, whether called 'Suspense account' or by any other name, in the books of account of a person liable to pay ST. Even the Point of Taxation Rules include a proviso to the effect that where the person providing the service is located outside India, the point of taxation in respect of associated enterprises shall be the date of debit in the books of account of the person receiving the service or date of making the payment whichever is earlier

3.12 We pointed out certain instances of non-compliance. We have discussed below, two such cases. In respect of the second illustration, we observed that though no actual payment had taken place, the service recipient's books of account depicted amount debited through creation of provision.

Box 3.4: Illustrative cases where ST liability not fulfilled by associated enterprises in respect of royalty payments

A. M/s Otis Elevators (India) Pvt. Ltd., in Mumbai ST-II Commissionerate, paid royalty of ₹ 19.76 crore to M/s Otis Elevator Company, New Jersey in foreign currency during 2008-09 and 2009-10. The assessee was liable to pay ST of ₹ 2.09 crore. The Ministry replied (March 2013) that the assessee has since made payment of tax liability. We are awaiting details of the same.

B. M/s Hindustan Unilever Ltd in Mumbai I Commissionerate remitted ₹ 514.63 crore towards royalty payments during the period 2008-09 to 2010-11 to its holding company, Unilever PLC and other associated concerns located abroad. The transaction being with associated enterprises, the taxable value of ST payments as indicated in ST3 returns would include amounts included in the books of account of the person liable to pay ST. Reconciliation of royalty payments with ST returns revealed that the assessee had not paid ST on amount of ₹ 282.23 crore. Resultant short payment of ST was ₹ 30.41 crore. The Ministry informed (March 2013) inter alia that the assessee calculates royalty on quarterly basis and accordingly raises credit note against the foreign entity. Further, for the last quarter of the year, they make a provision, as actual figures would not be available. The assessee discharges tax liability for the same on actualization of royalty. The Ministry stated that this appeared to be acceptable. However this goes against the explanation to Rule 6(1) of the ST Rules introduced vide Notification No. 19/2008 dated 10 May 2008.

Non-inclusion of Tax deduction at source in arriving at taxable value

Assessees determined the value of taxable services for service tax purposes incorrectly by excluding tax deducted at source under the Income Tax laws.

3.13 The value of taxable services received under the provisions of Section 66A is inter alia, equal to the actual consideration charged for the services provided. This means that the assessee would have to take into consideration the amount deducted under the Income Tax law as tax deducted at source under section 195 while arriving at the taxable value of service for ST calculation.

Box 3.5: Illustrative case where the assessee excluded TDS in computing taxable value

A. M/s. Cochin Shipyard Ltd. in Kochi Commissionerate, paid an amount of ₹ 179.23 crore during the period 2009-10 to 2011-12 to various foreign service providers; it also paid ST for the same. However, the unit excluded income tax deducted at source in arriving at the value of taxable service, which resulted in short payment of ST amounting to ₹ 2.43 crore. Accepting the audit observation, the Ministry informed (March 2013) that the Commissionerate had issued a show cause notice dated 19 October 2012 to the assessee.

Reimbursement of charges

3.14 Section 67 of the Finance Act provides for application of ST (Determination of Value) Rules, 2006 for the purpose of enabling determination of value of taxable services in cases where the value of consideration is not ascertainable. Rule 5 of the ST (Determination of Value) Rules, 2006 envisages that costs incurred by the service provider in the course of providing taxable service are to be treated as consideration for the taxable service provided and hence are to be included in the value of taxable service. But this was not applicable in respect of import of services as the Rules (prior to July 2012) provided that the value of taxable service received under the provisions of section 66A, shall be such amount as is equal to the actual consideration charged for the services provided.

3.15 In cases where an associated enterprise has borne the expenses for the other party, Audit observed that generally there would not be a specific contract or invoice indicating the provision of service by the other party located outside the country. However, Audit considers that in order to facilitate consistent treatment by field formations and audit parties, there may be need for a clarification covering contingencies such as incurring of project expenditure by Indian party as shown in related party disclosures -whether such incurring of expenditure could be considered as evidencing provision of service by the other party, and secondly whether in such cases this could be treated as covered under the explanation to section 67 relating to gross amount charged.

