

Part I

AUDIT MANUAL

CHAPTER – I

Introduction

1.1 This manual covers the subjects relating to principles, policies and special issues pertaining to the conduct of a Service Tax Audit. The guidelines are provided to ensure such audit in a uniform, scientific and efficient manner adhering to the latest, internationally recognised audit methodology. The manual does not deal with legal interpretation and rulings on Service Tax matters for which the provisions in the Service Tax law, Board's relevant Circulars and the relevant pronouncements of the Courts and Tribunals, as currently binding, have to be referred to.

1.2 The manual does not contain answers to all possible problems that may arise in the day-to-day audit work. In such cases, the auditor has to apply his mind in the light of legal provisions and Board's Circulars keeping in view the intention behind the principles and techniques described in the Manual.

1.3 It is important for auditors to bear in mind that the provisions of this manual are of a general nature. Some modifications in technique may be necessary keeping in view the business and accounting practices peculiar to the service provided by a particular taxpayer. Similarly, the manual prescribes general risk parameter(s) and these would have to be combined with service-specific risk parameters for selection of taxpayers for auditing. With the experience of auditing more and more services in future, it should be possible to develop service specific risk parameters. Any suggestion in this regard mentioning the parameters as well as the source document from which data for their calculation can be gathered, may be forwarded to the Director General (Audit) from time to time.

1.4 In order to facilitate service-specific capacity building, service profiles of three major revenue-yielding services have been prepared. These services are Telephones, Non-life Insurance and Stock Brokers. The profiles are placed in Part III of this Manual. Feedback from auditors in respect of these services as well as other services would be critical for improving these and developing new ones in future.

1.5 Revised updated editions of this manual will be issued at yearly intervals. However, the officers of the internal audit section of the Commissionerates should

keep abreast of the latest changes in the law and Board's instructions as well as the Court's and Tribunal's judgements for purposeful audit planning and verification.

1.6 Any suggestions for improvement and amendment in the Service Tax Audit Manual may be sent through the jurisdictional Commissioners to the Directorate General (Audit), New Delhi.

1.7 The Chief Commissioners should also monitor the changes in various enactments, laws and regulations of the Central Government, State Government, Union Territories and local bodies that have a direct bearing on the scope of services, service procedures and Service Tax liabilities. These changes may be intimated to the Directorate General (Audit), New Delhi to enable development of requisite strategies in the system of audit.

1.8 This Manual is for departmental use only. The officer to whom it is issued is responsible for its safe up-keep. On transfer or on superannuation of an officer the Manual should be properly accounted for and handed over to an authorised person.

CHAPTER – 2

Outline of Service Tax

2.1 Prior to 1st July 1994 only the manufacturing sector was subject to indirect tax in the form of Central Excise. This approach placed a disproportionate burden on the sector producing commodities, while service-sector, which contributed about 48.45% of GDP, escaped taxation. The base of tax system was required to be extended specially when present thinking favours lowering of tariff rates together with wide-ranging input-duty relief. There is also a crying need for improving the tax-GDP ratio. Therefore, the Service Tax was imposed in 1994 for the first time on (i) Telephone services, (ii) Services relating to non-life insurance and (iii) Services by Stock Brokers.

2.2 The report of the Chelliah Committee on Tax Reforms had also mentioned services as a potential base for increasing revenue. On these recommendations, the then Union Finance Minister, while introducing the Budget for 1994-95 stated that:-

“There is no sound reason for exempting services from taxation, when goods are taxed and many countries treat goods and services alike for tax purposes. The Tax Reforms Committee has recommended the imposition of tax on services as a measure for broadening the base of indirect taxes”.

2.3 Depending on the socio-economic compulsions, each country evolved a taxation system on services adopting either a comprehensive approach or a selective approach. While most of the developed countries tax all the services with very few and limited exemptions, some of the developing countries tax select services only. Hitherto, India has adopted a selective approach to taxation of services.

2.4.1 The legal provisions for the levy and collection of Service Tax were introduced through Finance Bill 1994. Thus, the law relating to Service Tax was enacted vide Chapter V of the Finance Act, 1994 (Sections 64 to 96 thereof) as amended from time to time. Under the charging Section 66 of the Finance Act, 1994 as amended, the Service Tax is levied at a uniform rate on all taxable services (@ 8% with effect from 14.5.2003). Except for certain limited exemptions/

concessions as allowed under Section 93 of the aforesaid Act, there are no general exemptions from Service Tax.

2.4.2 Service Tax is applicable to the whole of India except the State of Jammu and Kashmir. The provisions for Service Tax have been extended to the designated areas in the Continental Shelf and Exclusive Economic Zone of India vide Notification No.1/2002-ST dated 1.3.2002.

2.4.3 A new Chapter “V-A” has been inserted in the Finance Act, 1994 to provide for advance rulings in respect of a question of law or fact regarding the liability to pay Service Tax in relation to a service proposed to be provided, in the manner specified.

2.4.4 Earlier, Notification No.6/99-ST dated 9.4.1999 exempted the taxable service for which payment was received in foreign convertible currency provided such foreign exchange was not repatriated outside India. The said notification has been rescinded by Notification No.2/2003-ST dated 1.3.2003. Consequently Service Tax is leviable on all taxable services irrespective of the fact whether the payment is received in foreign exchange or not.

2.4.5 Service Tax Credit Rules, 2002 were also introduced with effect from 16.8.2002 to allow credit of duty paid on the input service within the same category of service. Section 94 of the Finance Act, 1994 has been amended so as to empower the Central Government to make rules to provide the credit of Service Tax paid on the services consumed or duties paid or deemed to have been paid on goods used for providing a taxable service.

2.5 Salient features of Service Tax law and procedure are as under:

2.5.1 **Authority for levy**

The authority for levy of Service Tax on specified services is contained in Section 66 of the Finance Act, 1994. At present, this section stipulates a rate of tax of 8 per cent of the value of these services.

2.5.2 **Payable by whom**

The tax is normally payable by the service provider. However in special circumstances, the Government may notify the payment not by the service provider but by a person as notified. Considerations like administrative ease, cost of collection may require the shifting of the burden of payment from the service provider to service receiver or any other person. To illustrate, the service Tax

leviable on service provided by an insurance agent is not to be paid by the insurance agent himself but by the insurance company.

2.5.3 Presumption that incidence is passed on

Service Tax is collected from the service provider. However, being an indirect tax, its incidence is normally passed on by the service provider to his client. Under the law, therefore, every person who has paid Service Tax is deemed to have passed on its full incidence to the buyer of the service. This is because section 12B of the Central Excise Act has been made applicable to Service Tax.

2.5.4 Taxable Value

“Value of taxable service” as defined under Section 67 of the aforesaid Act means the gross amount charged by the service provider for the taxable service rendered by him. In certain cases, Board’s circulars clarify the said value or an alternative basis provided by a notification. For example, in the case of advertising services, it is clarified that out of pocket expenses are not included in the value of taxable service. Air Travel Agents have an option under Notification No. 20/97-ST to pay the Service Tax at the rate of 0.4% of the basic fare relating to domestic bookings and 0.8% of the basic fare in the case of international bookings.

2.5.5 Exemption

There is no basic exemption limit. Full exemption is admissible for services provided to United Nations or an International Organisation (as defined) vide Notification No. 16/2002 – ST dated 2.8.2002. Notification No. 17/2002 – ST dated 21.11.2002 provides full exemption to taxable service provided to a developer or units in a Special Economic Zone (SEZ) subject to specified terms and conditions.

2.5.6 Registration

The taxpayer has to submit an application in form ST-1 for registering himself with the jurisdictional Superintendent of Central Excise. This application is to be made within 30 days from the date a particular Service Tax is levied or within 30 days from the date of commencement of business, whichever is later. There is no registration fee. Where an taxpayer provides more than one taxable service, he may make a single application stating all the services provided by him. He will be under the jurisdiction of one Superintendent of Central Excise in respect of all the taxable services rendered by him. The Superintendent shall grant a certificate of registration in form ST-2 within 7 days failing which it will be deemed as if the

taxpayer has been registered. If a taxpayer has the system of centralized billing, he may apply for a single registration for the office from where the centralised billing is done and not a separate one for each office. Even in cases where an taxpayer has central accounting system instead of centralized billing, he can make a request to the jurisdictional Commissioner for registration of central accounting office only. The Commissioner can permit it if he is satisfied that such registration shall not be detrimental to the interest of revenue.

There is a penalty for failure to register under Section 75A of the Finance Act, 1994.

2.5.7 Every taxpayer is required to obtain a Service-Tax Code (STC) No. based on PAN allotted by Income-Tax department. For details, Board's Service Tax Circular No. 35/3/2001-CX.4 dated 27.8.2001 may be referred to.

2.5.8 **Records**

No specific records are prescribed. Under Rule 5(1) of Service Tax Rules, 1994 the records as maintained by a taxpayer (including computerized data) in accordance with various laws in force from time to time shall be acceptable. Further, as per Rule 5(3) of Service Tax Credit Rules 2002, the output service provider availing Service Tax credit shall maintain proper records in which the following information shall be recorded:-

- a) Sr. No. and date of document on which Service Tax credit is availed;
- b) Service Tax registration No. and name of the input service provider;
- c) Description and value of input;
- d) Service Tax credit availed;
- e) Service Tax credit utilized for payment of Service Tax on output Service.

2.5.9 As per Rule 5(2) of Service Tax Rules, 1994, every taxpayer shall furnish to the jurisdictional Superintendent of Central Excise, at the time of filing his return for the first time, a list of all accounts maintained by the taxpayer in relation to Service Tax including memoranda received from his branch offices.

2.5.10 **Assessment:**

Self assessment is to be done by the taxpayer and return filed with the jurisdictional Superintendent of Central Excise (Section 70 of the Finance Act, 1994). The Superintendent will verify the correctness of the tax assessed. For this purpose, he may ask for any relevant accounts and documents etc. In case he feels that the correct amount of Service Tax has not been paid by the taxpayer, he will refer the matter to Assistant / Deputy Commissioner. The Assistant / Deputy Commissioner would pass an assessment order on the basis of all relevant materials and assess the tax actually payable. For any wilful omission or incorrect supply of facts involving short payment of tax, the department can initiate recovery proceedings extending up-to a retrospective period of 5 years. In the remaining cases of short payment, dues can be recovered within the normal time of one year. In case the taxpayer has paid Service Tax but the taxable service is not so provided by him either wholly or partially for any reason, he may adjust the excess Service Tax so paid by him (calculated on a pro-rata basis) against his tax liability for the subsequent period, provided the taxpayer has refunded the value of taxable service and the Service Tax thereon to the client.

2.5.11 **Provisional Assessment**

In case, due to any reason, a taxpayer is unable to calculate the amount of tax payable correctly, he can request the Assistant / Deputy Commissioner for provisional assessment for which he has to follow certain formalities including execution of bonds in terms of Rule 6 of Service Tax Rules.

2.5.12 **Payment of Tax**

The tax is to be paid for a particular period only on the value received for the taxable service provided and not on the amount billed to the client. In the case of corporate taxpayers, Service Tax on the value of taxable service received during a calendar month has to be paid by 25th of the month immediately following that month. Non-corporate taxpayers have to pay the tax on a quarterly basis i.e by the 25th of the calendar month immediately following the last month of the quarter. Thus, payment of service tax is due from non-corporate taxpayers by the 25th of April, July, October and January respectively in each financial year. The tax is

required to be paid under TR6 challan (yellow colour) in the specified branches of designated banks.

If the Service Tax is deposited by cheque, the date of presentation of cheque to the designated bank is deemed to be the date of payment. However, if the cheque is not honoured, it would amount to non-payment of Service Tax and would attract necessary penal consequences. There is a simple interest on delayed payment of tax under Section 75 of the Finance Act, 1994. In addition, penalty under Section 76 is also attracted on failure to pay the tax.

2.5.13 Credit of Service-Tax on input services while providing a taxable service.

2.5.13.1 Section 94(2)(ee) of the Finance Act, 1994, allows the credit of Service Tax paid on the services consumed for providing a taxable service where the services consumed and the service provided fall in the same category of taxable service. With the Budget 2003, a further Clause (eee) is inserted under Section 94(2) empowering the Central Government to make rules to allow the credit of Service Tax paid on all input-Services consumed or duties paid or deemed to have been paid on goods used for providing a taxable service. However, rules are yet to be notified under this provision to permit availment of credit of duty paid on goods used for providing a taxable service.

2.5.13.2 Under the amended Rule 3 (1) of the Service Tax Credit Rules, 2002 where the input service falls in the same category of taxable service as that of output service, an output service provider is allowed to take credit of the Service Tax paid on such inputs service provided invoice or bill or challan is issued on or after 16.8.2002. With effect from 14.5.2003, the scheme has been widened so that credit of Service Tax paid on input service is allowed for payment of Service Tax on any of the output services provided by the person availing of such credit. In such cases Service Tax Credit is admissible on such input service provided invoice or bill or challan is issued on or after 14.5.2003.

2.5.13.3 It is also provided that the output service provider shall be allowed to take such credit, on or after the day on which he makes payment of the value of input service and the Service Tax paid or payable as indicated in invoice or bill or challan referred to in Rule 5(1) of the Service Tax Credit Rules.

2.5.13.4 No Service Tax credit is admissible on input service received and consumed in relation to rendering of such output service which is either exempt from whole of Service Tax leviable thereon or is not a taxable service except in the circumstances mentioned below:-

(I) where a service provider avails credit on any input service and renders such output service which are chargeable to Service Tax as well as exempted services or non-taxable services, as the case may be. In that case he shall maintain separate accounts for receipt and consumption of input service meant for consumption in relation to rendering of output services which are chargeable to Service Tax and those meant for consumption in relation to rendering of output services which are exempted services or non-taxable services as the case may be. He shall take credit only on that portion of input service, which is intended for use in relation to rendering output services which are chargeable to Service Tax.

(II) If the service provider opts not to comply with the provision stated in preceding para, he shall be allowed to utilize Service Tax credit for payment of Service Tax on any output service only to the extent of an amount not exceeding 35% of the amount of Service Tax payable on such output service.

2.5.13.5 Service Tax credit on the service provided in relation to telephone connection is permissible only in respect of such telephone connections which are installed in the premises from where output service is provided.

2.5.13.6 While paying the Service Tax on the output service, the Service Tax credit shall be utilized by a corporate taxpayer only to the extent such credit is available on the last day of a month, for payment of Service Tax relating to the month. In case where the taxpayer is an individual or proprietary firm or partnership firm, credit is available to the extent such credit is available on the last day of the quarter for payment of Service Tax relating to the quarter.

2.5.13.7 Rule 4 (2) of the aforesaid rules also provides that refund of Service Tax credit available on input service shall not be allowed under any circumstances.

2.5.14 **Return**

A half-yearly return has to be filed by every taxpayer in form ST-3 or ST-3A (i.e. for periods April to September and October to March) by the 25th of the month following the half year. Form ST 3 A is applicable to cases of provisional assessment and is in the nature of a Memorandum for provisional deposit. Section 77 provides for a penalty for failure to furnish returns.

2.5.15 various sections of Central Excise Act, 1944 have been made applicable to Service-Tax as per Section 83 of Finance Act, 1994. A list of these provisions alongwith their subject matter (in brief) is given in the Table below:

Section of the Central Excise Act, 1944	Subject (in brief)
Sec 9C	Presumption of culpable mental state
Sec 9D	Relevancy of statements under certain circumstances
Sec 11	Recovery of sums due to Government
Sec11B	Claim for refund of duty
Sec 11BB	Interest on delayed refunds
Sec 11C	Power not to recover duty of excise not levied or short-levied as a result of general practice
Sec 11D	Duties of excise collected from the buyer to be deposited with the Central Government
Sec 12	Application of the provisions of Act No.52 of 1962 to Central Excise duties
Sec 12A	Price of goods to indicate the amount of duty paid thereon
Sec 12B	Presumption that incidence of duty has been passed on to the buyer
Sec 12C	Consumer Welfare Fund
Sec 12D	Utilization of the Fund
Sec 12E	Powers of Central Excise Officers
Sec 14	Power to summon persons to give evidence and produce documents in inquiries under this Act
Sec 15	Officers required to assist Central Excise officers
Sec 35F to 35O (both inclusive)	Appeal provisions
Sec 35Q	Appearance by authorized representative
Sec 36	Definitions
Sec 36A	Presumption as to documents in certain cases
Sec 36B	Admissibility of microfilms, facsimile copies of documents and computer print outs as documents and as evidence
Sec 37A	Delegation of powers
Sec 37B	Instructions to Central Excise officers
Sec37C	Services of decisions, orders, summons etc.
Sec 37D	Rounding off of duty, etc.
Sec 40	Protection of action taken under the Act

Chapter 3

Auditor's Responsibility and Authority

3.1 Definition of Auditor

3.1.1 Service Tax is an indirect tax administered by Central Excise Department. Accordingly, an 'Auditor' means a Central Excise officer entrusted with the duty of conducting audit.

3.2 Role of the Auditor

3.2.1 While conducting audit, the Auditor is required to carry out his duties with utmost sincerity, integrity and diligence. The Auditor has to aim at detection of non compliance, procedural irregularities and leakage of revenue due to deliberate action or ignorance on the part of the taxpayer. At the same time, the Auditor should keep in view the prevalent transactional and professional practices, as also the practical difficulties faced by a taxpayer. Therefore, the Auditor should take a balanced, fair and rational approach while conducting the audit. During the course of the audit if any purely technical infractions, without any revenue implications are noticed, the Auditor should exercise sense of proportion and should guide the taxpayer in correcting the procedures, especially as many of the taxpayers may have come under the tax net recently.

3.2.2. The audit process should be transparent so that the findings are discussed with the taxpayer and an opportunity is given to him to give his view-point before an objection is finalised and recovery measures are initiated.

3.2.3 The Auditor should consider the view-point of the taxpayer regarding all points of dispute before taking any definitive stand. Whenever in doubt, the Auditor should contact his supervisor or Assistant / Deputy Commissioner to ensure that the view taken by him is consistent with established law and procedure.

3.2.4 An Auditor should endeavour to conclude all issues raised by him during a particular audit. He should document all his findings in the working papers so that a record of steps leading to an audit point is available. The working papers for each of the step should be written as soon as that step is completed before proceeding to the next step.

3.3 Dealing with the Public

3.3.1 The Government's objective is to collect correct amount of tax levied under the Service Tax law in a cost-effective, responsive, fair and transparent manner and also to maintain public confidence in the integrity of the tax system. The audit should be participative and a fact finding mission with the objective of guiding the taxpayer while at the same time guarding against any leakage of revenue. It should not be a fault finding mission.

3.3.2 The Auditor should maintain a good professional relationship with the taxpayer. The Auditor should recognise the rights of the taxpayers, such as, the right to impartial and uniform application of law; the right to be treated with courtesy and fairness, the right to information permitted by law and the right to confidentiality of information disclosed only for Departmental audit. Normally the taxpayers have the following advantages from such Audit:-

- a) They will be better equipped to comply with the Service Tax Law and Procedures;
- b) The preparation of ST-3 Return and self-assessment of Service Tax will be better focused and complete;
- c) The scrutiny of business accounts and reports/returns submitted to various agencies, in the course of audit, will help them in removing any deficiencies in their accounting, documentation and internal controls;
- d) The disputes and proceedings against them would be minimised or even eliminated.

