

Handling of Audit By Department and Handling of Adjudication

For Nagpur Branch of WIRC Of ICAI

PRESENTED BY

CA. Dr. Sanjay S. Burad

S. S. Burad & Associates, Nashik

Cell: 9422249572

Off -: 0253-2314225,2316037

E-mail- buradsanjay@gmail.com

21.11.2014

Assessment or Scrutiny of Service Tax Returns

As per section 70 (1) of the Finance Act, 1994

- every service tax payer assesses his tax liability himself and pays the same (**Self Assessment**).
- 'Provisional Assessment' on assessee's request
- Central Excise Officer can make '**Best Judgement Assessment**' under section 72 in case of Failure to file Returns, Failure to Properly Assess Tax or Availing Cenvat wrongly. However, under the service tax law there are currently no other separate provisions for scrutiny or assessment of service tax returns by the Service tax department like Income Tax.

Assessment or Scrutiny of Service Tax Returns

➤ CBEC vide circular dated 23-4-2009 has specified scrutiny system for service tax returns filed by assessees.

Two types of scrutiny-

- i. Preliminary scrutiny
- ii. Detailed scrutiny.

➤ The role of officer carrying out scrutiny shall be limited to finding out facts about correctness of the self assessment by the tax payer. In case any default are found, the office has to communicate the same to Audit or Anti-evasion for further action.

Assessment or Scrutiny of Service Tax Returns --

- Section 73 provides for issue of show cause notice for recovery of service tax short-paid, not paid, not levied or erroneously refunded and thereafter passing an order.
- However, the process by which the department ascertains whether there is a default is either by way of investigation (letters, summons, etc. leading to an issuance of a Show Cause Notice) or **by audit.**



Various Audits

- 1) Special Audit- Section 72A
- 2) Cost Audit – Section 14AA of Central Excise Act, 1944
- 3) EA-2000 Audit

Special Audit

- The Finance Act, 2012 has introduced section 72A empowering Commissioner of Central Excise/Service Tax to appoint Chartered Accountant or Cost Accountant for carrying out special audit of the records of the assessee on behalf of Department. The Commissioner can direct for such audit when he has reason to believe that any person liable to pay service tax–
 - (i) has failed to declare or determine the value of a taxable service correctly or

Special Audit-

(ii) has availed and utilised credit of duty or tax paid –

- (a) which is not within the normal limits having regard to the nature of taxable service provided , the extent of capital goods used or the type of inputs or input services used or any other relevant factors as he may deem appropriate, or
- (b) by means of fraud, collusion, or any wilful misstatement or suppression of facts or Registration

Special Audit--

iii) has operations spread out in multiple locations and it is not possible or practicable to obtain true and complete picture of his accounts from registered premises falling under jurisdiction of the said commissioner.

-Scope, period of audit and completion Time for conducting the audit shall be stipulated by the Commissioner.

-Report has to be submitted to the Commissioner.

-Audit can be conducted irrespective of the fact whether the accounts of the assessee have been audited under any other law or not.

Special Audit---

- The person liable to pay tax (assessee) shall be given opportunity of being heard in respect of any material gathered in audit which is proposed to be utilised in any proceedings by the commissioner.

Cost Audit

-Section 14AA of Central Excise Act ,1944

to empower the Commissioner of Central Excise to direct cost audit in cases of abnormal availment or utilization of Cenvat Credit or availment or utilization on account of fraud, collusion or any wilful mis-statement or suppression of facts.

This provision is rarely used as costs are to be borne by the department who may later be questioned by audit.

EA-2000 Audit

- The present EA-2000 audit is conducted from 1st January 2002 vide Circular No. 598/35/2001-CX dated 09th Nov. 2001 based on new manual.
- The service tax audit made applicable to all services vide circular No.775/8/2004 – C X , dated 17.02.2004.
- The Service tax audit is conducted as per EA-2000 methodology / Guidelines.
- For the Service tax audit the department has issued Service Tax Audit Manual 2011 effective from 01.04.2011.

EA-2000 Audit-

- Service tax Manual covers details of role, responsibility of every officer in the department, function of audit wing, methodology of audit, selection of tax payer, Format of reports, duration.
- EA-2000 is conducted by Superintendent and inspector. As per new system now the audit team will consist of Assistant Commissioner, Superintendents and Inspectors.



EA-2000 Audit

- Selection/Eligibility criteria
- Preliminary Review
- Time limit prescribed
- Maintenance and Preservation of Records
- Conclusion
- Follow ups

➤ Selection of Taxpayers for Audit

CBEC vide Letter F.No.381/145/2005 dated 6th June, 2006 has revised the norms for Service Tax Audit

Type	Annual Tax Payment (Cash + Cenvat)	Frequency
A	More than Rs.50 lakh	Every Year
B	Between Rs. 25 lakh to Rs.50 lakh	Once in Two years
C	Rs.10 lakh to 25 Lakh	Once in Five years
D	Below Rs. 10 Lakh	2 % every year

Selection of Taxpayers for Audit --

Vide Para 13.1 of JS (TRU-II)'s DO letter F. No. 334/3/2011-TRU dated 28-02-2011,

“Individual and Sole Proprietor assesseees with Turnover up to 60 Lacs will not be subject to Audit”.