During the Exit Conference, the Ministry acknowledged that this could be a trigger for detailed investigation. We discuss below two cases, Audit came across.

A. M/s Exchanging Solutions Ltd., in Bangalore ST Commissionerate (subsidiaries in USA, UK and Singapore) undertook business process outsourcing (BPO) and Information technology services. Expenditure in foreign currency included project work expenditure amounting to ₹ 58.83 crore between 2008 and 2010 on which ST liability if applicable, would amount to ₹ 6.06 crore. The overseas subsidiary entered into contracts with third parties or customers. The assessee was primarily responsible for development for software and the subsidiaries were front entities involved in finalisation of contracts with independent third parties. The overseas subsidiary performs the entire marketing functions for the assessee. The responsibility for execution of all technical coding and

documentation of software developed offshore was with Exchanging Solutions Ltd and the overseas subsidiary was responsible for timely delivery of services to the third parties onsite. Periodically the overseas subsidiary cross-charged both onsite revenue (got from third party clients) and onsite cost to Exchanging India as per transfer pricing model. The assessee maintained that it only exported services to the subsidiaries and there was no import of services. While the assessee had issued invoices to the subsidiary, the overseas subsidiary did not issue any invoice on the holding company.

Audit observed that the assessee by its own admission was the party responsible for overall project management. The assessee incurred project expenses in foreign remittances as shown by the related party disclosures. By invoicing only the services rendered by the Indian holding company and cross charging the onsite costs to the Indian assessee, the assessee could bypass the requirements of ST liability under section 66A of the Finance Act. CERA issued an audit observation to the department on 2 July 2012. The department while admitting the objection (December 2012) intimated that a show cause notice was issued for ₹ 23.59 crore for the period during 2007-12 and the case had been investigated by Anti Evasion Wing.

The Ministry subsequently intimated (March 2013) that the department had already noticed the issue and that the Anti-Evasion wing of the Commissionerate on investigation found short payment of ST on the transfer pricing model – IT services and other services during the period 2007-08 to 2011-12. Audit noted that the Anti Evasion Wing had visited the assessee's premises on 17 August 2012 for verification of facts and issued a Show cause notice for ₹ 23.59 crore on 19 October 2012.

Audit observed that in respect of transactions between associated enterprises, one of which was outside the taxable territory, there was always the possibility that services even where provided by the party outside the taxable territory to the other for consideration, were likely to suffer from lack of evidence (absence of invoice etc). Hence in order to facilitate consistency of interpretation between various field formations and audit parties, it may be desirable for CBEC to issue instructions/clarify whether contingencies such as incurring of project expenditure by Indian party as shown in related party disclosures could be treated as evidencing provision of service by the other party. CBEC may also consider clarifying whether explanation to section 67 on "gross amount charged" covers such expenditure. While acknowledging that this could be a trigger for detailed investigation, the Ministry stated that in the light of the new law and Place of Provision of Services Rules, 2012, there is no requirement for a clarification. Audit reiterates that even after the newly introduced definition of service under section 65(44) as an activity involving consideration and the framing of the Place of Provision Rules 2012, there is likelihood of differing treatments of similar situations because the basic issue of determining existence of 'service' is to be resolved before the Place of Provision of Service Rules could be considered.

B. M/s Jet Airways (India) Limited in Mumbai I Commissionerate reimbursed staff costs, communication costs, rentals and other administrative costs to its associated concerns. The agreement between M/s Jet Airways (India) Ltd and M/s Jet Airways of India Inc. in USA dated 13 June, 2005 provided that M/s Jet Airways of India Inc. would recruit on its rolls such personnel for the purpose of carrying out operations of M/s Jet Airways (India) Ltd at New Jersey Branch office. The assessee during the period 2009-10 to 2011-12 had paid an amount of ₹ 154.09 crore towards reimbursement of expenses out of which it is yet to furnish details relating to ₹ 57.09 crore, the ST liability, if applicable, of which would work out to ₹ 5.88 crore.