3.3.3 Auditor should use a constructive and tactful approach to gain the goodwill and confidence of the taxpayer. In return, the Auditor can expect the taxpayer to be

co-operative and provide the necessary documents and information. In cases of non-co-operation, deliberate failure to provide information by the taxpayer or any other exigency, the Auditor should inform his superiors and follow it up by a written report, if necessary.

3.3.4 Confidentiality should be maintained in respect of sensitive and confidential information furnished to an Auditor during the course of audit. All records submitted to the audit parties in electronic or manual format, should be used only for verification of levy of service tax and tax compliance. These shall not be used for any other purposes without the written consent of the taxpayer. Further, the officers should not disclose particulars learnt by them in their official capacity during the discharge of their duties.

3.4 Auditor's authority under Service Tax law.

3.4.1 Now, all taxable services in the entire country are required to be audited. Section 65 (120) of the said Finance Act, 1994 provides that words and expressions used but not defined in Chapter V of the said Finance Act and defined in the Central Excise Act, 1944 or the rules made thereunder, shall apply, so far as may be in relation to Service Tax as they apply in relation to a duty of excise. Rule 2(2) of Service Tax Rules, 1994 lays down that all words and expressions used but not defined in Service Tax Rules but defined in the Central Excise Act, 1944 and the rules made thereunder shall have the meanings assigned to them in that Act and Rules. Accordingly, the definition of "Central Excise Officer" as contained in the Section 2(b) of the Central Excise Act, 1994 will also apply to the Central Excise officers conducting Service Tax audit. Thus, a Central Excise officer assigned the duties of Audit in Service Tax is a proper officer for conduct of Service Tax audit.

3.4.2 Vide Service Tax Circular No. 19/13/96 dated 21.11.96, the Board directed the audit of taxpayers providing services relating to telephones, insurance and stock broking. Subsequently, vide Service Tax Circular No. 38/1/2002-CX dated 7.2.2002, the Board issued instructions for audit of specified Service Tax taxpayers registered in the metropolitan cities of New Delhi, Mumbai, Chennai and Kolkata. This circular also enclosed a proforma for conducting such audit based on EA 2000 audit being carried out on the Central Excise side. Efforts are also required to be made to have the said audit done by teams of officers already familiar with EA

2000 audit who should familiarise themselves properly with the law and procedures relating to Service Tax. The audit teams were also required to ensure that during the course of audit, there is minimum hindrance in the normal working of the taxpayer.

3.4.3 Service Tax Act and Rules framed thereunder do not prescribe any specific records to be maintained by the taxpayer. However, Rule 5 (2) of Service Tax Rules, 1994 requires every taxpayer to furnish to the Superintendent of Central Excise, at the time of filing his return for the first time, a list of all accounts maintained by the taxpayer in relation to Service Tax including memoranda received from his branch offices. Rule 5 (1) of the said Rules also mentions that the records (including computerised data) as mentioned by a taxpayer in accordance with various laws in force from time to time shall be acceptable. Besides, Rule 5 (3) of Service Tax Credit Rules, 2002 lays down that the output service provider availing Service Tax credit shall maintain proper records in which the relevant information regarding the Serial No. and date of document on which Service Tax credit is availed, Service Tax Registration No. and name of the input service provider, description and value of input service, service tax credit availed, service tax credit utilised for payment of service tax on output service, shall be recorded.

3.4.4 In view of the above, all records and documents pertaining to the business of rendering taxable service including those relating to availment of credit in terms of Clause(ee) and (eee) of Section 94 (2) of the Finance Act, 1944 (as amended) including computerised accounts, can be appropriately examined by the officers conducting audit.

Chapter 4

Broad Principles of Audit

4.1 The basic objective of audit is to measure the level of compliance of the taxpayer with the provisions of Chapter V of the Finance Act, 1994 and the rules framed thereunder. It should be consistent with departmental instructions and make use of professional audit methodology and procedures.

The basic principles are:

- i) The audit should be conducted in a systematic and penetrative manner.
- ii) Emphasis should be on the identified risk areas and on scrutiny of records maintained in the normal course of business.
- iii) Audit efforts should be based on materiality i.e. degree of scrutiny will depend on the nature of risk factors identified.
- iv) Recording of all checks and findings.
- v) Audit should be normally distinct from anti-evasion operation in as much as it can detect irregularities only to the extent of their reflection in the books of accounts.
- vi) If during the audit, it is seen that the guidelines in this manual are in conflict with the provisions of the Chapter V of Finance Act, 1994 and the Rules framed under Section 94 thereof or Notification/instructions because of any changes in the law and policy subsequent to the issue of this manual, the provisions of the Act/Rules/Notification and latest Circulars of the Board shall prevail over the contents of this manual.

4.2 Standards for conduct of audit:

4.2.1 In keeping with the principles of audit outlined above, Service Tax audit has to be conducted in a transparent and systematic manner with focus on business records of the taxpayer according to the audit plan for each taxpayer. The taxpayer's participation in the course of audit is also envisaged so that instead of purely technical and explainable objections (without any revenue implications), the focus is kept on substantive issues.

4.2.2 The auditor should ensure that audit is conducted in a focused manner with optimum utilisation of time and resources. The auditor must use judgement and experience to determine the materiality of any discrepancies and/or irregularities

observed and decide what action is necessary under the circumstances, for example,

- (i) Cumulative effect of small items: An error of one isolated item might be insignificant but the cumulative effect of many individually unimportant items would signify systems' failure. In fact, the relative materiality of an individual item has to be viewed against the net total effect on over-all compliance and revenue interest.
- (ii) General or Particular Items: An error made in a particular transaction may be an aberration if it is a stray single instance but the effect may be material, if it is of recurring nature. (Frequency of error).
- (iii) Effect in relation to scale of an assessee's operation: An error by itself may appear small but may have sizable implications due to the huge scale of an assessee's operations.

4.3 Period to be covered during audit:

Every audit should invariably cover the retrospective period up to the previous audit by the Departmental Audit Party or the last 5 years (limited to the commencement of levy on particular service) whichever is less and should extend up to one completed month preceding the date of current audit.

4.4 Duration of audit

Efforts should be made to complete each audit within the following general time limits:-

- i) Taxpayers with Service Tax payment above Rs.10 lakhs (mandatory units) – 7 working days.
- ii) Taxpayers with Service Tax payment between Rs. 3 lakhs and Rs. 10 lakhs – 5 working days.
- iii) Taxpayers with Service Tax payment upto Rs. 3 lakhs – 3 working days.

The duration, as above, covers the entire period spent on audit of a particular taxpayer from Desk Review to preparation of report of audit results (i.e. days spent in office as well as in the taxpayer's premises). In exceptional cases, the aforesaid period may be extended with the approval of Deputy/Assistant Commissioner (Audit). Further, in accordance with the requirements of the audit of

a particular taxpayer such duration can suitably be reduced with the express prior concurrence of the Deputy/Assistant Commissioner (Audit) provided the verification as per the Audit Plan has been completed in the prescribed manner.

4.5 The stage-wise action for audit is briefly as under;-

- i) Preparation of master file with a view to having clear and comprehensive taxpayer profile.
- ii) Selection of taxpayers for audit.
- iii) Desk review on the basis of relevant documents and information about the taxpayer,
- iv) Formulation of specific audit plan for each service provider based on desk review.
- v) Verification in the premises of the taxpayer.
- vi) Apprising the taxpayer of the irregularities noticed and ascertaining his view point.
- vii) Suggestions to taxpayer for future correction/improvements.
- viii) Preparation of draft audit report and its submission to the senior officers.
- ix) Monitoring of the work done as reflected in draft audit report by a committee headed by a Commissioner including approval of the objections raised.
- x) Issue of final audit report.
- xi) Follow up action, for monitoring the compliance of various points by the field officers and issue of SCNs wherever warranted.

Chapter 5

SELECTION OF TAXPAYERS:

5.1.1 Mere coverage of more number of taxpayers necessarily dilutes the quality of Audit. Selection of taxpayers for audit is vital as it permits more effective use of Government's resources for achieving better audit results. Selection of taxpayers for audit means selection of taxpayers to be audited during a specified period depending upon the available administrative resources.

5.1.2. Notwithstanding the above principle, there are certain types of taxpayers (depending on criteria such as the quantum of annual Service Tax payment and nature of service), which are to be audited mandatorily within a given span of time. Thus, taxpayers whose annual service tax payment (in cash and input service credit taken together) was Rs.10 lakhs or more in the preceding financial year should be subjected to mandatory audit each year.

5.1.3. The Audit selection guidelines, therefore, would apply to the non-mandatory taxpayers, forming part of the discretionary workload. These taxpayers should be selected on the basis of assessment of the risk potential to revenue. This process, which is an essential feature of audit selection, is known as Risk Assessment. It involves the ranking of taxpayers according to a quantitative indicator of risk known as a 'risk parameter'.

5.1.4 Method of selection of taxpayers based on risk assessment: The selection of taxpayers for audit should be carried out for the entire year at the beginning of the financial year. The following steps should be undertaken in sequence:

- Preparation of updated list of all registered taxpayers of the Commissionerate falling under different tax slabs (i.e. above Rs. 10 lakhs, between 3 lakhs and 10 lakhs and below Rs. 3 lakhs).
- Deciding upon the maximum number of audits that can be carried out in different tax slabs in non-mandatory categories taking into account:
 - 1) the instructions of the Board,
 - 2) the available man power in audit section, and

- 3) available audit man-hours after conducting the mandatory audits
- Working out of risk parameter S1 as prescribed in paragraph 5.1.5 below or pending development of database for the calculation of this risk parameter in the manner prescribed in paragraph 5.1.6.
 - Working out local risk parameters which may vary from one Commissionerate to another or one service category to another. An illustrative list could be :
 - a) High tax payers;
 - b) Taxpayers showing a significant increase in avilment of input service credit;
 - c) Taxpayers providing both taxable and non-taxable services;
 - d) Taxpayers providing both taxable and exempt services;
 - e) Taxpayers whose value of taxable service exhibits a downward trend
 - Preparation of final annual lists of taxpayers selected for audit by applying the prescribed risk parameters together with local risk parameters. In doing so, taxpayers should be selected in descending order of their risk perception keeping in mind the availability of manpower

5.1.5 Computation of risk parameter S1:

The S1 rupee risk values of all non-mandatory taxpayers should be calculated using the following method:

- ❖ Ascertain the total (gross) income from (sale of) services earned by the taxpayer in the previous financial year (complete financial year immediately preceding the year of selecting the tax payer for audit) – Y (T_1). This would be available in the Profit and Loss Statement of the company. In cases where a company has several profit centres one or more of which may lie within the jurisdiction of a Commissionerate, the disaggregated figure for each profit centre would be required. This would be available in the Trial Balance. To cite an example, if each branch office of a courier company is separately registered as a taxpayer for Service Tax, the respective income figures for each would have to be ascertained from the Trial Balance. In the case of taxpayers that are not required to prepare Profit and Loss Statement

(e.g. Proprietorship firms etc.), the income from services may be ascertained from other sources like Income Tax Return.

- ❖ Ascertain the value of taxable service realized by the taxpayer during the previous financial year – $V(T_1)$. This figure would have to be compiled from the half-yearly ST-3 returns filed by the taxpayer for that year.
- ❖ The value of S1 parameter for the previous financial year would be

$$= Y(T_1) (-) V(T_1)$$

For this to be meaningful, ensure that both the income from services and the value of taxable service are denominated in the same unit such as thousands, lakhs or crores. It is possible that the S1 parameter for some taxpayers may be zero.

- ❖ S1 rupee risk for the previous financial year would be

$$= S1(x) \text{ Ad valorem rate of service tax}$$

To give an illustration, assume that the income from services for a particular taxpayer ABC was Rs. 1,42,00,000 in a financial year and his value of taxable service for the same period was Rs. 1,30,00,000. Then, the S1 rupee risk for the financial year would be

$$\begin{aligned} &= (1,42,00,000 - 1,30,00,000) \times 0.08 \\ &= \text{Rs.}96,000 \end{aligned}$$

- ❖ All the non-mandatory taxpayers should be arranged in the descending order of rupee risk and included in the audit schedule in that sequence.

5.1.6 A comprehensive database capturing details necessary for the calculation of S1 parameter for all non-mandatory taxpayers would have to be created in each Commissionerate. This may take time to develop. As an interim measure, the selection of units may be done in the following manner:

- ❖ Using Service tax revenue as a criterion, list out the top 20 service categories in the Commissionerate.
- ❖ For each of these services, list out the non-mandatory taxpayers (i.e. remove taxpayers yielding annual revenue of Rs. 10 lakhs or more)
- ❖ Pick out the top two taxpayers from each of these service categories and include them in the audit schedule
- ❖ Depending on the availability of manpower and time, select one or two taxpayers from all the remaining service categories for which taxpayers are

registered in the Commissionerate. This would enable comprehensive coverage and capacity building for all services under the tax net.

5.2 Preparation of audit schedule:

5.2.1 Annual and Quarterly. The selection of taxpayers for audit should be done at the beginning of the financial year for the whole year. The list of taxpayers so chosen shall form the basis for preparation of audit schedule. While preparing the schedule care should be taken to ensure that all taxpayers to be audited mandatorily during the year are covered under it. As regards the balance units, it is suggested that a schedule of units to be audited should be prepared in such a manner that the high-risk units are placed at the top. This will ensure that in the event of time overrun in conducting some of the audits, only the low risk units are left unaudited. Normally, the final audit schedule is prepared on a quarterly basis. Such schedules should be made well in advance so as to ensure that all taxpayers listed for audit receive the intimation at least fifteen days before the commencement of audit.

5.2.2 Service Tax Audit Cell (hereinafter referred to as the Audit Cell) in the Audit Sections.

5.2.2.1 The audit section in each Commissionerate should have a separate Service Tax Audit Cell. The said Cell should comprise of officers with proven track record and knowledge of Service Tax Law and procedures together with current audit techniques. Educational qualifications of an officer should also be factored in for such selection.

5.2.2.2 Efforts should be made to arrange special training programmes with regard to Service Tax audit techniques, peculiarities of major taxable services and risk factors unique to important service categories so that auditors have the necessary knowledge and insight. Allotment of service providers for audit should be done for a quarter well in advance so as to give enough time for auditors to prepare background material and familiarise themselves with the relevant service.

5.3 Allocation of Audit:

Each Service Provider included in the Audit Schedule should be assigned to a particular group in the Service Tax Audit Cell. This has to be done carefully after taking into account the experience and specialization of the auditors. For audit of

service providers maintaining accounts in electronic format, a computer savvy group of auditors would be desirable. Audit groups can be reconstituted in accordance with the needs.

5.4 Deployment of Auditors

5.4.1 Normally, officers selected and posted to Service Tax Audit Cell should be allowed to continue for a minimum period of 3 years.

5.4.2 Generally, each audit party may consist of two Superintendents, one Inspector and a Deputy Office Superintendent. The senior most Superintendent should lead the audit party. If a particular taxpayer is known as one with heavy work load (in view of number of transactions, their complexity and connected matters) the number of officers in an audit party may suitably be increased. The supervisory officer of the rank of Assistant/Deputy Commissioner must frequently (specially in important and sensitive units) associate with the audit verification by attending to select risk areas as identified in the desk review. In addition to a minimum advance-notice of 15 days to the taxpayer, every audit party should inform the supervising Assistant/Deputy Commissioner (Audit) (as also the jurisdictional Divisional Assistant/Deputy Commissioner) of the dates of their visit to a service-provider so as to enable them to contact the audit party whenever necessary.

Chapter 6

Preparation for Audit

6.1 Master File on each Service Provider:

6.1.1 Risk assessment-based audit requires a strong database for profiling each taxpayer so that risk-factors relevant to a taxpayer may be identified in a scientific manner and audit planned and executed accordingly. Some of the relevant data has to be collected from the taxpayer during the course of audit, while the rest is to be procured from the jurisdictional Commissionerate. It may have to be culled from the registration documents and returns filed by the taxpayer as well as from his annual financial statements, reports/returns to regulatory authorities or other agencies etc.

6.1.2 The Audit Cell should collect all relevant information and documents about the taxpayer from various sources (including the service provider himself), arrange it methodically and regularly update it. For this, it is necessary to maintain separate Master Files for each service provider registered with the department. The master file should contain all relevant information about a taxpayer in three parts. The first part is the Taxpayer's profile, the second part contains information about the business particulars of the taxpayer and the third part contains the copies of documents such as application for registration, balance sheets, annual reports etc., pertaining to the taxpayer. The information should be in the form of statistical data as well as in narrative form. The format of Master file is given in **Annexure A** to this manual.

6.1.3 The hard copies of the documents should be maintained for a period of 5 years. Documents older than 5 years should be removed unless relevant to any current proceedings. The disposal of the documents removed from the master file should be done with the approval of Deputy Commissioner / Assistant Commissioner (Audit).

6.1.4 The Audit Cell should allot a separate electronic folder to each taxpayer's computer and make all entries for a Service Provider in that folder only. The folder should be up dated after every subsequent audit. However, the Audit Cell, on a half yearly basis should update the information that changes or develops periodically. Initially, most of the information would be available in the form of hard copies and

the updating has to be done manually. Progressively, the information would be maintained in electronic format with automated data transfer through networking system and could be automatically updated.

6.1.5 The electronic data should be kept in properly secured format so that it can be altered or modified only by the authorised officer of the Audit Cell. The data should, however, be accessible to all the concerned officers.

This file would be useful not only for audit but also for other purposes such as generating Management Information System (MIS) reports and replying to Parliament Questions.

6.1.6 The Audit Cell is responsible for the upkeep and update of the master files on each taxpayer. If not already opened, such files should be created immediately, in any case, before conduct of next audit.

6.2 Desk Review on the basis of relevant documents and information about the taxpayer:

6.2.1 This is the first stage of the audit exercise done in the office. From the point of view of auditors, the idea is to assimilate maximum possible relevant information about the taxpayer and his business before visiting his premises. It involves scrutiny and examination of upto date relevant information (including that already captured in the Master File on taxpayer) by the audit team. The objective of desk review is to devise a focused audit plan. The proper desk review, preferably, under the supervision of a senior officer is vital for drawing up a meaningful audit plan.

6.2.2 The specific points mentioned under the heading 'Desk Review' in the proforma of Working Papers (Part II of this manual) should be covered in the desk-review.

6.3 Gathering Information about the taxpayer and the Systems followed by him:

6.3.1 The next step in the audit process is to gather information about the taxpayer and documenting the business systems or processes in use at his unit. The need for documentation may arise only if the Master File does not already contain this information. It is important to stress that even where the business processes and accounting practises are documented, the auditor may need to discuss them with the Management of the taxpayer for their proper understanding. From this point of view, discussions with the Senior Management of the taxpayer

are critical for developing a meaningful audit plan. Keeping in mind the objective of gathering accurate and complete information it may be useful not to conduct a formal interview, but to engage the taxpayer in informal discussions. At the same time, it is important to prepare points/questions (on which information is required) beforehand. Important non-compliance issues derived from the profiles should also be discussed during the discussions and while gathering information from the taxpayer. Special emphasis should be placed on any organization or systemic changes that may have occurred since the last audit. In case of mandatory units, such discussions can be held during a brief preparatory visit to the taxpayer. In other case, this may be done at the beginning of the visit for audit verification. Under no circumstances, should this stage be skipped.

6.3.2 During the discussion details regarding the internal systems used by the company for financial and tax accounting may be obtained. During the process of gathering systems information, it may be ascertained how the service tax is accounted for in non-routine such as services provided to related units, cancellation / revision of Service tax payment and excess / short payment of service taxes etc. Any special registers or accounts maintained for such transactions should be made note of.