(As announced by FM in Budget 2011- para191)

Preliminary Review

- After the selection of taxpayer, the Auditor (Central excise Officer who is in charge of Audit) sends a letter intimating the taxpayer about the audit to be conducted. This letter seeks certain information in Questionnaire form and various documents, reports etc. for the preliminary scrutiny at their end. The Audit party should at least give 15 days notice to the Tax payer before commencement of Audit and for submission of reply to the letter. This period can be extended at the request of the tax payer on giving valid reason.
- The Audit party also gathers and documents systems information by interviewing key personnel and tries to understand the organisational pattern, flow of transactions, authorisations, decision making etc. Such interview of key personnel can be taken by calling them to the Department.

Time Limit prescribed

Although Strict time limit for completion of audit has not been stipulated , the audit manual speaks about timely completion of Audit and certain guidelines for desirable time limits for completion of audit depending upon type of Taxpayer.

Type	Annual Tax Payment	Time Limit
A	Above 3 Crores	Up to maximum 10 working days
B	1 Crores to 3 Crores	Up to maximum 7 working days
C	25 Lacs to 1 Crore	Up to maximum 5 working days
D	Up to 25 Lacs	Up to maximum 3 working days

Maintenance and Preservation of Records

(ref. para 3.4.3 of Service Tax Audit Manual, 2011)

- **The Act does** not specify any mandatory records which are to be kept by the assesseees.
- Rule 5(1) provides that ‘records including computerised data as maintained by an assessee in accordance with various laws in force from time to time shall be acceptable’. Thus, the records as required under other laws such as Company Law, Income Tax Act etc applicable to an assessee will be the records required for service tax.

Maintenance and Preservation of Records --

- Rule 9(5) and 9(6) of Cenvat Credit Rules, 2004 provides for maintenance of records by provider of output service with respect to receipt and consumption of inputs, capital goods and input services in respect of which Cenvat Credit has been availed..

Details usually asked /Documents examined

- Copies of ST-3 returns,
- Income Tax Returns alongwith 3CD,
- Annual Report, Balance sheet and Profit and loss account;
- Sales Tax Returns
- Cost Audit Report
- Annual turnover bifurcated into taxable turnover year-wise, service wise;
- Details of exempted turnover along with justification for claiming exemption under notifications if any or on account of Export of services;
- Reconciliation of ST-3 returns with financial statements or bank statements;



Details usually asked /Documents examined –

- Details of pending SCNs and appeals;
- Break up of Other Income so as to determine whether any item thereof would come within the ambit of service tax;
- Details of various expenses so as to determine non-payment of service tax by the assessee as a recipient of services e.g. GTA, reverse charge mechanism;
- Details of Foreign expenses incurred as mentioned in the notes to the accounts to the financial statements.

Details usually asked /Documents examined --

Reconciliation statements

- Returns must be 'compared' and tallied with the financial statements and accounts of the enterprise during the course of finalizing the accounts or the returns whichever is earlier.

- E.g. In order to find out Value of services received as reported in ST 3 as compared to Sales or Income reported in Profit & Loss Account; a reconciliation of Debtors (i.e. Op. Bal + Sales – Cl. Bal.) is required till 31st March . Thereafter the amount of Sales + Advances Recd should tally with ST3.

Details usually asked /Documents examined ---

Following statements which should be examined to ensure compatibility and consistency in the reporting of figures in the service tax returns-

- Financial statements i.e. Balance Sheet and Profit and Loss Account;
- Tax Audit Report alongwith the income tax return; VAT returns.
- TDS returns under the Income Tax Act, 1961/ Form 26 AS
- Records – Sales register, Cenvat credit register, Debit Note/Credit Note Register etc.

Details usually asked /Documents examined ---

- The above examination/ reconciliation maybe done while finalising the service tax returns if the above statements are prepared subsequent to the filing of service tax returns then at that point it may be reconciled and checked and if there are any discrepancies the service tax returns may have to be revised.

➤ ***Details usually asked /Documents examined ----***

➤ Following reconciliation statements could be prepared –

➤ Reconciliation of value of taxable services provided
➤ charged and collected with financial statements. The reconciliation starts with the turnover as per accounts to arrive at the turnover on which service tax is paid.

➤ Reconciliation of service tax paid on overseas payments with financial statements.

➤ Reconciliation of service tax paid on freight with financial statements

➤ A reconciliation statement similar to above can be prepared for service tax payments made in other cases where reverse charge mechanism or Partial Reverse Charge is applicable.

➤ The Cenvat credit balance unutilised at the end of the year as per the service tax returns should

Significant Points to be noted at the time of audit

Any information / detail, which is being furnished to the audit party, should always be furnished along with a covering letter and if possible an acknowledgment of the audit party should be obtained on such covering letter.

Similarly, the audit party should also be requested to furnish any audit objections raised by them in writing.