The Ministry stated (March 2013) that administrative expenses such as office rent, catering, repairs to office equipment, cargo charges, insurance to office etc incurred at various locations outside India pertaining to M/s Jet Airways (India) Ltd's airlines operations are made by their Associate concerns on their behalf and are reimbursed on actual basis upon receipt of debit notes raised by the Associate Concerns. Since the foreign locations are treated as separate establishments, under section 66A (2), the liability of ST does not arise.

The reply of the Ministry is not acceptable since the services rendered by the separate establishment outside India would be in the nature of business support services/business auxiliary services vis-à-vis the Indian company and would be covered under rule 3(iii) of the Taxation of Services (Provided from Outside India and Received in India) Rules, 2006. The benefit of services provided by enterprise outside India accrues on the associated enterprise located in India and, therefore, the latter as recipient of services was liable under reverse charge mechanism.

Utilisation of data available with Central Ministries and RBI

The department did not have a system of periodically accessing information available with certain other Ministries and the RBI.

3.16 Audit observed that in respect of remittances for transactions of certain nature such as hiring of transponder space in foreign satellite, lease rentals paid towards aircraft leasing and payments for consultancy services exceeding prescribed limit, prior approval/intimation of the Central Ministry concerned /RBI is required. The department may consider the possibility of utilising such information through an Annual Information Return or other similar mechanism. Audit observed non-fulfilment of ST liability in the following instances, two of which Internal Audit had earlier pointed out. Audit observes that there is a pressing need for building up a mechanism to obtain and utilise data on such high value transactions of specific nature, from concerned monitoring Ministries/RBI etc to ensure that no high value transaction of such nature is left uncovered by the department. The Ministry replied (March 2013) that the feasibility of the same would be examined.

Box 3.6: Illustrative cases of transactions where prior approval of /intimation to Central Ministries/RBI was mandated

A. M/s Zoom Entertainment Network Ltd in Mumbai ST-I Commissionerate paid ₹ 5.21 crore in foreign exchange towards transponder charges and website charges for the years 2007-08 to 2009-10 on which he was liable to pay ST of ₹ 85.65 lakh along with interest. Such hiring by Television channels or Internet Service Providers involving remittance abroad is required to be with the approval of the Ministries concerned[7] as per the RBI's Master Circular on remittances from India. The Ministry replied that Internal Audit had raised the issue in August 2011.

B. M/s. Deccan Charters Pvt., Ltd., in Bangalore ST Commissionerate, paid an amount of ₹ 25.17 crore as lease rental for aircraft to the foreign service provider which falls under the category of Banking and other Financial Services but did not pay ST of ₹ 2.59 crore. All persons hiring aircrafts are obliged to get the approval of the Directorate General of Civil Aviation. The Ministry replied that the department had raised the issue earlier; it was initiating periodical notice for the period 2010-11.

C. M/s. Suven Life Sciences, in Hyderabad Commissionerate, paid an amount of ₹ 11.29 crore to foreign service providers for patent filing and other related works towards legal and attorney charges under Legal Consultancy Services, on which the applicable ST of ₹ 1.16 crore was not paid. As per RBI's Foreign Exchange Management (Current Account Transactions) Rules, 2000, remittances exceeding US$ 10,000,000 per project for any consultancy services in respect of infrastructure projects and US$ 1,000,000 per project, for other consultancy services procured from outside India require the prior approval of the RBI. The Ministry intimated (March 2013) that the assessee paid the amount of ₹ 1.42 crore including interest.