The results of Desk-Review, alongwith Working Papers written upto this stage, should be submitted to Deputy Commissioner / Assistant Commissioner (Audit) for information and guidance.

6.4 Audit Plan

6.4.1 Audit Plan is the most important stage before taking up audit verification. At this stage, the auditor is in a position to take a reasonable view regarding potential risk areas, abnormal trends and unusual developments, which need detailed verification. Audit Plan is not a routine list of checks which can generally be exercised, but is an exact formulation of issues selected for detailed scrutiny in respect of a particular service-provider based on the aforesaid desk review and risk analysis. Audit Plan should be a clear plan of action in a standard Format (as per **Annexure F** to this manual). It should be consistent with the scale of operation of a

service provider as also the reasons for selection of a taxpayer in the Audit Schedule. How the issues are pin-pointed for an audit plan is illustrated below:-

- (a) Under-valuation of taxable service by excluding any specific component of gross amount charged for the service.
- (b) Suspect discounts.
- (c) Service Tax nomenclature involving non payment of tax on a service that may actually be taxable but is misdeclared or concealed as non taxable.
- (d) Apportioning of value in favour of non-taxable or exempt services when composite, or multiple services are provided.
- (e) Possible leakage of revenue because of sub-contracting of a service or part thereof.
- (f) Long pendency of provisional assessment.
- (g) Disproportionate availment of credit of duty/tax on input goods or services.

Chapter 7

7.1 Evaluation of Internal Controls of the Taxpayer

7.1.1 Internal Controls form a basis for reliability of the company's own accounting records. The evaluation of Internal Control is necessary for determination of the scope and extent of audit checks required for the taxpayer. If the internal controls are well designed and working properly, then it is possible to rely on the books maintained by him. The scope and the extent of the audit can be reduced in such a case. The reverse would be true if the internal controls are not reliable. One of the ways of evaluating internal control is to do a '**walk through**' (as explained in para 7.5.2 of this manual).

7.1.2 An evaluation of Internal Controls helps in gauging the internal controls of the taxpayer. The level of deficiencies in internal controls would determine the coverage and depth of audit verification required for a particular sub-system in the unit. In this regard, an auditor would normally examine the following:

- (i) Characteristics of the company's business and its activities.
- (ii) System of maintenance of records and accounts.
- (iii) Identifying the persons handling records for accounting purposes.
- (iv) Allocation of responsibilities at different levels.
- (v) System of internal checks.
- (vi) System of movement of documents having relation to Service Tax assessment.
- (vii) Inter-departmental linkages of documents and information, and
- (viii) System of Service Provider's own internal audit.

7.1.3 An auditor needs to acquaint himself with the systems of control and documentation in operation. This knowledge is obtained either by discussion with various managers or by going through documents like procedure manuals, organisation charts, job descriptions, flow-charts and records maintained. In the case of first audit, the auditor needs to maintain detailed written record of his observations of the internal control system.

7.1.4 It is essential to test the application of internal controls in practice to judge and form an opinion about how effectively the prescribed procedures are actually followed. This study will enable an auditor to assess the level of compliance and level of reliability of the prevalent internal control system. This is done by selecting a few representative samples from different categories of transactions and examining them in depth, especially with regard to the procedural and control aspects. This can be done by reviewing key controls that prevent or detect the providing of services that are not invoiced. The system can be examined to ascertain whether it is possible for services to be invoiced but not recorded in the books of accounts. Similarly, key controls may be examined for recording of all cash transactions: these controls may include scrutiny of numbered cash transaction invoices, daily reconciliation of cash invoices, separation of taxes etc. Key controls may also be examined to detect the possibility of mis-classification of services for the purpose of availing exemptions. The above steps may have to be undertaken by the auditor in the unit of the taxpayer. Undertaking a 'walk-through' and conducting ABC analysis during this process would help the auditor to evaluate the system of internal control in a scientific manner.

7.2 Techniques of evaluating the Internal Controls.

7.2.1 Tour of taxpayer's premises

Generally speaking, touring a service-provider's premises would not be meaningful from the auditor's point of view owing to the intangible nature of business. Yet, in the case of services involving physical processes or some physical output as in the case of photographic services, it may be useful for auditors to observe the process. For services not involving such processes a tour may be used as an opportunity to hold discussions with officials of the taxpayer to collect information on aspects that are unique to that taxpayer such as billing pattern, package of services on offer etc. on which published information may not be available. However, even in these cases visits should be made sparingly only when the revenue implication is likely to be significant and with prior approval of the Deputy Commissioner / Assistant Commissioner (Audit).

7.2.2 Walk-through

‘Walk-through’ is a process by which the auditor selects any transaction by sampling method and traces its movement from the beginning through various sub systems. The auditor verifies this transaction in the same sequence as it had moved. By this method the auditor can get a feel of the various processes and their inter linkages. It is also useful method to evaluate the internal control system of a Service provider. The auditor for example can undertake a walk through of the business processes of a service provider so as to identify the points of collection of service tax and the points of billing of service charges. Similarly a walk though may be conducted on the process of compiling service tax returns in terms of its postings to the various financial documents. Certain Model Walk-through routes are given in **Annexure D**.

7.2.3 ABC Analysis:

7.2.3.1 It is a known fact that in any field of activity an enormous data is generated and all data is not equally important. In order to filter out the irrelevant or relatively insignificant data, various techniques are applied and ABC Analysis is one of such data management techniques. This technique is particularly useful when auditors are required to scrutinise and examine a large volume of data/documents within a limited time period. In ABC analysis the whole data population is classified into three categories based on the importance. A-category is the class of data that is most important from the point of view of managing and controlling the same. B-category is the class of data, which should invariably be controlled, but the degree of control is not as intense as for A-category. C-category is the class of data, which has far less revenue-implications and can be controlled by suitable test-checks.

7.2.3.2 The auditor can apply ABC Analysis specially in case the quantum of data/information to be analysed is voluminous. In such a case auditor can classify them according to their utility towards potential risk into A, B and C categories. To give an example, transactions with top five customers/clients of a taxpayer may alone be taken up for detailed examination by auditors. Similarly when verifying credit utilization by the taxpayer, documents relating to the receipt/procurement of major input services may be examined. The technique of ABC analysis can also be

suitably applied for evaluating the systems of internal controls while carrying out verification.

7.2.3.3 As a result of the observations and test carried out, the auditor has to evaluate as to how far he can rely on the internal control system. He should assess whether the control procedures as prescribed and applied in practice are effective in preventing or detecting material errors and irregularities in the accounting system. This is essentially a question of best judgement in a particular situation. If there exist certain errors or infirmities in the system, he should try to adjudge the impact of the same on tax compliance. Based on the evaluation, the auditor will grade the soundness of the level of internal control of each sub-system as “reliable”, “adequate” or “poor”. Thus, evaluation of internal control is important as it helps in determining the scope and duration of the audit.

7.2.4 Revenue Risk Analysis:

7.2.4.1 Risk Analysis is a method of identifying potential revenue risk areas by employing modern techniques. Having assessed the reliability of company’s accounting records, the next step is to assess the “potential” risk to revenue. If the risk is low, i.e. accounting records are accurate; extensive tests may not be required. There are several methods to assess the revenue-risk, the most important one being a comparison of the derived (from financial records) taxable value and tax liability vis-à-vis actual value shown and Service Tax paid.

7.2.4.2 There may be instances where the amount of taxable services shown in the ST 3 return filed to the department is different than that shown in ledger/final account/Profit and Loss statement. Conversely, from the reconciled figure of Service Tax payment, value of the services rendered can be worked out. This can then be compared with the “Income from Services” figure shown in financial records. The difference, if any, must be analysed. In one instance of Customs House Agent, it was noticed on verification of the Profit and Loss Account statement that the taxpayer was receiving container handling charges and showing the same separately, without paying Service tax as they were required to do as Shipping Agent service category.

7.2.4.3 An illustrative example of the scope of this audit step is given as below:

A. RECONCILIATION OF TAX BASE AS SHOWN IN RETURN WITH INCOME STATEMENT.

1. TOTAL REVENUE FOR THE PERIOD PER INCOME STATEMENT =A
2. DETECT REVENUE ITEMS NOT SUBJECT TO SERVICE TAX
 - Sales Revenue =B
 - Non taxable service =C
 - Misc. Income =D
3. TAXABLE SERVICE REVENUE BASE = S = A-(B+C+D)
4. ESTIMATED TAX = 5% =T= S x 0.05
5. DEDUCT : TAX REPORTED ON RETURN = t
6. VARIANCE AMOUNT OR POTENTIAL RISK = V=T-t
7. VARIANCE PERCENTAGE ON TAXES PAYABLE =V x 100/T
8. RESPONSE / CONCLUSION

B. RECONCILIATION OF SERVICE TAX PAID AS PER RETURN WITH THAT SHOWN IN FINANCIAL ACCOUNT.

Tax reported in Return i.e. “t” should invariably be first reconciled by the amount of tax paid in the financial accounts. For this purpose the relevant account heads where service tax transactions are recorded should first be identified and then a reconciliation be first made between Service Tax paid as per Return vis-à-vis Service Tax paid as shown in financial accounts depending upon the accounting policy being followed. The auditor must first ascertain the accounting system, to ascertain whether service tax collected from customers and service tax paid to the Government are accounted separately or combined. If both the above accounts are clubbed then, a detailed extract of the combined account must be scrutinized and then tabulated so as to make meaningful comparison. If the two transactions are accounted for separately, then the two accounts should first be reconciled and then compared with the tax return.

C. Auditor should also look towards the Income vs. Expenses incurred (including capital investment), whether there is any possibility of suppressing the income liable for service tax. Auditor should also weigh the charges in the current charges for billing service (with the charges for billing for service during audit period as per record). Any large variation in such charges without any reasonable basis is an indicator for suppression of income and therefore, service tax.

7.2.5 Trend Analysis:

7.2.5.1 Trend analysis is a type of computational support needed for the analysis preparatory to planning, by analysing historical data and working out future projections. Historical data is analysed to discover patterns or relations that would be useful in projecting the future production, clearances and values etc.

7.2.5.2 For audit purposes either absolute values or certain ratios are studied over a period of time to see the trend and the extent of deviation from the average values during any particular period.

The auditor can study the following trends:-

1. Trends in service tax collection over the last two years
2. Trends in service tax of a particular service industry compared to overall growth of that industry.
3. Trends in proportion of value of exempted services to the total value of services.

Some of the important ratios that an auditor may analyse are given in **Annexure B**.

Chapter 8

Verification/Conduct of audit

8.1 Audit should be conducted as per the principles mentioned in this Manual in accordance with the audit plan. Entry in the working paper must be made for each item of the audit plan. At the end of each entry in working paper, auditor must indicate the findings. If any of the planned verifications is not conducted the reasons for the same must be recorded. Audit objections raised must be fully supported by documentary and legal evidence. This will greatly help in explaining and discussing the objections with the taxpayer and other follow up action.

8.2 While conducting the verification, the auditor should try to determine whether the apparent weakness in the internal control system of the service provider has led to any loss of revenue. He should also identify the procedural infractions on part of the taxpayer, which are recurrent in nature and which may obscure a significant fact. During the process, he must cross check the entries made by the taxpayer in various records and note discrepancies, if any. In all cases involving discrepancies, the auditor should make detailed enquiries regarding the cause of the discrepancies and their revenue implication.

8.3 The auditor should examine the documents submitted to various Government departments/Regulatory Authorities, Income Tax, other agencies, Banks, etc. by the taxpayer. This should be used in cross verification of the information filed by the taxpayer for the Service Tax assessment.

8.4 The audit verification is not a mechanical process. This gives maximum opportunity to the auditor to go through the taxpayer's records in his unit. Therefore, auditor may come across a new set of information or documents, not earlier known, during any of the earlier stages. Further, while examining an issue, the auditor may come across a fresh issue also requiring detailed examination. In such a situation, the auditor should go beyond the audit plan after obtaining the approval of his Deputy Commissioner/Assistant Commissioner and recording full reasons for the same. Though audit verification is a structured process, it is flexible enough to accommodate the spot-needs.

8.5 The auditor should conduct the verification in a systematic manner, following the sequence of steps, envisaged in the audit plan, as far as possible.

8.6 Apparently, the financial and other documents maintained by the taxpayer for his private use and in compliance of other statutes are of great importance which may reveal irregularities with regard to Service Tax. An indicative list of items to be examined from the Trial balance, Profit & Loss Account, Balance Sheet and Tax Audit reports is given in **Annexure C**. If the auditor comes across any new or additional document apart from those already known, which may be useful for future audits, he may report the same through proper channel to the Directorate General of Audit, New Delhi.

A check list giving details of points/issues to be verified during the conduct of audit is appended as **Annexure E** and should be gone through during verification to ensure that no relevant issue is left out.

8.7 Apprising the service provider of the irregularities noticed and ascertaining his view point.

8.7.1 It is important that the auditor discusses all the objections with the taxpayer before preparing draft audit report. The taxpayer must have the opportunity to know the objections and to offer clarifications with supporting documents. This process will resolve potential disputes early and avoid unnecessary disputes.

8.7.2 The ultimate aim of conducting audit is to increase the level of tax compliance of service provider. Therefore, no audit can be considered to be complete unless the auditor has made all efforts to ensure maximum recovery of short levy before he leaves the premises of the taxpayer.

8.7.3 As the Audit system adopts a transparent methodology, it is necessary that all the audit objections noticed by the audit party are conveyed to the taxpayer with a view to ascertaining his view point before preparing the draft Audit Report. Accordingly the audit objections should be intimated in writing to the taxpayer. It should be clarified in such written communication that the same is not in the nature of any show cause notice and is only a part of participative and fact-finding audit scheme under which even the preliminary and tentative audit observations are being shared with the taxpayer to know his view point. Where

satisfactory explanation or evidence is submitted to the auditor, the findings should be revised as necessary after approval of Deputy/Assistant Commissioner (Audit).

8.7.4 It is the auditor's responsibility to explain all his objections to the taxpayer and to make all attempts to resolve any disagreements before they are finalised. It is also the auditor's responsibility to make sure that his senior is aware of potential disagreement and the position taken by the taxpayer.

8.7.5 The taxpayer must be advised of his rights and obligations with respect to items in dispute. However it should be pointed out that interest would continue to accrue in terms of Section 75, Clause V of Finance Act 1994.

8.7.6 Where the taxpayer is in agreement with the short levy, as noticed, the auditor should persuade him to pay the Service Tax promptly.

8.7.7 Where a substantial amount remains unpaid, because of taxpayer's disagreement or otherwise, the auditor should attempt to collect any information that will aid in future collection. This will include bank information, ownership of the assets and receivables, financial liquidity, cash flow situation, statements given to financial institutions or any other factor, which may help recovery of Service Tax.

8.8 Suggestions to the Taxpayer for future compliance

8.8.1 Before leaving the Taxpayer's premises, the auditor must discuss future compliance issues with the senior management of the Service Provider. Steps the management can take to reduce specific errors detected in the audit and to improve compliance and systems should be pointed out. Written or verbal assurances as given by taxpayer should be recorded in the Audit Report.

8.8.2 If there is any way the department can assist the taxpayer to reduce errors and improve compliance, attempts must be made to offer such assistance.

Chapter 9

Preparation of Audit Report and Follow up

9.1 Preparation of draft audit report and its submission to the senior officers

9.1.1 After completing audit verifications, the auditor should prepare the verification paper. This document should record the results of verification conducted as per audit plan. Any additional issue (not mentioned in the original plan) verified/point noticed should also be mentioned. The auditor would then discuss with the taxpayer each of such issues pointing out either non payment or procedural infractions. The initial views of taxpayer must be recorded in the verification document. Details of spot recoveries and willingness of the taxpayer to pay short levy should also be recorded. This document would then become the basis of preparing the draft audit report.

9.1.2 The draft Audit Report must be prepared in consultation with the Deputy Commissioner / Assistant Commissioner (Audit), in standardised format as given in the Board's circular No. ST Circular No. 38/1/2002-CX dated 7.2.2002 (copy of the Audit Report placed at **Annexure G**). The narration of the objections in the audit reports should be concise, to the point and self-contained. Where the objections are based on any circulars or clarification issued by the Board, these should be quoted. Cases in which certain specified conditions are not fulfilled giving rise to objections should be clearly brought out. Similarly, where objections are backed by interpretations as decided by the court judgments or decisions made by the Appellate authorities or supported by technical literature, these should be cited. All objections should be sequentially numbered. The auditor should enclose the following documents alongwith the draft audit report:

- (i) Completed Working Papers of all the steps prior to audit plan with a summary report.
- (ii) Copy of audit plan.
- (iii) Copies of verification papers.
- (iv) Copies of all the documents/evidences in support of the objections, alongwith calculation sheets of the non payment details.

9.1.3 The draft audit report should be finalised within the shortest time span possible i.e. within 20-25 days of the commencement of the audit in the

taxpayer's place. Before submitting the draft audit report it should be given a unique serial number as follows:

A. R. No./Name of Commissionerate/Name of Division/Year.

Even a nil report should be allotted numbers.

A. R. (Audit Report) No. is a running Serial No. to be given for the financial year. This should be obtained from 'Audit Follow-up Register' maintained in the Audit Cell (see para 9.5.6). The information in columns 1 to 8 in the said Register should be filled up at the time of taking A. R. No. from the Register. The same unique Sr. No. will also be the File No. in Audit Section which will obviate any separate file number for the audit file and will facilitate linking any future correspondence from field formations to the concerned file.

9.2 Monitoring of the work done as reflected in draft audit report by a committee headed by Commissioner including approval of objections raised.

9.2.1 The auditor should submit the draft audit report, to the Assistant Commissioner / Deputy Commissioner (Audit) alongwith all the enclosures, for examination and vetting. Thereafter the same, alongwith enclosures, should be submitted to Audit Cell for consideration in the Monitoring meeting.

9.2.2 The Audit cell should organise monitoring meetings periodically during which each of the audit objections/observations would be examined for its sustainability. To facilitate prompt decision, the jurisdictional Divisional and Range officers and the officers from the Technical branch should also attend these meetings to offer their views on the spot. The minutes of each such meeting should be drawn, pointing out the decision on each of the audit objection regarding its sustainability and directions for future action. The objections rejected by the meeting will be treated as closed. Similarly all points of a nil draft audit report are treated as closed after their approval by Additional/Joint Commissioner (Audit). Copies of the minutes should be,- (i) enclosed with the Audit Report, (ii) sent to all officers required to take future action and (iii) kept in the master file.

9.2.3 The audit section should maintain Registers of Audit Planning and Audit Follow-up in prescribed format (details as given below) until the closure of the audit point either by issue of a show cause notice and recovery of dues or by non-acceptance of the audit point by the Audit cell.

9.3 Final Audit Report

9.3.1 Based on the decision of the monitoring meeting, the draft audit report should be finalised by the Audit cell within fifteen days from the date of the meeting. In case of a nil draft audit report, the same should be finalised with the approval of Additional/Joint Commissioner (Audit). The Audit Report alongwith supporting documents should be forwarded to the officer required to take further action. In case the action is required to be taken by the officers of other Commissionerates, the Audit Group will be responsible for sending the communication to the concerned Commissionerate through their Commissioner. This may happen in cases like points relating to Service Tax where service provider may fall within the jurisdiction of other Commissionerate or the Service provider also has similar service in places falling in other Commissionerate.