A record of visit by the audit party should be maintained. For this purpose a log book may be maintained at the registered office wherein the audit party maybe asked to sign on each visit.



Significant Points to be noted at the time of audit

Verify the facts and figures before submitting the same to the department. It is advisable to get the same validated from the relevant operations personnel where required.

The presentation of details (facts and figures) to the audit party of the department is extremely important since it would form the basis of future litigation, if any.

Furnishing of correct/ relevant facts and figures helps focus the dispute, if any, only on points of law rather than on facts.



Conduct of Audit

(extracts from Service Tax Audit Manual)

- The Audit Party is supposed to conduct the audit transparently and without disturbing normal working of the taxpayer.
- Audit is normally distinct from Anti-evasion operation in as much as it can detect irregularities only to the extent of their reflection in Books of Accounts.
- Auditor should keep in view the prevalent transactional and professional practices as also difficulties faced by Taxpayer. Mere technical defaults not having revenue implications may not be viewed seriously.

Conclusion of Audit

Discussion of audit objections with the assessee before finalising their Draft Report.

Opportunity to be given to assessee to give view point on audit objections.

It is advisable to give reply or explanation in writing duly acknowledged by the Auditors.

The Draft Audit Report prepared by the audit party is placed before the Monitoring Committee for discussion. The jurisdictional Commissioner is chairman of the monitoring committee. The Monitoring Committee examines sustainability of each audit objection and decides about future action.

Follow Up

After taking approval of the monitoring committee the Final Audit Report is prepared, which is signed by the Deputy Commissioner , Audit.

The assessee can demand the copy of the Final Audit Report. If the revenue recovery, if any, pointed out in the report has already been done, then no further action is taken.

Otherwise the Audit Report is handed over to jurisdictional officers for recovery proceedings. He will issue letter and then if recovery as per audit is not paid, issue summons under Section 14 of CE Act,1944.

Jurisdictional CEO will record the statement and issue Show Cause Notice.

Handling of Adjudication

- Visits by Departmental Officers
- Service Tax Audit
- Summons
- Adjudication Proceedings
 - Issue of Show Cause Notice
 - Reply to Show Cause Notice
 - Personal Hearing
 - Issue of Order in Original

Visits by Departmental Officers

Search and Seizure (Section 82)

- Section 82 authorises to search the premises of the assesses and seize the documents , records .
- The Joint Commissioner authorises CEO for the search
- The Provisions of Civil Procedure code, 1973 (2 of 1974) relating to searches is applicable.

Visits by Departmental Officers

Search and Seizure---

➤ When officer has reasons to believe that any documents or books or things, which **in his opinion shall be useful for or relevant to any proceedings** under this Chapter **are secreted in place** they use the power under this section.

Summon (Section 83 of FA,1994)

- **Section 14** of CE Act, 1944 made applicable to Service Tax vide Section 83.
- CEO has **power to summon any person whose attendance, he considers necessary**
 - either to give evidence; or
 - to produce a document; or
 - any other thing in any inquiry which such officer is making for any of the purposes of this Act.
- Person so summoned is **bound to state the truth** upon any subject respecting which he is examined or make statements and to produce such documents & other things as may be required.

Summon--

- Every inquiry shall be deemed to be a “judicial proceeding” within the meaning of Section 193 & 228 of IPC, 1860.
- Section 193 of IPC...Punishment with imprisonment for a term up to 7 years & also fine for intentionally giving false evidence or fabrication of false evidence in any stage of judicial proceeding.
- Section 228 of IPC...Punishment with simple imprisonment for a term up to 6 months or fine upto Rs.1,000/- or both on person intentionally offering any insult, or causing any interruption to any public servant while such public servant is sitting in any stage of a judicial proceeding.
- Section 174 of IPC...Non attendance in response to summons is an offence punishable with imprisonment up to 6 months & fine up to Rs.1,000/-
- Documents required to be produced must be specifically stated in the summons

- **Summon--**

- Letter F. No.137/39/2007-CX4 dated 26/02/2007Instructions to be followed by CEO before issuing summons
 - Mode of communication should be either in the form of **telephone call** or by way of sending a **simple letter**
 - If the above mentioned modes **fail or found to be ineffective**, only then CEO shall issue summons for personal presence of the concerned person
 - Summons can be issued only after obtaining **prior written permission** from the officer not below the rank of Asst. Commissioner
 - The **reasons** for issuance of summons to be recorded.

Summon---

The officer authorizing issuance of summons must satisfy himself that **no harassment** has been caused during the visit of the person summoned.

A person **whose statement is recorded** during the inquiry has **no right to have a copy** of his statement **on the spot**. However, he is entitled to get the copy of statement **at the time of issue of SCN or otherwise** in case where the statement is proposed to be used against such person.

Statement made in pursuance of summons is valid even if retracted subsequently & can be used as evidence in the proceedings.



Adjudication Proceedings

Issue of Show Cause Notice

Reply to Show Cause Notice

Personal Hearing

Issue of Order in Original

Appeal to Appellate forum



Thank you!

S.S. Burad & Associates
Nasik