Absence of instructions from RBI to authorised dealers

3.17 Audit observed that while RBI had issued instructions to authorised dealers to ensure compliance with the provisions relating to R and D Cess Act and Income Tax related requirements before allowing the remittances, there was no such instruction from RBI to authorised dealers concerning monitoring fulfilment of ST liability as a prerequisite for allowing foreign remittances. The department was yet to initiate action and coordinate with RBI in this regard.

Box 3.7 : Illustrative case where remittance took place without fulfilling ST liability owing to absence of instruction

M/s. China First Metallurgical Construction India Pvt. Ltd., in Ranchi Commissionerate, paid an amount of ₹ 44.44 crore for detailed engineering drawing for project of Electro Steel Integrated Limited, to M/s. China First Metallurgical Construction Corporation Ltd., Republic of China which falls under the category of design service. However, the assessee did not remit the applicable ST of ₹ 4.58 crore in the absence of any such requirement on the authorised dealer. CERA pointed out this issue in April 2012. The Ministry informed that Internal Audit raised the issue in August 2012 and that show cause notice demanding ST of ₹ 5.63 crore is under process.

[7] Ministry of Information and Broadcasting and Ministry of Communication and Information Technology

The Ministry stated (March 2013) that the department would examine the matter and consider whether RBI should be approached to issue an advisory to authorised dealers for ensuring fulfilment of ST liability by the remitter.

Absence of system in LTU Commissionerate to utilise available information

3.18 Large Taxpayers Unit (LTU) setup was introduced with the intention of providing single window facility to taxpayers who pay direct and indirect taxes above a threshold limit and possess a single PAN. It also envisages the provision of certain advantages such as duty free movement of goods across the different units/ premises of a PAN holder, transfer of credit amount from one such premises to other, time bound disposal of refund claims and dispute settlements and single set of procedures for all units. However while ensuring better services to the tax payer, Audit observed that the department could also utilise available information to ensure fulfilment of the tax liability under law. Since the requirement under the Income Tax provisions requires the need for submission of Form 15CA and 15CB as a condition precedent for making foreign remittances, these Forms would be available with the Commissionerates and could be availed by the ST counterpart in the LTU Commissionerate to ensure fulfilment of ST liability. Audit however came across the following case of non-fulfilment of ST liability in respect of LTU assessee replying to which the Ministry informed that Mumbai LTU Commissionerate stated that Form 15CA and 15CB would be obtained from the Income Tax Authority henceforth so as to ensure proper discharge of ST liability by assessees. The Ministry may ensure that all LTU Commissionerates establish such system of utilizing information available with the Income Tax Authority.

Box 3.8 : Illustration of non-compliance by LTU unit

M/s Rashtriya Chemicals and Fertilizers Ltd in Mumbai LTU Commissionerate received design engineering consultancy services for modification of its Ammonia plant from M/s Haldor Topsoe, Denmark. While discharging ST liability, the assessee undervalued services (TDS element) to the extent of ₹ 1.45 crore resulting in short payment of ST of ₹ 14.99 lakh. The assessee made good the short payment based on the audit observation.

Incorrect application of exemption

3.19 In order to provide for levy and collection of a cess on all payments made for the import of technology, the Research and Development Cess Act, 1986 provided for levy of a cess at a rate not exceeding 5 percent on all payments made towards import of technology. Notification 17/2004 ST dated 10-9-2004 exempted the taxable service in relation to intellectual property rights (IPR) service from so much of the ST leviable thereon under section 66 of the said Act, as is equivalent to the amount of cess paid towards the import of technology. The cess is paid under the provisions of the Research and Development Cess Act, 1986 (32 of 1986) in relation to intellectual property service.