9.4 Follow up action, for monitoring the compliance of various points by the field officers and issue of Show Cause Notices wherever warranted.

9.4.1 Officers required to take action on an objection should forward the copy of the action taken documents (such as copy of SCN) to the Audit Cell. An objection should be closed after requisite action has been taken on it. In case new facts come to the knowledge of officers required to take action on an objection, which may involve re-consideration of findings in Audit Report, they should send their report with supporting material for reconsideration of the matter in the Audit Cell. But this action must be taken most expeditiously, say within one month of receipt of Audit Report. Only in exceptional cases involving cogent grounds, the views taken in the Monitoring Meetings can be requested for re-consideration.

9.4.2 Each audit report should be examined by the Audit cell. Any objection with major revenue implication, objection peculiar to a particular service or those describing a novel modus operandi should be selected for (i) issue of Modus operandi circular within the Commissionerate, (ii) for communicating the same to the Chief Commissioner's office for circulation within the zone and (iii) communicating to Director General (Audit) for issue of audit circulars.

9.4.3 On completion of the above procedure the Audit cell shall place the documents in Master file of Service Provider and update the electronic file of the taxpayer.

9.5 Records to be maintained in the Headquarters Audit Section:-

9.5.1 A register of all service providers planned for audit (Audit Planning Register) in the format given below should be maintained in Audit Cell. It will facilitate in ensuring:

- (i) all taxpayers allotted to an Audit Group have been audited; and
- (ii) wherever audit has been completed, the Audit Reports are issued in time.

It will also ensure that if audit of any taxpayer could not be taken up, the same can be included in the schedule for the subsequent period.

APR No./Sl. No. of the unit	Name of the unit	IAP No. & Name of the Supdt.	Proposed Month of Audit	Actual dates of visit to unit	Date of submission of report to Audit Cell	Audit Report No.	Date of issue	Remarks
1	2	3	4	5	6	7	8	9

The APR No. and Sl. No. of the unit shall be assigned by the Audit Cell while issuing the Audit Schedule. The Col. Nos. 1 to 3 shall be entered by the Audit Cell at the time of issue of Audit Schedule. The subsequent columns shall also be entered by the Audit Cell on receipt of a monthly Audit Performance Report discussed in ensuing paras.

9.5.2 To enable monitoring of the progress of audit after a taxpayer has been allotted to an Audit Group, it is necessary that all the service providers included in the Audit Schedule should be entered in the Audit Planning Register and all further action taken should also be entered in this register. As already mentioned in paras above, the Audit Schedule should be issued in each quarter to enable despatch of the advance audit intimation in time and also to plan the audit of large and small taxpayers by the Audit Group as per overall convenience of the taxpayers. For this purpose, each Audit Schedule should be given a unique Serial No. as follows:

ASR No./Serial No. of the unit/Year.

ASR No. may be given as ASR1/ASR2 and so on for each quarterly Audit Schedule. The Serial No. of the taxpayer will be a running Serial No. starting from No. 1 at the start of the financial year. For example, if 25 units have been planned for audit in the Schedule of the first quarter of the year, the Serial No. of the units

will run from No. 1 to 25. If 30 more units have been planned for audit in the next schedule, the Serial No. of the units will run from 26 to 55 and so on.

9.5.3 Monthly Audit Performance Report (Audit Group-wise):

Each Audit Group shall submit a monthly audit performance report by 2nd of each month to the Planning Cell in the following format:

Audit schedule No. / Sl. No. of the taxpayer	Name of the taxpayer	Proposed month of Audit	Actual dates of visit to unit	Date of submission of AR to Audit Cell.
1	2	3	4	5

AR No.	Date of issue	Amount involved in Audit Paras	Spot recovery during Audit	Reason for non-completion of audit
6	7	8	9	10

Note: Column Nos. 8 & 9 should be filled up only when Audit Report has been approved by the Monitoring Meeting.

Alongwith the said report, an abstract of important audit objections should also be given to the Audit Cell. The said information would be used for preparing quarterly Audit Bulletins.

9.5.4 The Audit Cell shall update the Audit Planning Register based on the reports received from audit group (Col. No. 4 to 8 of Audit Planning Register). This report will also be used for discussion during monthly meeting of audit officers to evaluate the performance of each Audit Group. In the 1st week of every month, an abstract of Monthly Audit Performance Report for all Audit Groups should be put up to Joint/Additional Commissioner in the format given below:

Abstract of Monthly Audit Performance Report:

Audit Group No.	OB of units to be audited	No. of new units planned for audit during the month	No. of audits completed during the month (AR issued)	Balance units for auditing
1	2	3	4	5

Period of Pendency			Total duty involved in objections raised during the month	Amount of Spot Recovery during the month
0 - 1 months	1 - 2 months	2 - 3 months		
6	7	8	9	10

Note: (i) Amount in Columns 9 and 10 should be entered only for the units where Audit Reports have been approved in Monitoring Meetings.

(ii) Audit is treated to be completed only when an Audit Report has been issued.

9.5.5 The Commissionerates must have their own mechanism and records for tracking the details of adjudication and further actions like appeals pertaining to the show cause notices issued as a result of the audit objection

9.5.6 The details of audit reports discussed by Monitoring Meeting, the decision taken in the meeting and the further follow up action should be entered in the Audit Follow up Register (maintained in the format given below), as soon as the Audit Report is approved.

Audit Follow Up Register:

Audit Report No.	Name and address of the taxpayer	Range and Division	Registration No. of the taxpayer	Period of Audit	Dates of Audit (dates of visit to unit)	IAP No. and Name of Supdt.	Para No. and objection in brief for each para	Whether objection accepted by the Monitoring Meeting (yes or no)
1	2	3	4	5	6	7	8	9

Duty involved in each para	Spot recovery during audit	Duty recovered other than spot recovery before issue of SCN	Divisional file No.	SCN No. & date	Amount demanded in SCN	Reasons for closure of para	Date of closure of para	Remarks
10	11	12	13	14	15	16	17	18

Note: (i) Col. No. 1 to 8 shall be entered by Audit Group while obtaining the file number.

(ii) Col. Nos. 9 to 11 shall be entered by the Audit Cell before issue of Audit Report .

(iii) Col. Nos. 12 to 15 shall be entered on receipt of replies from Division.

The following abstract for each month should be put up by Audit Cell to Additional / Joint Commissioner (Audit) by 10th of the following month.

Monthly Abstract of Audit Follow-up Register.

Opening Balance		Total No. of units audited during the month (Audit Note issued)	Paras accepted during the month for action		Total No. of Paras closed during the month		Total recovery during the month		Closing balance	
No. of paras	Total Amount involved		No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved
1	2	3	4	5	6	7	8	9	10	11

Period wise pending					
0 – 3 Months		3 – 6 months		> 6 months	
No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved
12	13	14	15	16	17

Note: The quarterly report to be sent to zonal Additional Director General (Audit) shall be prepared based on this report.

9.5.7 The quarterly report in the following format is required to be sent to the zonal Additional Director General (Audit).

(A) Details of IAD audit conducted

(Rupees in lakhs)

Name of the Commissionerate	No. of units scheduled for audit	No. of units audited	No. of revenue paras raised	Total short levy detected	Total recovery
1	2	3	4	5	6

(B) Action taken on final audit report paras accepted for action:

Opening Balance		Paras accepted during the quarter for action		No. of paras closed during the quarter and reasons					
				SCN issued		Amount recovered and paras closed		Other reasons like closure on merit	
No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved
1	2	3	4	5	6	7	8	9	10

Closing Balance		Period-wise pendency							
		0-3 months		3-6 months		6-12 months		> 1 year	
No. of paras	Total Amount	No. of paras	Total Amount	No. of paras	Total Amount	No. of paras	Total Amount	No. of paras	Total Amount

	involved		involved		involved		involved		involved
11	12	13	14	15	16	17	18	19	20

9.5.8 All officers (such as Divisions / Range, Headquarter preventive etc.) required to take future actions as per the minutes of the Monitoring meeting of Audit Cell should send a monthly status report of the action taken on the audit objections latest by the 10th of the next month. The same should be used by the Audit cell for updating the “Audit Follow up Register” mentioned above. The Audit cell should prepare monthly report on audit performance and follow up action.

CHAPTER 10

AUDIT MANAGEMENT

10.1 Introduction:

10.1.1. Audit management requires planning and effective execution of the audit process. Structurally and functionally this is to be undertaken at two levels – apex level and local level. In order to monitor, co-ordinate and guide the effective implementation of the new audit system, the Board has set up the Directorate General of Audit as the nodal agency. At the local level, management of audit is entrusted to the Commissionerates supervised by Chief Commissioners.

10.2 Management at the Apex Level:

10.2.1 The Directorate General of Audit with its 7 zonal units at Ahmedabad, Mumbai, Delhi, Bangalore, Kolkata, Chennai and Hyderabad is required to ensure the effective and efficient implementation of the audit system (based on EA 2000 methodology) as well as to evolve and improve audit techniques and procedures through periodic review. With the help of its zonal units, the Directorate General of Audit has to regularly monitor Service Tax audits conducted by the Commissionerates to see that the coverage of taxpayers is adequate in number and reflective of their risk profile as well as to ensure that these audits are conducted in accordance with the letter and spirit of EA 2000 methodology. For this purpose, it needs to interact closely with Chief Commissionerates and Commissionerates for eliminating the deficiencies and improving the performance. The other measures envisaged for the Director General (Audit) for enhancing the effectiveness of audits are:

- developing a sound database and risk parameters for selection of taxpayers
- developing service-specific profiles and expertise
- enhancing the skill of the auditors by coordinating training efforts with NACEN
- examining the various types of irregularities detected during audits and periodically circulating the major detections and unique modus-operandi on all India basis.
- developing an appropriate reporting system for monitoring

In its advisory role to the Board, Directorate General of Audit is required to suggest measures to enhance tax compliance, to gauge the level of audit standards and the taxpayers' views on the prevalent audit system. It should also interact with select taxpayers for taking a holistic view of the internal audit to formulate proposals which remove irritants and obviate the scope for irregularities.

10.3 Role of the Zonal Chief Commissionerates:

10.3.1 The office of Chief Commissioner is not an operational formation for the actual conduct of audit, but it provides an important link between the Directorate General (Audit) and the Commissionerates of the zone. The role of this office in the over all management of audit is as follows:

- i. Collection, compilation and analysis of the data received from Commissionerates and communication of the same to the respective zonal Additional Director General (Audit) and to Directorate General (Audit) in standard formats.
- ii. Review of the performance of the Commissionerates vis-à-vis audit targets fixed.
- iii. Dissemination of information pertaining to audit to the Commissionerates.
- iv. Resolving local level problems in implementation of audit system and giving feedback to Directorate General (Audit).
- v. Implementation of guidelines pertaining to the zonal Commissionerates issued by Directorate General (Audit).
- vi. Monitoring the training for auditors and the officers of the zone in techniques of service tax audit and accountancy.
- vii. Arranging assistance to officers of Directorate General (Audit) in regularly examining the conduct of audit and results, in making available the required information to such officers and in interacting with the audit wings of the Commissionerates.

10.4 Management at local level:

10.4.1 For management of audit at local level the Commissioner should constitute audit parties comprising officers with requisite experience and expertise to conduct Service Tax audits. Planning, Monitoring and Evaluation of Audits should be done by the existing Audit Cell within the Internal Audit Section of the Commissionerate

as is the case with the Central Excise audits. All the other steps involved in the conduct of audit would be the responsibility of respective audit parties.

10.4.2 The functions of Audit Cell are, -

(A) Planning of Audit:

- (i) To maintain a database of available manpower resources for effective deployment.
- (ii) To maintain data of units to be audited mandatorily and others to be audited on the basis of risk analysis.
- (iii) Selection of unit on the basis of: -
 - (a) Risk parameter,
 - (b) Board's guidelines,
 - (c) Available manpower.
- (iv) Maintenance of Taxpayer Master File
- (v) Planning the audit schedule in such a way so as to make optimum use of available resources.
- (vi) Ensuring proper desk review before commencement of audit.
- (vii) Ensuring audit follow-up.
- (viii) Preparation and submission of reports prescribed by the Directorate General of Audit

(B) Monitoring of Audits.

For monitoring of audits, the Commissioner should call a meeting once or twice in a month depending on the number of audit reports due for consideration. The meeting should be headed by the Commissioner and should be attended by the Audit Cell, Supervisory Officers of the Audit Teams, the concerned Divisional Deputy/Assistant Commissioner where required. The meeting should examine the sustainability of each audit objection and set out the future action points in the circulated minutes, which would be drawn and forwarded to the concerned field-officer alongwith the copy of relevant audit report. It should also examine the overall working of the audit system and identify the areas requiring special attention including training requirement.

(C) Performance appraisal and Quality Assurance.

The Audit cell should undertake monthly evaluation and scoring of the Working Papers. The emphasis of the scoring system would be on conduct of audit in

accordance with the norms laid down in this manual and the Working Papers, and also the results achieved. The Scoring system divides the entire process of audit into five parts: (i) preparation of the Audit Plan; (ii) conduct of audit; (iii) revenue points raised (major objections and their quality); (iv) realisation of revenue; and (v) issues relating to future compliance by the company. A greater responsibility, therefore, rests on the senior officers to duly assess the reports and bring out the strength and weaknesses of the audit reports. Such regular appraisal would help in steering the audit into areas, which are the core of the new audit system by making good the deficiencies noticed. The scores of each team in different areas of audit should be reviewed every quarter. If the quarterly average in a specific field is found to be below 60 per cent marks, immediate re-training of the concerned auditor for the subject should be organised. The cell should discreetly gather views from the trade/industry regarding the system of audit. Standard feedback format should be designed by the cell for this purpose. The conclusions of the cell should be an input for taking responsive measures. This cell should prepare a comprehensive report highlighting the areas needing training and quality improvement.

10.4.3 Role of Senior Officers:

(A) Commissioner:-

1. Holding fortnightly or monthly meetings of monitoring committee.
2. Taking a decision about the acceptability of audit objections involving a revenue of Rs. 2 lakhs or more or cases involving a systemic failure that render the audit process ineffective.
3. Ensuring that requisite follow-up action is taken (on objections that are accepted) by the Division, or other sections of the Commissionerate.
4. Reviewing audit performance at local level and taking steps for improvement.
5. Taking remedial measures on the report of Audit Cell on performance appraisal and Quality assurance.
6. Reviewing the performance and participation of the Additional/Joint Commissioner and Deputy/Assistant Commissioner of Audit wing.
7. Interacting with the major taxpayers in order to obtain feedback on the audit system

(B) Additional/ Joint Commissioner (Audit):

1. Co-ordination, planning and overall management of the audit branch.
2. Interacting with taxpayers paying annual revenue of Rupees one crore or above at the time of audit in order to share major audit findings and compliance issues
3. Final selection of non-mandatory units on the basis of risk assessment to be audited during the year.
4. Approving the audit plan after ensuring that all the steps have been completed.
5. Scoring and evaluation of audit reports.
6. Organizing training programmes for auditors.
7. Reviewing the follow-up actions.

(C) Deputy/Assistant Commissioner (Audit):

1. Co-ordination, planning and day to day management of audit section.
2. Preparing the list of units to be audited on the basis of required minimum number of units to be audited as per Board's instructions, rupee risk and availability of manpower etc.
3. Preparation of audit schedule with dates for each unit.
4. Supervision and approval of each of the steps leading to preparation of audit plan.
5. In select cases, interviewing the officers of the taxpayer during visit for preparing audit plan.
6. Visiting the units and suitably participating in the conduct of audit as frequently as possible especially in sensitive service categories.
7. Scrutinising the draft audit report.
8. Ensuring preparation/updating of taxpayer master file.
9. Discussion with the taxpayer regarding audit objections in select cases.

(D) Role of Divisional Officers:

1. Provide data to audit branch to build up data base. (Please refer to para 6.2 on Taxpayer Master File).

2. Supply balance sheets, annual report, trial balance, income tax report etc. of the taxpayer to the audit cell.
3. Discussions with auditors on audit findings prior to preparation of Audit Report.
4. Taking follow-up actions on audit objections.
5. Suggestions regarding selection of units for audit.

10.4.5 Role of Asst. Commissioners/Deputy Commissioners in-charge of other Sections in Headquarters.

- (i) The details of orders-in-original passed by Deputy Commissioners / Assistant Commissioners accepted/appealed against may be submitted once in a month to the Audit Cell for their information.
- (ii) Important CEGAT decisions specially on appeals filed by the department before the CEGAT should be brought to the notice of the audit cell on a quarterly basis.
- (iii) The technical branch would ensure that copies of general circulars are sent to audit cell and important notifications, which have a bearing on the department's work, are highlighted.
- (iv) The anti evasion branch would give the details of all important detections to Audit Cell. In cases where investigations are completed, a copy of the investigation report or a draft show cause notice may be sent to Audit Cell.

Part II

WORKING PAPERS

WORKING PAPER IN RESPECT OF SERVICE TAXPAYERS

A Taxpayer Profile

1. NAME OF THE Taxpayer:
2. REGISTRATION NUMBER:
3. DATE OF AUDIT:
4. DATE OF SUBMISSION OF AUDIT REPORT:
5. DRAFT AUDIT REPORT NUMBER:
6. PERIOD OF AUDIT:
7. AUDIT TEAM:

B NATURE OF BUSINESS OPERATION

Date of Preparation _____

1. Status of the Company I) __ Public Ltd. Co. II) __ Private Ltd Co. III) __ Proprietorship IV) __ Partnership V) __ Others.
2. Brief description of the services provided by the taxpayer:

Sr. No.	Description of Services provided
1	
2	

3. Brief details of the annual turnover and the Service Tax paid for the last three years:

(TAX figures given in Rupees)

Year	Annual Turnover	Service Tax paid

C. SUMMARY OF AUDIT RESULTS

Date of Preparation _____

Provide an outline of all objections, which involve short/non levy/collection of the tax. Details of objections of technical/procedural in nature without involving revenue/interests amounts should also be mentioned. Indicate whether the taxpayer has agreed to the objections and if so, has made spot payment (if so details thereof).

Sr.No.	Gist of Objection	Revenue implication, if any.	Taxpayer in Agreement YES / NO	Spot Payments made if any
1.				

2.				
----	--	--	--	--

D. PRELIMINARY OR DESK REVIEW:

Date of Preparation _____

1. Give reasons for selection of the unit for audit this time (as informed by Planning Cell).

Reasons:

2. The auditor should check whether the Taxpayer Master File is available in IAD and whether the same is complete. If not, the auditor should complete the same as far as possible from the information available in the office. Go through the information available in the Taxpayer Master File. Identify and mention (with justification), the areas or issues those merit verification during the conduct of audit.

3. Mention changes in the law pertaining to the service provided by the taxpayer.

4. Mention details of Anti-evasion cases booked in recent past or are in progress and past audit objections, which have not been settled so far, by way of assesses acceptance, adjudication, appeals etc.

5. Observations of the Auditor on issues (check-list) enumerated below during Desk Review.

Respond as per Check-List given below:

The first step is to understand the definition of service & nature of taxable value.

Registration

- 1 Check whether the Application for Registration, has been made by the service provider within 30 days from the date of which levy of Service Tax is notified. In case of new taxpayer it should be ensured that tax liability accrues from the date of commencement of service.

- 2 The registration certificate is not transferable and hence it should be ensured that the registered person is alone providing services.

- 3 Check whether the taxpayer is providing taxable service from more than one premises or office.
-
- 4 Check if the taxpayer has opted for common registration on the basis of centralised billing or accounting system. If yes, this fact has to be checked during subsequent steps.
-
- 5 Check whether taxpayer is providing taxable services pertaining to more than one service.
-
- 6 *Whether the services provider has authorized any other person to provide the service in the name and style of the taxpayer and if so whether the authorized person has obtained separate registration or whether the registered person includes the service charges received by the authorized person in the Return submitted by the taxpayer?*
-
7. *Check whether taxpayer is running business in different names to split the income and to avoid service tax by avoiding registration of other names.*
-

Payment of Service Tax & Filing of Returns

- 8 Check whether list of records maintained has been declared to the Department or not.
- 9 Check whether the Service Tax on the value of taxable services received during any Calendar months is credited to the Central Government account by the 25th of the month immediately following said Calendar month. Similarly, in respect of individual Proprietary Firm or Partnership Firm. Check whether the Service Tax is paid by the 25th of the month immediately following the Quarter.
-
- 10 Check whether the remittance of Service-Tax is done to a designated Bank and if it is done in any other Bank other than the designated one it would amount to non-payment of Service Tax.
-
- 11 Check whether the interest is charged at the rate of 1 ½ % simple interest per month or part of the for which the payment is delayed or 24% per annum as the case may be.
-

12. *Is there system of receiving service charges in advance and providing the services but raising the bill at a later date to have financial accommodation and defer the payment of service tax?*

13 *Whether the taxpayer is splitting up the bill as reimbursement of expenses and service charges? If yes, whether the reimbursement expenses are genuine and supported by actual payment bills?*

14 *Is there any service charges the taxpayer claims as written off and if so whether such written off amount is provisional or final? Is there any realization from such written off amounts at a later date and whether service tax was remitted on such realization?*

15 *Examine the transactions between the service tax taxpayer and their group/ related companies.*

16 *Check whether taxpayer receives any other income and nature of other income received.*

Provisional Assessment

17 Check whether the taxpayer has opted for provisional payment of Service Tax by making a special request in writing to the jurisdictional A.C./D.C. giving cogent reasons for payment of Service Tax on provisional basis. Ensure that Provisional Assessment is being done only after the express approval of Assistant Commissioner/Deputy Commissioner.

18 In case the taxpayer is filing application for provisional assessment ensure that the taxpayer has filed the Quarterly/Half Yearly returns along with a statement in form ST-3(A) giving details of the difference between the Service Tax deposited and the Service Tax liable to be paid for that month.

19 Check whether the provisional assessment have bee finalised and whether all the relevant documents or records have been called for from the taxpayer by the AC/DC before completing the assessment.

Other Issues

20 Check whether there are any exemption Notification which exempts from payment of Service Tax for e.g. Notification No. 3/94 (ST) exempts Service Tax on department run Public Telephones for local calls and free Telephones installed at Airports and Hospitals where no billing are being issued. Similarly, services provided to the United Nations are exempts from Service Tax vide Notification No. 48/98-ST dated 24-4-1998. Thus, it would be essential to sift through all the Customs Notifications concerning the particular Taxable Services before scrutiny of records of the Range.

21 The half yearly returns in form ST-3 and ST-3A (Provisional assessment) has to be filed along with copy of TR-6 challan before 25th of the month following particular half year even if no service is rendered during the half year no service tax is payable then also the taxpayer has to file the NIL return within the prescribed time limit. Failure to file such return in time will render the taxpayer liable to penalty up to an amount not exceeding Rs. 1000/-. Check if returns are filed on time.

22 Check if there is any mistake apparent from the face of record the AC/DC who has passed the order may amend on their own notion or if the mistake is brought to the notice by the taxpayer or by the Commissioner of Central Excise or by the Commissioner of Central Excise (Appeal). Such amendment can be made after giving reasonable opportunity to the taxpayer and followed by speaking order.

23 Check whether the Service Tax has been paid in the respective accounting code for the particular services.

24 *Check whether the TR-6 challan, which have been used for depositing service Tax, is yellow in color and that they are serially numbered for the financial year.*

25 Check for Board Circulars, DGST Circulars, Clarifications or Modus Operandi Circulated by DGST with respect to the Service.

26 *Was there any 'best judgement assessment' method made applicable to the taxpayer? If so, the basis of Best Judgement method? The documents relied upon to go for Best Judgement assessment?*

27 *Was there any reassessment? If so, the grounds of reassessment and the difference in the originally assessed value and reassessed value?*

28 *Was any rectification of mistakes carried out? If so, its implication on the service tax liability, interest and penalty? Was there any repeated rectification of mistakes?*

29 *Check whether any amount is collected indirectly i.e. in case of authorized service stations, free service for new vehicles upto certain mileage / time is provided and the free service amount is borne by the vehicle manufacturers. Check whether Service Tax is paid on the Indirect amount realized.*

30 *Check whether any service of the same kind is provided to the employees of the taxpayer without raising bills for a minimum amount and the balance being adjusted / collected in any other manner.*

E. Steps prior to preparation of Audit Plan

Steps namely Gathering and Documenting systems information, evaluation of Internal Control, Walkthrough and reasonableness steps are merged into a single step called 'Steps prior to preparation of Audit Plan'. The Auditors should conduct necessary interviews at the assesses premises. The auditor should, however, obtain complete list of documents/records maintained by the taxpayer and should also obtain copies of selected documents/records for undertaking study prior to preparation of audit plan.

DISCUSSIONS WITH THE TAXPAYER

Date of Preparation _____

1. Person(s) with whom discussions held with, their designation and dates of interview.

Give the gist of discussions specially in respect of:

- i) The date of commencement of Business and whether Service Tax Registration has been taken within 30 days of the date of commencement, if such date is later than date of notification of the said Service.

- ii) The head office / registered office of the unit, location of its operations and location of its Business records (especially Accounting Records):

- iii) Whether Company is a ancillary unit or independent unit;

- iv) Other Business ventures of the taxpayer with annual volume of such transactions:

- v) Any Organisational or systemic changes that has occurred since last audit:

- vi) Check whether taxpayer has availed certain services, which were liable for Service Tax. Check if such liability was serviced. Source check from jurisdictional Commissionerate of service provider is to be made. (List out such services with annual value of transaction)

- vii) To which other Govt. Departments or Financial Institutions are they required to submit records/returns (List out such Records/Returns)
-
- viii) Check if any such service is being rendered by the Taxpayer for which he has not registered.
-
- ix) Check for professional standards or affiliations to professional institutions and any reporting required to such institutions.
-
- x) Check whether there is a centralised accounting system or centralised billing system in respect of service rendered to client from each of such premises or office. If the premise is more than one, common registration can be opted for if centralised billing system exists. However, in case of centralised accounting system separate registration in respect of each premises or office has to be taken unless exempted by the Commissioner for registering only one premises provided he has satisfied that such registration shall not be detrimental to the interest of revenue.
-

FINANCIAL AND TAX ACCOUNTING INFORMATION

Date of Preparation _____

Obtain audited Balance Sheet and Profit and Loss Account, Trial Balance and Chart of Accounts. Review any notes in the Balance Sheet / Profit and Loss Account. If the unit is a division of a Company, check if internal financial statements are prepared for the unit being audited before consolidated with other related units. Obtain a copy of last two reports. Mention issues to be verified during conduct of audit.

Identify various business activities like different Services rendered, source of 'Other / Misc. Income'. Mention issues to be verified during conduct of audit.

Compare total turnover as per Profit and Loss Account with the corresponding figures submitted to the Department in the returns for three years. Mention discrepancies to be verified / reconciled during conduct of audit.

Indicate Sales pattern in the following proforma:-

Sr. No.	Nature of Sale Transfer etc.	Yes	No	If yes, nature of Services(s)	Whether Service Tax is being paid by

					taxpayer
1	Direct Service (to actual Customers)				
2	Sub-contracted service either in same category or other category				
3	Sales which are exempted from Service Tax (Break-up to be given Exemption Notfn. No. wise)				

- 1 Examine selected Debtor Account (Customer) to find out any recovery other than shown in sales invoice (check Debit Note and Journal Vouchers also). Mention issues to be verified during conduct of audit.

- 2 Identify other revenues as reported in the financial statements (Incomes other than from sales). Mention such other revenues which may have a bearing on the value of taxable service (for verification during conduct of audit).

- 3 Any other relevant information gathered by the auditor during the course of Visit to the premises of the taxpayer.

EVALUATION OF INTERNAL CONTROLS:

Date of Preparation _____

- 1 Perform a walkthrough for the Sales / Revenue System. Trace a sample of transactions (all types, including Credit) from source documents through to Service Tax amount. Mention results.

- 2 Perform a walkthrough of the process of compiling a tax return for half year, tracing from tax return amounts through to their sources. Check sales as per Sales Account in ledger with value shown in return. Mention results.

- 3 Any other relevant information gathered by the auditor during the course of Evaluation of Internal Control. Mention issues to be verified during conduct of audit.

- 4 Verify the list of Records maintained (acquired during Desk Review) with the actual Records maintained by the Taxpayer, if any other records are maintained, list them below:

REVENUE RISK ANALYSIS

Date of Preparation_____

Prepare the Revenue Risk Analysis, covering a period of one year or a minimum of one return, for Service Tax. The Service tax payable may be derived from the Income Statement in the Profit & Loss Account and applying the rate of Service Tax levy. This may be compared with total service tax paid as per half yearly return. Mention results indicating possible problems areas and mention issues to be verified during conduct of audit.

TREND ANALYSIS:

Date of Preparation_____

Undertake analysis of trends as deemed relevant. Mention issues to be verified during conduct of audit.

Sr.No.	Data Type	Year	Year
1	Sales Value Services rendered		
2	Gross Operating Profit		
3	Export clearance (Qty.)		
4	Value of Services undertaken on sub-contract		
5	Total Service Tax Paid		

F AUDIT PLAN:

Date of Preparation_____

Audit Plan approved by _____

The audit plan must be based on the issues identified in the previous steps as to be verified during the conduct of audit and must be specific in the following format

Sr. No.	Subject	Specific Issue	Source document	Field Document	Coverage Period	Selection Criteria	Verification Paper No.
1							
2							

G VERIFICATION:

Date of Preparation_____

Carry out verification as per Audit Plan. The result of verification of each of the issues should be mentioned in the format below, whether or not there is any detection of discrepancy / audit point. Each verification paper should be given the same V/P Sr. No. as the Sr. no. given in Audit Plan. The issues verified which were not parts of original Audit Plan but verified later should be mentioned at the end.

LEGAL AND PROCEDURAL REQUIREMENT FOR SERVICE PROVIDERS:

Following Legal and Procedural requirements on the part of the taxpayer may be specifically verified:

1. The legal and procedural requirement of each type of Service Tax being different and a common yardstick and guidelines can not be prescribed for e.g., in respect of Stock Broker, Sub-brokers and not covered in service Tax. So also certain activities undertaken by a Broker like jobbing business, his own transaction, public issue consultation fee, do not attract Service Tax.
2. Care should be taken to ensure that for each transaction a separate bill is raised and Service Tax is charged on the transaction. Check whether Service Tax is being charged separately or not in the bills not are raised.
3. Check whether the Service rendered to a Foreign Client or to Clients in the state of Jammu Kashmir has attracted Service Tax, as there is no exemption.
4. Check whether the Service Tax is levied on the taxable service provided by the taxpayer on the gross amount and not on the net amount.
5. Check whether the registered taxpayer has submitted or surrendered his registration certificate after ceasing to carry on the service (if applicable).
6. Check whether taxpayer has availed certain services, which were liable for Service Tax. Check if such liability was serviced. Source check from jurisdictional Commissionerate of service provider is to be made.
7. Mere scrutiny of records would not be adequate. Intelligent cross verifications with other records and returns submitted by the taxpayer to other Government Department or Financial Institutions would be of abundant relevance. By Co-relation it has to be seen whether the Books of account or other documents in the possessions of the assessee ensure that not false entry or statement or he has willfully omitted any relevant entry in such books of accounts. Thus enabling such person not only to evade any Service Tax but also the interest and penalty chargeable or impossible therein.

8. *Check the total income as per the profit and loss account and the total income as per the returns filed by the taxpayer. In case of variation, reconciliation should be called for. To know the exact nature of such income, all the income heading in the profit and loss account must be verified carefully.*

H POST VERIFICATION:

Date of Preparation _____

- 1 Once the verification, as per the audit plan, is complete, all the findings with taxpayer's agreement / disagreement must be consolidated in Part 2 of the draft Audit Report format and Part C of these working Papers for presentation to and discussions with the superiors and the taxpayer. The details of spot recovery made during the conduct of audit should also be mentioned in the relevant column of Part C of these Working Papers.
- 2 Indicate information provided and specific actions suggested to the taxpayer to improve future compliance. Where the taxpayer is in agreement with the suggestions, request a commitment in writing and include it in the audit report. If the taxpayer is unwilling to give a written undertaking, obtain a verbal commitment. Mention results.

PART III

SERVICE SPECIFIC PROFILES

SERVICE TAX PROFILES

Service Tax Audit requires a greater understanding of the uniqueness of each service. Unlike in the manufacturing sector where there is a broad degree of uniformity of defining characteristics, each service tax is unique in its business structure, accounting systems and the regulatory authority / association monitoring it. For example, Stock Brokers are broadly regulated by SEBI, Non-life Insurance would fall within the administrative domain of the Insurance Regulatory Authority. Such instances can be multiplied. Therefore for effective Service Tax Audit, it is necessary to prepare Service Tax Profiles for each service on the basis of test audits. Like the commodity supplements in Central Excise, these profiles can be a useful addition to the Service Tax Audit Manual.

2. Based on the experience gained during the test audits, three important services viz., Telecom, Non-life Insurance and Stock brokers were identified for preparation of profiles. Service Tax Profiles have been prepared broadly covering the following areas:

- a) Date of Introduction
- b) Definition
- c) Taxable event and scope of service
- d) Board's Instructions
- e) Value of taxable service
- f) Exemptions
- g) Risk areas (identified during test audits)
- h) Central Registry to identify important Web sites from where lists of functioning service tax units can be extracted
- i) Description of the business
- j) Description of the accounting systems with focus on service tax accountal and payment.

The service tax profiles would have to form an important part of the desk review and the scheme for preparation of the audit.

These service tax profiles are placed herein below -----.

PROFILE OF STOCK BROKERS

1. Date of Introduction: 01.07.1994 vide Notification No.1/94-ST dt.20.06.1994.

2. Definition:

“Stock Broker” means a stock-broker who has either made an application for registration or is registered as a stock-broker in accordance with the rules and regulations made under the Securities and Exchange Board of Indian Act, 1992 (15 of 1992).”

(Section 65(69) of Finance Act, 1994 as amended)

The service provided by the stock broker becomes liable to Service Tax subject to the conditions that the -

- (a) Stock Broker should be registered as per SEBI Act, 1972.
- (b) Stock should be listed in the Stock Exchange.
- (b) The Stock Exchange must be recognized Stock Exchange as per Securities Contract (Regulation) Act, 1956.
- (c) The Sale/Purchase should be on behalf of an investor.

3. Taxable event and scope of service:

Taxable service means any service provided to an investor by a stockbroker in connection with sale or purchase of securities listed on a recognized Stock Exchange.

(Section 65(72)(a) of Finance Act, 1994 as amended)

“Securities” has the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

(Section 65 (61) of Finance Act, 1994 as amended)

Section 2 (h) of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) reads as follows:

“Securities” includes

- (i) shares, scrips, stocks, bonds, debentures, debenture stock, or other marketable securities of a like nature in or of any incorporated company or body corporate;
- (ia) derivative;
- (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
- (ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities.”

“Recognized stock exchange” has the meaning assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

(Section 65 (58) of Finance Act, 1994 as amended)

Section 2 (f) of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) reads as follows:

“Recognized stock exchange” means a stock exchange which is for the time being recognized by the Central Government under section 4.

The Central Government has recognized the following 22 Stock Exchanges:

- (1) Bombay Stock Exchange
- (2) Delhi Stock Exchange Association Ltd.
- (3) Madhya Pradesh Stock Exchange (Indore)
- (4) Ahmedabad Stock Exchange
- (5) Madras Stock Exchange
- (6) Calcutta Stock Exchange
- (7) Uttar Pradesh Stock Exchange Association Ltd.
- (8) Pune Stock Exchange Ltd.
- (9) Bangalore Stock Exchange Ltd.
- (10) Ludhiana Stock Exchange Association Ltd.
- (11) Hyderabad Stock Exchange Ltd.
- (12) Gauhati Stock Exchange Ltd.
- (13) Cochin Stock Exchange Ltd.
- (14) Mangalore Stock Exchange Ltd.
- (15) Magadh Stock Exchange Association
- (16) Bhubaneshwar Stock Exchange
- (17) Saurashtra Kutch Stock Exchange
- (18) Jaipur Stock Exchange
- (19) Vadodara Stock Exchange
- (20) Coimbatore Stock Exchange
- (21) Over The Counter Exchange of India
- (22) National Stock Exchange.

4. Board's Instructions

Own trading: In case, a broker enters into a transaction on his own account, with an investor who is a non-member on the stock exchange, the service provided will be taxable service, and subject to Service Tax.

Arbitrage: In the case of arbitrage transaction i.e. the transaction between two brokers of different stock exchanges, the service is provided by a broker i.e. the member of a stock exchange even though the investor may be a member of another stock exchange, there being an investor involved in the transaction, the service so provided to the investor will be a taxable service and subject to Service Tax.

(Ministry's F.No.148/1/94 CX-4 (Pt. I) dt. 31.12.1996)

National Stock Exchange using Very Small Aperture Terminals (VSAT) installed at trading members office allow the members of local stock exchange to carry on business compulsory within the jurisdiction of the said Stock Exchange where he is registered. Board is of the view that Trading members/Stockbrokers of National Stock Exchange will have to register their premises with the Central Excise Commissionerate having the jurisdiction over the place where trading membership is granted and infrastructural facilities are provided for installing the Very Small Aperture Terminals and operating the business.

(Ministry's F.No.148/5/96-CX.4 dt.16.09.1996)

A Broker who is registered with Kanpur Stock Exchange has to apply for registration with Commissionerate of Central Excise, Kanpur. All the officers of this broker irrespective of location will be registered with Commissionerate of Central Excise, Kanpur.

(Ministry's F.No.148/1/94-CX.4 dt.06.09.1994)

For the issue raised as to whether service tax can be collected for a transaction in Sikkim Stock Exchange, which has not yet been recognized, it is clarified that service tax is required to be collected from Stockbrokers. Stockbroker as defined in the Act itself, i.e., a stockbroker who has either made an application for registration or is registered as a stockbroker in accordance with the rules and regulations made under the Securities and Exchange Board of Indian Act, 1992 (15 of 1992). Hence, all stockbrokers are covered by service tax scheme.

(Ministry's F.No.148/1/94-CX.4 dt.06.09.1994)

For reasons of transparency, service tax charged/collected should be shown separately in the Contract Note/Bills.

(Ministry's F.No.148/1/94-CX.4 dt.06.09.1994)

Charging of service tax from an investor who is provided with taxable service by two brokers of different stock exchanges does not amount to double taxation.

5. Value of Taxable Service:

Value of the taxable service provided by Stockbroker, is the aggregate of the commission or brokerage charged by the stockbroker on the sale or purchase of securities from the investors and includes the commission or brokerage paid by the broker to any sub-brokers.