3.20 We observed that eight assessees[8] in various Commissionerates availed the benefit of this exemption in respect of ST liability under section 66A as against Section 66 referred to in the cited notification. The total taxable value in respect of units selected by Audit worked out to ₹ 84.18 crore. The Commissionerates(Chennai LTU, Chennai ST, Puducherry, and Madurai) contested the observation stating that that Section 66A is not an independent charging section. Section 66 continued to be the charging section for import of services also. However Audit observed that though the department had earlier taken this stand in another context(cenvat related) vide its Circular letter F.No.354/148/2009-TRU dated 16 July 2009, it had later amended Rule 3(1) of Cenvat Credit Rules, 2004 in 2011 introducing reference to "ST leviable under section 66A of the Finance Act". It had also issued other notifications such as Notifications 18/2009- ST dated 01 July 2009 and 17/2011-ST dated 01 March 2011, which refer to both Sections 66 and section 66A as sections under which ST, was leviable. The implication is that section 66A is a distinct charging section. Even Joint Secretary (TRU)'s letter dated 19 April 2006 addressed to Members (CBEC) and to all Commissioners seems to indicate the same position.

3.21 Audit however noted that the inconsistency in the departmental stand concerning the charging section (relating to period prior to 1 July 2012) may have been however taken care of with the enactment of section 66B (wef 1 July 2012) in Finance Act as the sole charging section. Notification 14/2012-ST dated 17 March 2012 refers to section 66B of said Act. However, as regards the prior period, the earlier notifications would still be effective. Though the Ministry forwarded the replies from the Commissionerates concerned, Audit is yet to receive Ministry's views on the inconsistency pointed out. If ST is not leviable under section 66A, the department may consider amending notifications 18/2009- ST dated 01 July 2009 and 17/2011-ST dated 01 March 2011.

3.22 We further observed that though according to notification No.17/2004 dated 10.9.2004, taxable service provided by the Intellectual Property Rights holder is exempted from payment of ST equivalent to the amount of R and D cess paid, M/s ABB availed the benefit of exemption before the actual payment of R and D cess. The Commissionerate reported that the assessee had paid ST on IPR services before payment of R and D cess as it had taken into consideration the due date for payment of ST. Hence, the assessee had paid interest on the R and D cess amount corresponding to the period between the payment of ST and the payment of R and D cess. Audit observes that the cited notification does not provide any scope for such liberal interpretation.

[8]M/s Hyundai Motor India Limited, in Chennai LTU M/s. Borgwarner Cooling Systems Limited, in Chennai ST, M/s Nagarjuna Oil Corporation Limited in Puducherry,M/s Fenner Conveyer Belting Limited, in Madurai, M/s. ABB Limited, in LTU Bangalore and M/s HSI Automotives Limited, M/s. Mobis India Ltd., and M/s PHA India Ltd., in Chennai ST Commissionerate,

Other instances of unfulfilled ST liability

3.23 Apart from the issues mentioned above, some of the other instances of ST liability remaining unfulfilled at the time of audit of service recipients' records are as shown in the table below. Scrutiny of records indicated unfulfilled ST liability on services such as consulting engineer's service, architect's services, legal consultancy services, management, maintenance or repair service and business support services received from outside the country.

Table 3.1 : Instances of ST liability pointed out by Audit

crore ₹

Sl no	Name of assessee	Name of Commissionerate	Amount of ST pointed out in audit	Amount paid
1.	Vedanta Aluminum Ltd	Bhubaneswar II	1.74	0.40
2	BGR Energy Systems	Chennai ST	0.95	-
3	South India Corporation Ltd	Chennai ST	2.22	-
4.	Hindustan Zink Ltd	Jaipur II	2.05	-
5.	Intec Infonet Pvt Ltd	Delhi ST	1.08	1.10
6.	Verizon Communications Pvt Ltd	Delhi ST	1.67	1.67
7.	Otis Elevators (India) Pvt. Ltd.	Mumbai II ST	1.04	-
8.	Sistema Shyam Teleservices Ltd.	Delhi ST	5.39	5.98
9.	Zee Entertainment Enterprises Ltd.	Mumbai I ST	1.85	2.18

3.24 Besides, we observed one instance in which the department had issued show cause notice without considering all similar transactions upto the period of issue.