(Section 67 of Finance Act, 1994 as amended)

“Sub-broker” means a sub-broker who has either made an application for registration or is registered as a sub broker in accordance with the rules and regulations made under the Securities and Exchange Board of India Act, 1992.

(Section 65 (70) of Finance Act, 1994 as amended)

6. Exemption and Exclusion:

1. Jobbing – In a transaction on principal to principal basis between brokers, no investor is involved and as such no taxable service is provided and therefore, no Service Tax is chargeable.

(Ministry's F.No.148/1/94 CX-4 (Pt.I) dt.31.12.1996)

2. Taxable service means any service provided to an investor, by a stockbroker in connection with the sale or purchase of securities listed on a recognized stock exchange. The commission charged by stockbroker as underwriters is for floating securities. Hence, it is not covered.

(Ministry's F.No.148/1/94 CX-4 dt.06.09.1994)

3. Sub-brokers are not covered by service tax.

(Ministry's F.No.148/1/94-CX.4 dt.06.09.1994)

4. The following transaction undertaken by the Stockbrokers do not attract the levy of Service Tax.
- a. Private placement charges
 - b. Public issue consultancy fee
 - c. Brokerage or primary market operations

7. Case laws:

U.S.Chaudhary V/s. CCE, Kanpur [1999 (110) ELT 925 (Tribunal)]

No service tax is payable when the brokers of the same stock-exchange or brokers of one stock exchange with another stock-exchange carry on business in purchase or sale of securities since in either of the situation no investor is involved.

8. Central Registry:

All stock brokers are registered in the National Stock Exchange. The database of the exchanges (local, SEBI, NSE etc.) could be made use of for the purpose of identifying names and addresses of stockbrokers having offices in the jurisdiction.

More information can be available from

- ❑ SEBI, Mittal Court, "B" Wing, 1st floor, 224, Nariman Point, Mumbai- 400021.
- ❑ Internet download from the search engine of the site www.rediff.com is placed here. It also gives a link to the directory of the Indian stockbrokers.
- ❑ **FirstGlobal**<http://www.firstglobal.co.in> >>>more like this Institutional Brokerage house officers online and offline trading in NSE securities, Mutual fund investments, badla financing, IPOs and corporate deals, portfolio management services, research, etc.
- ❑ **TataTDWaterhouse** <http://www.tata-tdw.com> >>>more like this Online stock trading portal from Tata Finance, in association with TD Waterhouse. Includes quotes, free research and charts, portfolio manager, and more.
- ❑ **Trading Pundit** <http://www.tradingpundit>

>>>[more like this](#) An online broking portal with sections on the latest news and information on stocks, contests, research, broking mutual funds, deposits, insurance, housing and car loans, tax, forex, NRIs, bullion, PO schemes, and much more.

- ❑ **Directory of Indian stock brokers** <http://www.indianstock>
>>>[more like this](#) Directory on members of the Indian stock broking fraternity. Includes paid web-hosting and e-mail services targeted at the Indian stock market intermediaries.
- ❑ **AcumenSecurities**<http://www.acumenindia.com> >>[more like this](#)
News and opinion, demat list, investment tips, and more from this sub-broker on the Bombay Stock Exchange. Also offers online trading.

9. Description of the organization

All stockbrokers applying for registration with SEBI have to furnish certain details such as identity and financial solvency of the company / firm. After registering with SEBI they have to seek permission from the concerned stock exchange BSE / NSE or others to conduct business in the exchange. The particular exchange keeping in view the volume of the transaction that the stock broker is likely to undertake, takes surety / securities from him and allots him an unique code number which the broker has to quote in all his transactions. The broker can do trading within the transaction limits given by the exchange and in case he exceeds these limits he has to apply immediately to the exchange for enhancing the surety amounts. There is an upper ceiling limit for brokerage charge of 2.5% which must be adhered to by all stock brokers.

It is mandatory for every stockbroker to maintain following records under Regulations 17 of SEBI Regulations, 1992 read with Securities contracts (Regulations) Rules, 1957.

- (i) Register of transactions (Sauda book)
- (ii) Client Register,
- (iii) General Ledger,
- (iv) Journal,
- (v) Cash Book,
- (vi) Bank Pass Book,
- (vii) Document Register, which should include particulars of Shares and Securities, received and delivered,

- (viii) Member's Contracts book showing the details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicate of memos of confirmation issued to such other members.
- (ix) Counterfoils or duplicate of memos of confirmation issued to clients.
- (x) Written consents of the clients in respect of contracts entered into as principles.
- (xi) Register of accounts of sub-brokers.

10. Description of business

All transactions are done on a terminal provided by the particular stock exchange with which the stockbroker is registered. No transaction is generally executed otherwise. This ensures that all transactions done by the broker can be verified with the exchange. At the end of the day, bills for all transactions are electronically generated. These Bills contain the details of the transactions alongwith the brokerage and the Service Tax charged. The bill accompanies a contract which mentions particulars such as the date of sale / purchase of the share, quantity, rate of brokerage etc.

11. Accounting of tax revenue (service tax)

While generating the bills / invoices for each transaction in which the brokerage amount is also given, the stockbrokers have a software which calculates the Service Tax on the brokerage amount automatically and credits the same into the Service Tax account maintained by them on the basis of which the tax returns is prepared by the stockbroker. The brokerage amount is entered in a brokerage ledger maintained on a client basis by the stockbroker. The entries in the brokerage amount are made from the books of stockbrokers known as Vallans where weekly settlements are entered. For 52 weeks in a year the broker has 52 Vallans and these are entered in the ledger account.

12. Non-compliance issues and risk factors relating to stock brokers

Issues	Financial Account To Be Verified
1.Establishing the correctness of the brokerage amount, which is the value of the taxable service on which Service Tax is calculated.	a) Comparing the brokerage amount given in the Profit and loss account of the broker with the brokerage amount declared in the S T-3 Tax return submitted to the department.

	<p>b) The Brokerage amount and the Service Tax payments are contained in the book for weekly settlement called Vallans, maintained by the stockbrokers. This could be tallied with the corresponding vallans maintained by BSE/NSE in their books for stockbrokers and may also be tallied with the Service Tax-3 returns submitted to the department.</p> <p>c) The 'other income' head of the P&L account may be scrutinized to find out whether there is any category, which could include the brokerage amount to facilitate escape of payment of Service Tax. One such head that has been noticed is income from professional services. The contract order may be scanned alongwith the correspondence bills raised to ascertain whether professional service fee is in fact another name for brokerage.</p> <p>d) Amounts are also recovered from the clients in the guise of TG(Trade Guarantee), BC(Brokers contingency) and AC (Associates in Charge) . It is possible that these may also include brokerage charges in order to avoid payment of Service Tax.</p>
2. It is required to be ascertained whether the stock brokers conducts business with family clients. It is seen in number of cases that a token brokerage of 1 paisa is charged. The contract documents of all family member clients should be thoroughly scrutinized in order to ascertain the quantum of business done and amount of brokerage charged.	Contract document entered into between stock brokers and family clients.
3. Many stockbrokers also undertake transactions i.e. business with other stock exchanges where the broker is not a member. The contracts and bill of such arbitrage business should be scrutinized in order to know whether Service Tax has been	The contract and bills of arbitrage business may be scrutinized.

discharged on such business or not.	
4. Whenever a Stock Broker has two separate companies one for the Bombay Stock Exchange and another for National Stock Exchange if so then both companies should be taken together for audit purposes.	
5. The Computer package used by the brokers should be studied in advance so that the possibilities of deleting certain entries from the Computer are ruled out.	
6. The component of transaction on which no Service Tax is charged for example self trading and trading without levying brokerage should be examined for any mis-declaration.	Bills covering transaction where no brokerage amount is shown may be scrutinized on a sample basis.
7. It also requires to be ascertained whether the Stock brokers provides any other services, which is subject to Service Tax. An illustrative list is given below:- ☐ Underwriter Service ☐ Depository Services (Banking and Financial Service). Check if the broker is a Depository Participant. Portfolio Management Service (Banking and Financial Service)	

Profile of Telephone Service

1. Date of Introduction: 01.07.1994 vide Notification No.1/94-ST dt.20.06.1994.

2. Definition:

“Telegraph authority” has the meaning assigned to it in Clause (6) of section 3 of the Indian Telegraph Act 1885 and includes a person who has been granted a licence under the first proviso to sub section (1) of Section 4 of that Act.

(Section 65(74) of Finance Act, 1994 as amended)

As per Section 3(6) of Indian Telegraph Act, 1885, “ Telegraph Authority” means the director General of Posts and Telegraphs including any officer empowered by him to perform all or any of the functions of the Telegraph authority under this Act.

Section 4 (1) of Indian Telegraph Act, 1885 reads as under:

“Within India the Central Government shall have the exclusive privilege of establishing, maintaining and working Telegraphs:

Provided that the Central Government may grant a licence on such conditions and in consideration of such payment as it thinks fit to any person to establish, maintain or work a telegraph within any part of India:

Provided further that Central Government may, by rules made under this Act and published in Official Gazette, permit, subject to such restrictions and condition as it thinks fit the establishment, maintenance and working-

- (a) of wireless telegraphs on ships within Indian territorial water and on aircraft within or above India, or Indian territorial water, and
- (b) of telegraphs other than wireless telegraphs within any part of India.”

3. Taxable events and scope of service:

Taxable service means any service provided to the subscriber by the telegraph authority in relation to a telephone connection.

(Section 65 (72) (b) of Finance Act 1994 as amended)

“Subscriber” means a person to whom any service of a telephone connection or a facsimile or a leased circuit or a pager or a telegraph or a telex has been provided by the telegraph authority;

(Section 65 (71) of Finance Act 1994 as amended)

4. VALUE OF THE TAXABLE SERVICE:

The value of taxable service shall be the gross amount charged by the telegraph authority and includes the adjustments made by the telegraph authority from any deposits made by the subscriber at time of application for telephone connection but excludes initial deposit made by the subscriber at the time of application for telephone connection.

(Section 67 of Finance Act, 1994 as amended)

5. VARIOUS TAXABLE SERVICES COVERED BY TELEPHONE

There are a large number of services, which would broadly come under Telephone services for the purpose of Service Tax. These are categorized head wise based on the practice in the Telephone Department and their taxability or otherwise is also indicated.

TYPES OF SERVICES	A/C HEADS	SUB A/C HEADS	TAXABLE- YES (Y) OR NO(N)/WEF
A. TELEPHONES	1.Rentals	Rentals from subscribers	Y/1.7.1994
		Share of rental transferred from OYT deposits	Y/1.7.1994
	2. Metered call charges	Local calls/STD calls	Y/1.7.1994
		Income from VCC	Y/1.7.1994
	3. Trunk calls charges	Domestic / International	Y/1.7.1994
	4. Public Call Offices (PCOs)	Departmental locals (CCB Type),	N
		Private guaranteed locals (CCB Type)	N
		Village Panchayat Telephones Locals	Y
		PCO run by Disabled person Locals	N
		Departmental STD/ISD	Y/1.7.1994

		Private STD/ISD	Guaranteed	Y/1.7.1994
	5.Rent of wires/circuits/instruments leased from	Railway		Y/1.7.1994
		Canals		Y/1.7.1994
		Private Bodies		Y/1.7.1994
	6. Other fees	Installation, Reconnection & shifting fee		Y/1.7.1994
		Provision for additional facilities		Y/1.7.1994
		Royalties on licences for private lines and systems		Y/1.7.1994
	7. Surcharge for delayed payments of bills of	Telephones		N
		Telephones wires, circuits & instruments		N
	8.Charges & fee received from value added services operators	Access charges from RPG & RELIANCE		N
	9. Charges & fee received fro basic services operators (Bharti Telenet Ltd)	Access charges		N
		Charges for various communications resources and supporting		N
B. RADIO PAGER SERVICES	Radio Pager Services	Rent		Y/1.11.1996
C.TELEGRAPHS	1. Telegrams-domestic & international	Charges realized in cash, on NCR and by book transfer		Y/16.7.2001
		Cost of message booked under deposit account system		Y/16.7.2001
		Phonograms charges realized through telephone bills		Y/1.7.1994
	2.Telex	Rentals on Telex Installations		Y/16.7.2001
		Telex call charges		Y/16.7.2001

	3.Rent of telegraph-wires/circuits/instruments	Railways	Y/16.7.2001
		Canals	Y/16.7.2001
		Private Bodies	Y/16.7.2001
	4. Surcharge on delayed payments	Telegraphs wires & circuit	N
D.VALUE ADDED/NEW SERVICES	1. I Net (Pocket Switched Public Data Network Bangalore)	Call Charges	Y/16.7.2001
	2. Leased data Network	Rent	Y/16.7.2001
	3.Internet	Rent	Y/16.7.2001
		Other Charges	Y/16.7.2001
	4. Mobile Phone Services	Rent	Y/1.7.1994
	5. Facsimile (FAX)	Ordinary fax charged through telephone bills	N
		Bureau Fax	Y/16.7.2001
		Internet Fax	Y/16.7.2001

6. BOARD'S INSTRUCTIONS

In the case of plastic roaming facility, the home operator (home network), i.e., where the subscriber belongs to and who arranges roaming facility in other metro cities through the arrangements with the service operators (visiting network) should collect and pay the service tax.

(Ministry's F.No.149/1/97-CX4, dt.03.09.1997)

In the case of International roaming the foreign visited network operator forwards the usage bills to the Home network operator pertaining to the subscribers of Home Network operator who have made usage of visited network. On receipt of the usage bill from the foreign network operator the Home network operator includes the said amount and roaming surcharge in the regular monthly

bill of the subscriber. As the value of taxable service under section 67 (b) of the Finance act, 1994 as amended is the gross total amount charged by the telegraph authority (here Home Network operator) from the subscribers, the Board is of the view that the service tax shall be chargeable on the comprehensive (gross) bill raised by Home Network operator on its subscribers inclusive of foreign usage bill and roaming surcharge.

(Ministry's F.No.149/6/97-CX-4 dt.04.06.1999)

For the difference between the amount of service tax to be collected (based on billed amount) and service tax actually collected, the department may not insist at this stage for reconciliation of the figures of such service tax billed and collected and may place reliance on the financial control system of Telecom Department for the reconciliation of the telephone bills which would automatically mean reconciliation of service tax.

(Ministry's F.No.149/5/95-CX-4 dated 15.10.1996)

The amount received by the cellular telephone Company from subscribers towards SIM Card would form part of the taxable value for levy of Service Tax. As the SIM Card, unlike the telephone instrument cannot be purchased by the customer from elsewhere, the charges towards the Sim Card can essentially be viewed as processing charges for activating the cellular phone. The taxable amount should, therefore necessarily include the value of the Sim Card.

In cases where the telegraph authority has extended services at a discounted price, the Service Tax liability is limited to the discounted price so charged.

(Ministry's Circular No.23/3/97-ST dated 13.10.1997)

7. EXEMPTION AND EXCLUSION:

1. The telephone services provided to the following are exempted from payment of Service Tax
 - U.N. or an International Organization.
 - Specified diplomatic mission or its Members.

- Departmentally run public telephones for local calls.
- Guaranteed public telephone only for local calls.
- Free telephone at Airports and Hospitals where no bills are being issued. –
(Authority:- Notfn.3/94-ST dt. 30.06.1994, 5/96-ST dt. 03.04.1996 and 48/98-ST dt.24.04.1998)

2. The Public Mobile Radio Trunking Services (PMRTS) are not covered within the scope of taxable services provided in relation to “telephone connection”.

(Ministry’s F.No.341/16/2000-TRU dated 10.08.2000)

3. Cellular phone operators are realizing rent and access charges from their subscribers and as such when cellular companies pay service tax on the amounts received by them from their subscribers it includes rent and access charges and as such to charge again service tax on their charges by DOT will amount to double taxation. Board is of the view that no service tax is again chargeable on rent and access charges paid to DOT by cellular phone operators.

4. Service provided free and no amount is received by the telegraph authority. In that case the question of service tax liability dose not arise.

(Ministry’s Circular No.23/3/97-ST dt. 13.10.1997)

5. Interest earned on refundable deposits has got no nexus with the value of taxable service. Therefore, the Service Tax would not be leviable on interest earned of refundable deposits.

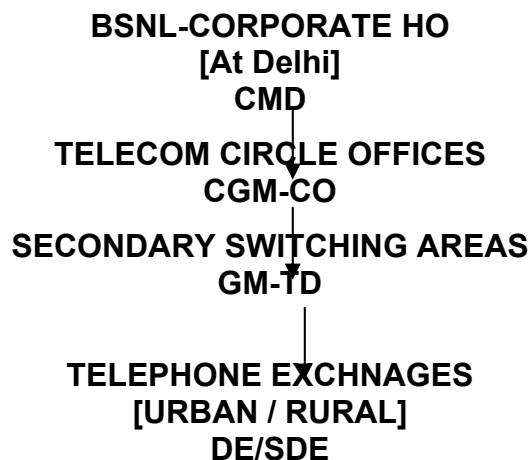
6. As per the provisions of section 65(72) (b) of Chapter V of the Finance Act, 1994, service tax is leviable on the service provided by the Telegraph authority to a subscriber, in relation to a telephone connection. Further, under section 67 (b) of the said Finance Act, the value of taxable service has been defined to include only the amount charged for the services provided by Telegraphic Authority to a subscriber. On a harmonious interpretation of the above provisions and also taking note of the fact that the amount of surcharge on delayed payment of a telephone bill does not alter the value of taxable services, it is hereby clarified that service tax is not leviable on the amount of surcharge collected for delayed payment of telephone bills. Consequently, Board’s Service Tax circular No.29/3/99, dt.15.07.1999 (issued from F.No.149/5/97-CX.4), which is contrary to the above position, stands withdrawn.

(Ministry's F.No.341/1/2000-TRU dt.20.12.2000)

7. The licence fee charged by the Central Government from licence holders is not covered as it is not recovered from subscribers and it is not service charges. However, if the service provider recovers the licence fees from the subscriber, service tax will be attracted, since the value of the taxable service is the gross amount recovered from the subscriber.

8. DESCRIPTION OF THE ORGANIZATION

The Department of Telecommunication was the main organization which was earlier discharging the excise duty on telephone. However, with effect from 1.10.2000 the Bharat Sanchar Nigam Limited took over all the functions and became an independent public sector undertaking. The organization of the BSNL which is the successor organization of the Department of Telecommunication is given below:-



All the above Telephone Exchanges are digital exchanges.

9. DESCRIPTION OF THE BUSINESS AND ACCOUNTING SYSTEM

In the organizational chart given in para 8 supra the secondary switching area is the point where the billing is made, which is also where the computer-billing center is located. The business in this service sector begins with the billing system. To facilitate ease of billing, the billing schedule varies with the category of the consumer and these bills are generated as per the billing cycle, which varies for each group. In Bangalore for example the billing cycle is as given below:-

Sr.No.	Billing Date	Type
1.	11 th , 18 th & 25 th	Domestic Telephones.
2.	6 th	Group billing (institutional billing ie., all lines

		in respect of multi location offices like Police, Wipro, Banks etc.)
3.	10 th	Local PCO
4.	5 th & 20 th Fortnightly Billing	STD PCO
5.	7 th	DID- Direct Inward Dialing
6.	8 th	ISDN
7.	10 th	Local PT
8.	Advance Annual Billing, Presently, optional Quarterly Billing is available	Leased Circuits (Press, Hotline, Pvt Wire Circuits, Access Circuit for ISPs, Cellular Operators, Telex, etc.)

Once the bills are issued to the customers as per the separate billing schedule, the customer produces the bill for payment at various payment centers, which covers Customer Service Centers, Departmental Telegraph Offices and Telecom Centers. The procedure is that once the customer produces the telephone bill, the bar code is scanned and the bill details are automatically flashed on the computer screen. On entering the details of the cash / cheque / DD received the receipt is generated on the computer. At the end of each day when the transactions are closed a daily list is generated on the basis of which a 'daily summary' statement, collection center were generated which gives the following details.

- ❑ Total vouchers issued.
- ❑ Total cash received
- ❑ Total cheques received
- ❑ Account head-wise breakup like
 - Account receivables i.e., Bill only
 - Other receipts like application free etc
 - Telephone deposits towards new connection, transfers, security deposits, STD PCOs
 - Rentals from disconnected telephones ie., arrears payment
 - Rent – DID(Direct Inward Dialing) and leased Circuits.

Once the collections are made they are remitted to the Bank by the Collection Centers on the next day. The 'daily summary' statement prepared at the collection center are then sent to the computer billing center which is generally located at the Secondary Switching stations alongwith the counterfoils of the telephone bills. A Telephone Revenue Collection (TRC) daily list is prepared under various heads

like OYT, Non OYT, Telex, Leased circuits, other deposits, STD PCO, Telegram, VCC, FAX DPCO etc. for the telecom circle as a whole. On the basis of the daily TRC a monthly TRC is prepared which is submitted to CBC Accounts officer (Sub ledger section, deposit Section and CAO (TRC). In the case of lease circuits, advance payments are received by the circle office and manual bills are generated here by the circle office issued by the Accounts officers (TLX – circuits) which are then later fed into the computer at the computer billing centers for generation of the 'sub ledger account receivable' and the 'tax sub ledger'(important financial records). Importantly the computer-billing center also generates the payment schedule collection center wise which takes the form of account receivables. RMCC denotes remittances from all the Customer Service Centers; the RMCTO denotes the remittances from the Departmental Telecom Offices and Telegraph Offices and RMPO denotes remittances from all the Post offices.

AR	Account Receivable (Sundry Debtors for Telephones)
TGR	Telegraph Receipts
DAR	Deposit Account Register
SCR	Surcharge for Delayed Payments
EDR	Excise Duty Register – Service Tax
DPR	Excess Payment Register

After details of payment are entered made at the Pos, Banks, DTOs, RCSCs and through Electronic Clearing System, are fed into the computer system at CBC, the break up of the total amount received automatically gets posted under different heads viz., rentals, call charges, trunk calls, phonograms, tax, surcharge etc. **the date of payment fed into the system is the actual date of submission of the cheque/cash at the collection centers and not the date of the making over of the consolidated cheque by the collection agency/centers.** The monthly Tax Sub Ledger and the Trial Balance are also automatically generated by the System.

10. ACCOUNTING OF TAX REVENUE

The Service Tax payment is based on the computer generated **tax sub ledger**. The senior officer (sub ledger) on receipt of the sub ledger from the CBC arranges for funds for payment of Service Tax as per the amounts indicated in the tax (sub ledger). The TR 6 challan is prepared and the cheque for the Service Tax is submitted to the designated Banks. Earlier under DOT, journal slips were issued and book adjustments were made with the Ministry of Finance in respect of the Service Tax liability.

11. NON COMPLIANCE ISSUES

1. As the entire system of accounting is computerized which spells out the date of submission of the cheque and the date of payment of service tax, it is easy to identify cases of delayed payment of service tax. Such delays would normally occur in cases where the accounts are transferred to M/s. BSNL manually and not through computer. As per the latest instructions dated 24.09.2001 issued by M/s. BSNL amounts of telephones revenue collected by way of cash is to be remitted on the next day by the concerned Head Post Office to the designated Accounts Officer.
2. In the case of payment through cheques remittance is made only on the day of realization of the cheques. Hence, in cases where the cash as-well-as cheques (after realization) are sent to the Accounts Officer delays are likely to take place. Service tax is then likely to be collected as-soon-as the revenue is received by the BSNL through the Post Office. In respect of collection of telephone bills through banks there is a clause for penalty for late remittance. Here all amounts is required to be received within 7 days of the transaction. Scrutiny of the penalty for late remittance as-well-as date of remittance when compared to the date of collection of the bills would indicate delayed payment of Service Tax.
3. During test audit done it was found that service tax was not paid on:-
 - a) STD PCO run by department (CTO/DTO).
 - b) Telegraph / telex / Bureau Fax / E.mail (w.e.f .16.7.2001) run by CTO/DTO
 - c) Leased wire circuits had not been billed from (Secondary Switching Area) SSA, but form Circle office, and hence service tax had not been paid as the transaction had not been included.
 - d) Internet Service Provider (ISP) services.

- e) Telephones run by Post Offices, for which receipts are passed on to the callers an amount is transferred by Post Office to BSNL. Here the receipt is shown in cash book, but computer billing is not made and no TAX is paid.
- f) In respect of Advice Transfer Credit Notes received from other circles, the liability to pay Service Tax would be at this end since the services are rendered by this circle. The amount realized at the outside circle has not been considered for payment of Service Tax.
- g) On services provided to Postal Department.
BSNL is collecting Service Tax amount on telephones etc from Postal Department, and also paying tax. But the DOT had not paid the tax prior to 1.10.2000. Both the department provided services to each other but did not collected service value from each other. The arrangement was – ‘Barter System’.
- h) Service Tax is not paid by BSNL through TR 6 challans, but through book adjustments even after it corporatisation into BSNL, from DOT, a Govt department. (this point needs verification)
- i) Service Tax is not paid on Village Panchayat Telephones. The same is being treated a local PCO, although the same is installed in Panchayat Bhawan in a village and the call charges are shared by the Panchayat and BSNL in the ratio of 40:60. It is to clarify that public is charged for the calls. The accounting of VPT (Village Panchayat Telephone) is done separately as against Local PCO. It may be stated that unlike specific exemption to Local PCO, there is no exemption for VPT.

4. Registration not in the name of BSNL- As para (ii) to (iv) of Service Tax Circular No. 5/5/94 dated 11.10.94 issued by Ministry of Finance, each SSA is required to:-

- (i) be individually registered with the Collector of Central Excise in whose jurisdiction they are located.
- (ii) Credit Service Tax collected during the month under the head 044 Service Tax , Service Tax on Telephone Billing by 15th of following month and
- (iii) File Service Tax return on quarterly basis indicating payment of Service Tax by way of book transfer.

Further attention is invited to Circular No. 33/1/2001 dated 29.01.2001 issued by Ministry of Finance vide which the Circular dated 11.10.94 has been modified to the extent that book transfer facility will not longer be available to BSNL, as it is no longer a Government Department. Accordingly, as per Service Tax Circular No. 33/1/2001 dated 29.01.2001 when read with Service Tax Circular No. 5/5/94 dated 11.10.94, the situations emerges as under:-

- (a) They have to obtain separate registration as per Service Tax Rules Rule 2(2) and 2 (3) as all the SSAs are doing independent billing and independent accounting and their trial balance etc. is being prepared at SSA level.
- (b) They have to pay Service Tax in their respective jurisdictional Commissionerate by TR-6 Challan till they get a Centralized Registration permission in this regard.

Despite the above clear position as clarified by Ministry vide Circular No. 33/1/2001 dated 29.01.2001, in many of the Commissionerates SSAs are not making payments in the nominated Banks. The SSAs have not even applied for registration in the name of BSNL.

5. Concerns in Accounting of Service Tax (Scrutiny and matching of financial records) -

The following infirmities in the accounting systems were noticed during test audits:-

- a) On comparison of Cash / Bank Book with payment schedules it is found that some payments received from STD PCO of CTO/DTOs, and sale value of VCC cards etc are not accounted for in the Sub Ledgers. In other words, Sub Ledger (tax) does not reflect the true picture of amount billed for and payments received.
- b) Moreover, calculated tax on payments shown in Sub Ledger (AR) does not tally with tax recovered shown in the Sub Ledger (Tax), on the basis of which tax is paid. This may happen when manual billing done at the Circle Office is not captured by the Computer billing center at the SSA.
- c) In computer accounting the classification of taxable and non-taxable value of services is not proper leading to non-compliance. According to the taxpayer, some of the non-taxable amount is also included in the payments of Sub Ledger (tax), and that is why calculated tax ie. 5% of payments received does not tally with tax recovered shown in the Sub Ledger (tax). They are not able to classify the taxable services correctly, and so is the payments received.
- d) The reconciliation of Bill Register with Amount Billed for Schedule (ABF) carried out for the month of February, 2002 resulted in difference, which could not be explained. Such difference over total accounting period may assume large proportion and may have bearing on Service Tax. Attempt to reconcile the Revenue Receipt (TRC) with Payment Schedule also resulted in unexplained differences.
- e) Perusal of sub ledger (Accounts receivables) indicated existence of Dummy Telephone Exchange where in certain receipts have been shown

but no corresponding tax shown to have been paid. The audit memo issued is still unreplied.

- f) Totaling mistakes of Rs. 53 lakhs in respect of Service Tax. It appears that Service Tax had not been paid to this extent.
- g) Computerized Sub-ledger for the year 1997-98 did not tally with the manual Sub-Leger for the same period
- h) Assessment of tax was not finalized since October 2001
- i) Two different methods for calculating Service Tax have been followed. In one case, tax is calculated on gross receipts whereas in other case, it is calculated on Net payments plus Adjustments of Sub-Ledgers. Implications on Service Tax are significant in 1994-95. Service Tax for 7/94 though collected but not paid. The same could not be verified.

6. Calls Verification-

There is no system of regular verification of total calls made by the subscribers and metered in the Telephone Exchanges with total calls billed by the Computer Billing Cell for every month.

Profile of Non-Life Insurance

1. Date of Introduction: 01.07.1994 vide Notification No.1/94-ST
dt. 20.06.1994.

2. Definition:

“Insurer” means any person carrying on General Insurance Business in India.

(Section 65(33) of Finance Act, 1994 as amended)

“General Insurance Business” has the meaning assigned to it in Clause (g) of Section 3 of the General Insurance Business (nationalization) Act, 1972.

The said clause (g) provides that “general insurance business” means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.

(Section 65(27) of Finance Act, 1994 as amended)

3. Taxable events and scope of service:

Taxable service means any service provided to a policyholder, by an insurer carrying on general insurance business.

(Section 65(72)(d) of Finance Act, 1994 as amended)

4. Value of Taxable Service:

In the case of Insurance, the value of taxable service shall be the gross amount of the premium charged by the service provider viz., insurer from the policyholders.

(Section 65(67) of Finance Act, 1994 as amended)

The General Insurance business is carried on mainly by five public sector Insurance Corporations, viz., GIC, NIAC, NIC, OIC & UIC. Though the service tax is collected by the brokers along with the premium, yet registration and payment obligations are complied by the Head office of each corporation. Each corporation will furnish a list of their Divisions and Branch offices along with the accounts maintained by them. As Private Insurance Corporations are being licensed now, Commissioners may devise suitable procedure in this regard in consultation with the Companies.

5. Exemptions & Exclusions:

- i. Following activities under insurance are exempt from the levy of Service Tax.
 - (a) General insurance service provided to U.N or International organizations.
 - (b) Services provided to policyholder of Jan Arogya Bima policy in relation to General Insurance business.
 - (c) General insurance business for non life insurance premium to specified Diplomatic mission.
 - (d) Personal Accident social security and Hut Insurance Scheme.
 - (e) Comprehensive crop Insurance Scheme.
 - (f) Cattle Insurance under Integrated Rural Development Programme.
 - (g) Janata Personal Accident Policy and Gramin Accident Policy.
 - (h) Group Personal Accident Policy for self-employed women.
 - (i) Agricultural Pumpset and failed well Insurance.
 - (j) Premia collected on insurance of Export of goods from India and Export Credit Insurance.
 - (k) Premium received from Re-insurance both domestic and overseas.
 - (l) All business for which premium is booked outside India.
 - (m) Small transactions involving premium of less than rupees fifty except Motor insurance.
 - (n) Group personal accident scheme in relation to General Insurance Business for the employees of Government of Rajasthan.
(Authority: - Notification No. 3/94-ST dt. 30.06.1994, No. 10/96 dt. 26.11.1996, 12/97-ST dt. 14.02.1997, 48/98-ST dt.24.04.1998 & 1/2000-ST dt.09.02.2000)
- ii. The Central Government vide Notification No. 3/2000-ST, dt. 06.07.2000 has exempted premium paid for general insurance business in relation to National Agricultural Insurance Scheme or Pilot Scheme. This exemption from the whole of taxable services leviable under Section 66 of the Act. The term National Agricultural Insurance scheme is also called Rashtriya Krishi Bima Yojana.
- iii. The Central Govt. has exempted vide Notification No. 4/2000-ST, dt. 31.07.2000 from the whole of taxable services levied in relation to general insurance provided under the Central Sector Scheme on Cattle

Insurance. This exemption is meant for social upliftment in relation to cattle breeding.

- iv. Service provided in relation to Life Insurance is not covered by Statute and hence not leviable to Service Tax.
- v. The service tax on general insurance business was made, w.e.f., 01.07.1994. So policies issued prior to 01.07.1994 even though the premiums were paid earlier but policies continues to be effective subsequently and also in cases where premiums are being paid after 01.07.1997 are not covered by the levy. In both the above situations, the risks continues to be covered after 01.07.1997 (Refer F.No.150/1197-CX.4 dt. 02.03.1997)
- vi. When the amount of risks covered is very large, the lead insurer shares the risk with other co-insurers. The lead company receives the entire amount along with the co-insurers. Since premium is received from policyholders by the lead company, service tax is payable by that company.

(Ref. F. No. 150/1194-CX.4 dt.02.03.1996)

6. CENTRAL REGISTRY

More information available from

- ❑ The insurance Regulatory Development Authority, Ground Floor, Jeevan Bharti Building, Tower-1, 124, Connaught Circus, New Delhi – 110001.
- ❑ General Insurance Corporation of India.

Sites like www.insurancemust.com have a lot of information on this service available on this site, state-wise and city wise.

On Internet URL http://www.indiamart.com/dir/indianservices/s_insur.html gave the following only sample other wise the database of insurance service providers is fairly large)

Chanakya Service Station Provide automobile services like proper maintenance of your vehicle, insurance claim of automobiles etc. Address: Kapasera-Bijwasan Crossing, Old Delhi, Gurgaon Highway, Khasra No.:- 28/5, Vill –Samalka, New Delhi – 110 037, India Phone : +(91)-(11)-

5069174/5069175 Fax:+(91)-(11)-5069174 Send On-line Service Enquiry or visit : <http://www.Indiamart.com/chanakya/>

Chankra Lakshmi Chit Fund Pvt. Limited A company deals into informal finance, insurance, deposits and loan schemes. Address:- 105-106, A-1, A-2, Satya Mansion, Ranjit Nagar Community Centre, New Delhi – 110 008 , India Phone: +(91)-(11)-570455/5704356 Send On line Service Enquiry or visit : <http://www.chitfund.com>

Lamba Associates Provides services as Insurance consultants, surveyors, loss assessors, valuers, Investigators for motor, machinery, property, household goods etc. Address: 15 Church Road, Bhogal, Jangpura, New Delhi – 110 014, India, Phone : +(91)-(11)-4316062/4317025 Fax:+(91)-(11)-4317025 Send On line Service Enquiry or visit: <http://www.indiamart.com/jointtechnocare/>

Similarly search on “Insurance Service” on Internet search engine www.rediff.com yielded the following results:-

Bajaj Allianz General Insurance Company <http://www.bajajallianz.co.in>

>>>>more like this A joint venture between Bajaj Auto Limited and Allianz AG of

7. DESCRIPTION OF THE ORGANIZATION AND BUSINESS PRACTICE:

The organization structure of Non life Insurance company generally comprises of Branch Offices, Division offices and Head office. The transaction of underwriting of insurance policies is carried out either at the branch office or at the division office. At the head office only consolidated figure of total amount of premium received after adjusting the premium refunded and co-insurance premium received and paid, is reported. In cases of co-insurance where the branch /division office is the leader, the gross amount of premium received is passed on to other co-insurance agencies in the ratio of risk undertaking. Re-insurance business is looked after by the head office only. In the case of some business like the insurance of Aviation Sector, the business is transacted at the head office level itself. Similarly, in the case of major projects like insurance of satellite etc it is possible that head office may directly undertake the insurance business.

8. ACCOUNTING OF SERVICE TAX.

Monthly payment of Service Tax is made by the head office based on the figures reported by the regional office who in turn obtain the figure of service

tax liability from the divisional office who in turn receive the figure from the branch office. At the end of the year, total amount of Service Tax liability is calculated from each regional office based upon the financial report (trial balance) received from the Regional Offices. It has been noticed that there is no practice of reconciling Service Tax with the total premium chargeable to Service Tax. The Head Office simply multiplies the Service Tax paid by 20, in order to arrive at the taxable premium while filling up the Service Tax returns. In order to arrive at the total premium chargeable to Service Tax, the Branch / Division office should be asked to make the adjustments on account: -

- ❑ Premium refunded due to cancellation or transfer of policy,
- ❑ Exempted Policies,
- ❑ Co-insurance ceded,
- ❑ Co-insurance received.

9. NON-COMPLIANCE ISSUES AND RISK FACTORS RELATING TO NON-LIFE

INSURANCE

ISSUES	FINANCIAL ACCOUNT TO BE VERIFIED
1. Establishing the correctness of the premium amount, which is the value of the taxable service on which Service Tax is paid in respect of Non-life Insurance.	<p>a) Examine the monthly statement of premium (known as Premium Summary) sent to the next higher office as to verify total amount of premium received as per the said statement and calculate the Service Tax liability and compare with the service tax shown to have been payable by them as per other statement sent to next higher office.</p> <p>b) Ask the Branch /DO to prepare reconciliation for the total premium chargeable to service tax after making the following adjustment:-</p> <ul style="list-style-type: none"> (i) Premium refunded due to cancellation or transfer of policy. (ii) Exempted policies. (iii) Co-insurance ceded. (iv) Co-insurance received. (v) Any other aspect. <p>c) Examine the Trial Balance of the Branch/DO with respect to following aspects:</p> <ul style="list-style-type: none"> (i) Trial Balance will show the consolidated figure for premium received from the major department like fire, marine, mediclaim etc.