A. The department issued a show cause notice in November 2011 to M/s. Sterlite Industries (India) Ltd in Tirunelveli Commissionerate, for the non-payment of ST for ₹ 18.64 crore under section 66A in respect of the commission paid towards underwriters service for the period 2007-08. The assessee had further paid, an amount of ₹ 66.51 crore as commission for underwriter services in 2009-10; the department did not however include the corresponding liability of ST amounting to ₹ 6.85 crore in the show cause notice issued in November 2011. The Ministry informed (March 2013) that the assessee has gone on record that it had incurred no expenses towards underwriter's commission during the year 2009-10 and that the matter was under examination.

Non/Short levy of interest

3.25 Rule 6(1) of the ST Rules, 1994 requires an ST assessee to pay his ST liability by the 6th day of the month, immediately following the calendar month in which the payments are received. Further, section 75 of the Finance Act, 1994 provides that every person, liable to pay the tax in accordance with the provisions of section 68 or rules made thereunder, who fails to credit the tax or any part thereof to the account of the Central Government within the period prescribed, shall pay simple interest at the rate prescribed. We observed delayed payment of ST in 16 cases involving interest liability amount of ₹ 5.33 crore. Such instances indicate the non-adherence by the department

with the prescribed norm of 100 percent for preliminary scrutiny of returns. We have tabulated a few of the instances below:-

Table 3.2: Instances of interest liability pointed out

lakh ₹

Sl no	Name of assessee	Name of Commissionerate	Amount of interest liability	Amount paid by the assessee
1.	Tata Motors Ltd.	Mumbai ST- II	71.76	71.76
2.	BASF Ltd.	Mumbai ST – II	73.26	-
3.	Jaisu Shipping Company Pvt Ltd.	Rajkot	40.32	-
4.	Jetlite (India) Ltd.	Delhi ST	172.85	172.85
5.	Punj Lloyd Ltd.	Delhi ST	76.32	76.32

Recommendations

We recommended that

a. DG (Systems) consider the inclusion of facility in ACES to automatically update category of registrant assessee to include service recipient or to flag such cases where category of remitter in database needs updation , going by the data in returns filed.

DG(System)'s view was that any modification in the ST-1 Registration form may be initiated by the assessee only and that the best approach would be to make it mandatory for assessees to amend the data in their registration forms by making it a mandatory process before filing returns. Accepting the same, Audit recommends that the Ministry may examine the same for incorporation in the system.

b. the department take steps to encourage importers of service to get themselves registered as lack of awareness concerning liability on service recipient under reverse charge mechanism could be a factor for non-registration.

The Ministry accepted the recommendation to utilise the medium of advertisements to improve public awareness concerning ST liability relating to import of services.

c. the department utilise data from authorised dealers for broadening of ST base by identifying non registered importers of service by linking with ACES data.

Agreeing with the recommendation, the Ministry informed that Director General (Audit) had come across approximately 450 unregistered service recipients in a similar exercise undertaken. Audit recommends that the department may consider the allocation of responsibilities among different offices such as DGST, DG(Audit) and DGCEI in connection with collection of data from authorised dealers, its analysis and subsequent follow-up. For instance, follow-up in respect of non-registered service recipients may not be termed the responsibility of the Director General (Audit). Audit further recommends that the department may seek to impress upon RBI the need for enhancement in quality of data captured by authorized dealers.

d. the department consider tapping data relating to Export Oriented Units available with the Development Commissioner's office as a lead for the purpose of assessing ST liability.

The Ministry stated that it would examine the possibility.

e. priority be given to scrutiny and audit of units having transactions involving associated enterprises/holding company-subsidiary company transactions etc.

Agreeing with the recommendation, the Ministry stated that this could be included during scheduling, and while determining audit criteria. It added that the process of revision of audit criteria is underway. During such revision, the department would keep in mind the recommendation.

f. the department may consider issuing a clarification on whether incurring of expenses on behalf of an associated enterprise registered abroad would amount to evidence of import of service from the foreign company.

While acknowledging that this could be a trigger for detailed investigation, the Ministry stated in the light of the new law and Place of Provision of Services Rules, 2012 there is no requirement for a clarification. Audit reiterates that even after the newly introduced definition of 'service' under section 65(44) of the Finance Act as an activity involving consideration and notwithstanding the framing of the Place of Provision of Service Rules 2012, there is likelihood of differing treatments of similar situations because the basic issue of determining existence of 'service' and existence of 'consideration' is to be resolved before the Place of Provision of Service Rules could be applied.

g. the department may take up with RBI the need for issue of suitable instructions to Authorised dealers concerning precautions to be taken for ensuring fulfilment of ST liability by remitter.

The Ministry stated that the department would examine the matter and consider whether RBI should be approached to issue an advisory to authorised dealers for ensuring fulfilment of ST liability by the remitter.

C. Nedunchezhian

New Delhi
Dated: 29 April 2013

(C. NEDUNCHEZHIAN)
Principal Director (Service Tax)

Countersigned

New Delhi
Dated: 29 April 2013

(VINOD RAI)
Comptroller and Auditor General of India

APPENDIX

Appendix I

Purpose Code	Description
S0017	Purchase of intangible assets like patents, copyrights, trademarks etc.
S0202	Payment for operating expenses of Indian shipping companies operating abroad.
S0205	Operational leasing (with crew) – Shipping companies
S0402	Courier services
S0403	Telecommunication services
S0404	Satellite services
S0501	Construction of projects abroad by Indian companies including import of goods at project site
S0502	Payments for cost of construction etc. of projects executed by foreign companies in India.
S0601	Payments for Life insurance premium
S0602	Freight insurance – relating to import & export of goods
S0603	Other general insurance premium
S0604	Reinsurance premium
S0605	Auxiliary services (commission on insurance)
S0701	Financial intermediation except investment banking – Bank charges, collection charges, LC charges, cancellation of forward contracts, commission on financial leasing etc.
S0702	Investment banking – brokerage, underwriting commission etc.
S0703	Auxiliary services – charges on operation & regulatory fees, custodial services, depository services etc.
S0801	Hardware consultancy/implementation
S0802	Software consultancy / implementation
S0803	Data base, data processing charges
S0804	Repair and maintenance of computer and software
S0805	News agency services
S0901	Franchisee services – patents, copyrights, trademarks, industrial processes, franchises etc.

Purpose Code	Description
S0902	Payment for use, through licensing arrangements, of produced originals or prototypes (such as manuscripts and films)
S1002	Trade related services – commission on exports / imports
S1003	Operational leasing services (other than financial leasing) without operating crew, including charter hire
S1004	Legal services
S1005	Accounting, auditing, bookkeeping and tax consulting services
S1006	Business and management consultancy and public relations services
S1007	Advertising, trade fair, market research and public opinion polling service
S1008	Research and Development services
S1009	Architectural, engineering and other technical services
S1010	Agricultural, mining and on–site processing services – protection against insects and disease, increasing of harvest yields, forestry services, mining services like analysis of ores etc.
S1011	Payments for maintenance of offices abroad
S1012	Distribution Services
S1013	Environmental Services
S1019	Other services not included elsewhere
S1101	Audio-visual and related services – services and associated fees related to production of motion pictures, rentals, fees received by actors, directors, producers and fees for distribution rights.

Abbreviations

ACES	Automation of Central Excise and ST
AIR	Annual Information Return
BAS	Business Auxiliary Services
BPO	Business Process Outsourcing
BSS	Business Support Services
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise and Customs
CIB	Central Information Branch
DGCEI	Directorate General of Central Excise Intelligence
DGST	Director General of ST
EOU	Export Oriented Unit
FY	Financial Year
FEMA	Foreign Exchange Management Act
ITD	Income Tax Department
LTU	Large Taxpayer Unit
NSDL	National Securities Depository Limited
PAN	Permanent Account Number
RBI	Reserve Bank of India
SCN	Show Cause Notice
TDS	Tax Deducted at Source
TIN	Tax Information Network