	<p>Compare the figure of Trial Balance with the figure shown in the monthly summary sent to the next higher office. Examine the Journal Voucher for any adjustment made at the end of the month or at the end of the year for the premium amount received.</p> <p>(ii) Examine the Service Tax Account in the Trial Balance and compare the figure with the service tax liability reported to the next higher office.</p> <p>d) Examine the Trial Balance of the head office to find out the total premium received as reported in Trial Balance and Premium received reported in service tax returns. The difference may be on account of various reasons, which have been discussed above.</p> <p>e) Examine the Monthly/Quarterly/annual Returns sent to Insurance Regulatory Development Authority (IRDA) for total amount of premium reported and compare with premium reported in Service Tax Return. For differences call the re-conciliation statement.</p>
2. Verify the Premium Register, which shows the details of each policy alongwith the premium amount and service tax to find out the cases wherever service tax has not been paid. Select the policies on random basis and study the content of the policy so as to confirm whether the coverage of the policy is same is provided in the exemption notification.	
3. Examine the cases of co-insurance where the Branch/DO is the leader to verify whether service tax has been paid on the gross amount of premium received by them even though part of the	

premium have been paid to other co-insurer.	
4. Examine the whether service tax has been paid on the recovery of premium due to internal audit objections or any other reason.	
5. Whenever the premium has been refunded, please examine whether the service tax has also been refunded or not.	
6. Examine if the insurance have been undertaken for the vehicle or building or other properties of the employees and in that case whether the service tax has been paid or not.	
7. In cases of receipt of "Extra Endorsement" premium enhancing the sum of insured amount or enhancement of risk coverage, wherein the additional premium is collected from the insured party, it should be checked that corresponding service tax has been collected and deposited to the Government.	
8. In case of commission paid to Insurance Agent, it may be seen that all types of payment whether it is termed as Agent commission or Re-imbursement of expenses or bonus, have been taken into account for payment of Service Tax .	
9. In cases of re-insurance, wherever the insurance company has taken recourse to re-insurance	

agent, the brokerage received by the agent is liable to service tax, under the insurance auxiliary services. This needs to be checked.	
10. A list of intermediaries as defined under IRDA Act, ie., the Surveyor, Re-Insurance Agents, Insurance Agents etc., should be obtained from the Insurance Company being audited and later on it should be got checked by the service tax Cell as to whether all these intermediaries have got themselves registered and are paying Service Tax.	
11. If any business is being transacted at the head office level also, say in the case of GIC the insurance of Aviation Sector is being undertaken by GIC itself. Similarly, in the case of a major project like insurance of Satellite etc., it is possible that the head office may directly undertake the insurance business. For this purpose the Premium Received account at the head office level should be examined to find out as to whether any premium has been accounted for at the head office level also and appropriate Service Tax have been paid or not.	
12. Examine the interest payment liability for shortfall in the service tax	

<p>paid during the year. It has been noticed that some of the taxpayers are paying the interest actually from the next year. For example, if the shortfall has occurred during 2000-01, the interest has been calculated from 01.04.2001I whereas interest should have been paid from the month in which the shortfall had occurred.</p>	
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The test audits clearly show that in most of the cases the Branch/ divisional office report only net Service Tax liability to the head office through regional offices for payment of monthly Service Tax. It is, therefore, essential that **audit should be conducted both of the head office alongwith the concerned branch offices and division offices where the actual transaction of underwriting of non life insurance policy is carried out.** The test audit also show that monthly payment of Service Tax is made at the head office based on the figures reported by the regional office who in turn obtain the figure of Service Tax liability from the division office who in turn receives the figure from the branch office. It is invariably noticed that the amount of Service Tax payable reported on the monthly basis do not tally with the actual liability worked out at the end of the year. This results in payment of differential service tax at the end of the year, after finalization of books of account at the head office level. The difference may be on account of wrong accounting or wrong reporting or lack of adjustment for refund or co-insurance or claiming of wrong exemption etc.

It is therefore, essential that a complete re-conciliation should be called for the Service Tax liability, which was reported originally to the head office and the actual service tax payable. Wherever the difference is substantial the reasons for the same should be called for so as to examine whether the same mistake could have been occurred at other places also. The branches which have reported substantial difference (either excess or shortage reporting) may also be taken up for audit as a special case. Since no details are available at the head office about

the various transactions undertaken at branch/ divisional level, therefore, correctness of payment of service tax can be verified at the head office level to a limited extent only.

PART IV

ANNEXURES

ANNEXURE A

Some of the information for the master file may be kept in Computerised form. The electronic form of data may be comprised of the following;-

Part I - Taxpayer Profile

1. Name of the Service Provider.

[illegible]

2. Address of the Service Provider.

(i) Name of Premises/Building

[illegible]

(ii) Flat/Door/Block No.

[illegible]

(iii)	Road/Street/Lane
-------	------------------

[illegible]

(iv) Village/Area/Locality

[illegible]

(v)	Block/Taluka/Sub-Division
-----	---------------------------

[illegible]

(vi) Town/City/District (vii) State/Union Territory (*Please see instruction No. 6(a)*)

[illegible]

(viii)	PIN	Post office
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[illegible]

(ix) Telephone Nos.:

[illegible]

(x) Fax Nos. (xi) E-mail Address

[illegible]

3. Details of Permanent Account Number (PAN)

Tick any one box

(i) Not applied for PAN ☐ (ii) Applied for PAN but not received number

☐ (iii) Allotted PAN number ☐

If (iii) provide the following details:

(a) PAN

[illegible]

4. Description of the services provided.

[illegible]

5. List of input services in the same category in respect of which tax credit is availed.

(i)

(ii)

(iii)

6. Service-wise details of value of service and tax paid (for 3 years).

Period	Value of taxable services	Service Tax payable/paid	Total input credit utilized	Net Service Tax paid
Year 1 H ₁ H ₂				
Year 2 H ₁ H ₂				
Year 3 H ₁ H ₂				

7. Details of show cause notices issued alongwith brief facts and issue involved - Last 3 years.

8. Details of cases pending with CESTAT/High Court/Supreme Court.

Part II - Other information

1. Whether package of services is standardized (an example could be tour operators, Rent-A-Cab, Mandaap Keepers, etc.) or customized. Yes ☐ No ☐.

2. Form of Organisation (i.e. whether individual/partnership or private or public limited company etc.) (tick only one box)

Proprietorship ☐ Partnership ☐ Registered Co. ☐ Unregistered Co. ☐ others ☐.

3. Details of proprietor / partner / CEO / Chairman / Managing Director (as applicable).

Details of Proprietor/Partners/CEO/Chairman /Managing Director/Member etc.

(a) Name

[illegible][illegible][illegible]

(c) Residential address

(i) Name of Premises/Building

[illegible]

(ii) Flat/Door/Block No.

[illegible]

(iii)	Road/Street/Lane						

[illegible]

(iv) Village/Area/Locality

(iv) Village/Area/Location	

(v) Block/Taluka/Sub-Division

(vi) Town/City/District

(vii) State/Union Territory

(viii) PIN Post office

(ix) Telephone Nos.:
 (a) office (b) residence

(x) Fax Nos. (Please see instruction No. 6(a)) (xi) E-mail Address

Permanent Account Number (PAN)
 (issued by the Income Tax Department)

In case of more names provide the information in the above format.

4. Details of registration with any other Government Department/Agency or Regulatory Authority as the case may be.

1. Customs registration No. (BIN No.) yes ☐ no ☐ if yes give detail.

2. DGFT's IEC No. yes ☐ no ☐ if yes give details.

3. Sales Tax Registration Nos.
 State ST No. yes ☐ no ☐ if yes give details.

CST No. yes ☐ no ☐ if yes give details.

4. Registrar of Company's CIN No. yes ☐ no ☐ if yes give details.

5. Tour Operators with RTA yes ☐ no ☐ if yes give details.

6. Stock Brokers with SEBI yes ☐ no ☐ if yes give details.

5. Name and designation of the authorized person of the Service Provider.

(a) Name

(b) Designation

(c) Residential address
 (i) Name of Premises/Building

(ii) Flat/Door/Block No.

(iii) Road/Street/Lane

(iv) Village/Area/Locality

(v) Block/Taluka/Sub-Division

(vi) Town/City/District														(vii) State/Union Territory													
(viii) PIN														Post office													
(ix) Telephone Nos.:																											
(a) office														(b) residence													
(x) Fax Nos.														(xi) E-mail Address													

In case of more names provide the information in the above format.

6. Details of sub contractors in case any service or part thereof is got done by subcontractors.

Name, designation and address of sub contractor(s):

(a) Name																											
(b) Address																											
(i) Name of Premises/Building																											
(ii) Flat/Door/Block No.																											
(iii) Road/Street/Lane																											
(iv) Village/Area/Locality																											
(v) Block/Taluka/Sub-Division																											
(vi) Town/City/District														(vii) State/Union Territory													
(viii) PIN														Post office													
(ix) Telephone Nos.:																											
(a) office														(b) residence													
(x) Fax Nos.														(xi) E-mail Address													

In case of more names provide the information in the above format.

7. Name of the designated bank where the Service Tax is deposited.

(i) Name of the bank																											
(ii) Name of the branch																											

8. Details of the Bank accounts used for business transaction with name of the bank, its specific branch and account number.

(a) Account 1

(i) Name of the bank

[illegible]

(ii) Name of the branch

[illegible]

(iii) Account No.

[illegible]

Details of more Accounts used for business transactions yes ☐ no ☐

If yes,-

(b) Account 2

(i) Name of the bank

[illegible]

(ii) Name of the branch

[illegible]

(iii)	Account No.
-------	-------------

[illegible]

Note: In case of more than two bank accounts, two major bank accounts may be entered above.

9. Accounting system- whether centralized or not. Yes ☐ No ☐

10. Billing pattern - (a) whether centralized or decentralized, Yes ☐ No ☐

(b) billing stages e.g. billing of 20% of gross amount on conclusion of contract, another 20 % on completion of preliminary work and so on.

[illegible]

11. List of branch offices, alongwith their respective value of taxable services.

Part III - **List of hard copies to be kept in Master File.**

The other part of the master file should consist of hard copy of certain documents as illustrated below:-

- i) A copy of the taxpayer's application for registration (ST-1).
- ii) A copy of the list of all accounts maintained by the taxpayer in relation to Service Tax including memoranda received from his branch office as submitted under Rule 5 (2) of Service Tax Rules, 1994.
- iii) Copy of Balance Sheets, Profit & Loss Statement, Trial Balance, Annual Reports.
- iv) Copies of Tax Audit reports (under Income Tax Act) for 2 years.

- v) A copy of the previous audit reports (if taxpayer was audited previously) – whether by Internal Audit or CAG.
- vi) Copy of Service specific Profiles, if any, prepared in the department.
- vii) A copy of any other return / declaration sent to any other department / agency or to designated regulatory authority.
- viii) Scored Working Papers.
- ix) Minutes of Service Tax Monitoring Cell.
- x) Any other documents relevant for audit for service tax assessment.

ANNEXURE B
(Please see Chapter 7)

RATIO ANALYSIS OF DATA BASE

Nature of Ratio / Method of calculation	Utility of the Ratios in Service Tax Audit and manner of use.	Source Document
1. Major inputs service cost : Value of Taxable Service	<p>1. Compare the ratio over a period of 3-4 years. If the ratio is increasing there is possibility of the following irregularities.</p> <p>a) Rendering of unaccounted output services.</p> <p>b) Undervaluation of output services.</p> <p>c) Splitting of output service income into non-taxable services income.</p> <p>2. Compare this ratio (A) with <i>Credit availed: Total Service Tax payable</i> (B) If B ratio is more than A ratio, there is possibility of wrong availment of credit (either calculation mistake or availment of credit on input services not used in output services).</p>	Profit & Loss Account (Income & Expenditure Account) and ST3 return
2. Other incomes not charged to Service Tax : Value of taxable services	<p>Compare the ratio over a period of 3-4 years or with the taxpayers rendering the same services. If the ratio is increasing over a period of time or it is more compared to other service providers there is a possibility of under-valuation by splitting of output service income into non taxable/exempted service income. For example, a Chartered Accountant may show his income from auditing, which is chargeable to Service Tax as income from consultation, which is exempted or an Internet Café income as Computer Printout income, as he is also providing the said services and which is exempted.</p>	Profit & Loss Account (Income & Expenditure Account) and ST3 return
3. Additions to plant and machinery/ fixed assets during the year: Total value of assets at the beginning of the year	<p>A comparison of this ratio with the rate of growth of the value of taxable service during the year may be useful in verifying whether the value of taxable service has been correctly declared particularly in cases where the additions to plant and machinery/ fixed assets directly impact the volume of sales. For instance, the installation of additional processing equipment by a photographic laboratory would normally result in some increase in its value of taxable service. In the same</p>	Balance Sheet

	manner, increase in the number of computers in an internet café would generate additional business for the taxpayer.	
4. Amount of credit availed on input services : Total Service Tax liability	<p>Compare the ratio over a period of 3-4 years. If the ratio is increasing there is the possibility of the following irregularities.</p> <p>i) (a) Rendering of unaccounted output services; (b) Under valuation of output services; (c) Splitting of output service income into non taxable services income.</p> <p>ii) Inflation of input service credit.</p>	Tax Payer Profile.
5. Consumables/Fuel value : Value of taxable services	<p>Compare this ratio over a period of 3-4 years or with the taxpayers rendering similar services. If the ratio is increasing over a period of time or if the ratio of the taxpayer is more than other service providers there is a possibility of rendering of unaccounted output service or undervaluation of all the services. This ratio may be useful where consumables, fuel or power consumption are having relationship with the rendering of output services. For example in the case of photographic services, use of consumables like ink or toner has direct relationship with the processing of photographs. Similarly, in the case of tour operators, expenses on diesel or petrol have also relationship with the output services. This ratio may be used alongwith the ratio, namely, Major input service cost : Value of taxable services discussed above.</p>	Profit & Loss Account (Income & Expenditure Account).

ANNEXURE C

(Please see Chapter 8)

Indicative list of items to be examined in the Trial Balance / Profit and Loss Account / Balance Sheet / Tax Audit Report.

The perusal of the Trial Balance could achieve the following:

- (a) Familiarization with chart of accounts/account code and understand as to what extent the information is detailed and integrated with other subsystems; few sample Journal Vouchers may also be seen to understand the information mentioned therein.
- (b) Understand the grouping of sub accounts under main accounts for the purposes of summarization into Profit and Loss account and the Balance Sheet.
- (c) Identification of accounts, which have a prima facie relevance for service tax payment (may be direct or indirect). These accounts may have to be seen in detail at later stage of audit depending upon the result of subsequent audit processes;
- (d) Understand the tax accounting system in so far as it pertains to Service Tax payment and treatment of credit of service tax on input services;

During the study of the Trial Balance/ Profit and Loss Account the following areas could be studied in detail,-

- (a) All income accounts in the Profit and Loss Account:

Normally, the Profit and Loss Account would show a consolidated entry for business income from all sources. According to accounting standards, non-business income such as interest income or dividend income is required to be shown separately.

To begin with, auditors should call for the groupings of business income shown in the Profit and Loss Account. The said groupings would show the different heads under which the incomes have been accounted for. They should carefully study the nature of business income – some of which may have accrued from the sale of taxable services and the balance from the sale of non-taxable services. The exact nature of these services may be determined from the supporting documents such as Vouchers, bills or contracts. In doing so, auditors need to be guided by the nomenclature (used for each of these services) in the Trial Balance or Annexures to the Profit and Loss Account. It is possible that the true nature of the service is obscured or disguised by using a nomenclature that is either non-taxable or exempted.

(b) Expense Accounts:

Scrutiny of expense accounts would enable the auditors to identify major expenditure heads. In specific terms, such scrutiny may be useful in the following manner:

- ✓ Useful for verification of out of pocket expenses where deductions for these have been claimed.
- ✓ Correlation between expenditure head and value of taxable service e.g. fuel expenses and the value of taxable service in the case of tour operators.
- ✓ Analysis of trend in total expenses vis-à-vis the previous year to check whether income grew proportionately or not.

(c) Creditors' (Input service providers) accounts to be checked to verify whether payment was made prior to availment of credit

(d) Verify whether Service Tax has been paid by the Input service provider on the services received by the taxpayer.

Similarly, the perusal of the Balance Sheet could achieve the following:

(a) Auditors reports, accounting principles/policy and notes on accounts.

(b) Increase in Fixed Assets – This could be particularly useful where it is possible to correlate the output of the final service with the size of fixed assets e.g. the size of the fleet of vehicles would govern the output of a tour operator.

Tax Audit Report (Form 3CD) should be examined to verify and compare the following facts declared by the taxpayer,-

ANNEXURE 'D'
(Refer Chapter 7)
Flow Chart showing manner of verification of transactions and documents during Walk Through and Audit.

I. Verification of Sales of Services and Income:

- File of correspondences with the client/customer
- Quotation/Tender files
- Cost sheet to work out approximate cost of service (eg. cost of A.M.C. ,
Advertisement cost)
- Price List (in cases where price of services are fixed like in case of Insurance Premiums, Cable Operators, Coaching centers).
- Booking Register (eg. in case of Mandap keeper, Convention Centre, tour operators)
- Service Agreement/Contract like Agreement for Technical consultancy
- Job cards/work statements (eg. in case of AMC or repair of vehicle, job card may show value of services and material used)
- Advance Receipts (eg. in case Mandap keeper, tour operator, event management services)
- Invoices/Receipts
- Income Register (like Sales Register)
- Debit Notes
- Customers ledger Account (to verify total amount billed, by way of invoice, debit note, payment received, credit note issued)
- Returns filed with other Departments (like returns filed with Sales tax department for Works Contract Tax (Installation & Commissioning Services); with State Government for Luxury Tax (in case of Mandap keeper, Convention Centre), SEBI (Stock broker), IRDA (Insurance services)
- S.T.3 Return

II. Purchase of Input services and Availment of Credit

- Vendor/Supplier list
- Correspondence with vendor/supplier

- Tender/Quotation documents
- Purchase Order
- Purchase invoices/bills
- Debit Notes (for return of input services)
- Purchase Register
- Ledger Accounts of suppliers of services (to verify date of payment of services)
- Bank Account/Cash Account (to verify random cases for payment of services)
- Verify use of input services (eg. use of telephone for output services or for non-taxable work, insurance for property used for output services)
- Input Credit register
- Service Tax Credit Return.

III. Financial Record Scrutiny

- Trial Balance
- Check all Income Accounts (showing credit balances) in Trial Balance.
- Compare value of Income Accounts with value of taxable services shown in Service Tax return
- Verify invoices/bills/other documents of Income Accounts on which Service tax not paid.
- Verify major expenses Accounts to confirm whether any recoveries made from customer/client adjusted in the expenditure account.
- Check Journal Vouchers/Debit Notes to verify recoveries from Customer/clients on which service tax is not paid.

IV. Use of Input Services in Exempted Services:

- Check details of Input Services on which credit availed from Service Tax Credit Return.
- Check if any record maintained for quantifying input services used for exempted services or non taxable activity.
- Verify use of input services by tour of premises or verifying documents for its usage

- Check costing of output services (prepared for submitting quotation or prepared for calculation of cost of output services)
- Check job card/work statement to find out exact quantum of use of input services.

Annexure E

CHECK LIST FOR SERVICE TAX AUDIT

Desk Review Stage:

1. Check whether the PAN based **STC number** is allotted to the taxpayer in accordance with Board's Circular No. 35/3/2001 CX. 4 (F. No. 137/24/99-CX4 dt. 27.8.2001) read with Circular No. SRT-48/03/2002-CX (F. No. 137/24/99-CX4) dt. 21.2.2002. (This point is indirectly important for long-term compliance and will also facilitate any cross-verification with other Departments).
2. Prior to conduct of audit, the scope of the service as covered by the Service Tax Law and its correct taxable value must be ascertained in the light of latest statutory provisions, notifications and Board's circulars etc. Some definitions of taxable service include the expression like 'directly or indirectly' or 'in any manner'. In such a case the clarifications of the Board which, interalia, contain illustrative lists of certain activities falling within the scope of definition of the service should be referred to by bearing in mind that such lists are not exhaustive.
3. Check whether the list of records maintained has been declared to the department with the first return (as provided under Rule 5(2) of the Service Tax Rules 1994).
4. Before undertaking the audit of taxpayers belonging to C & F Services, Rent-a-cab Operator Services, Tour Operators Services, Banking and Financial Services and Broadcasting Services, the Auditor should study implications of the legislative changes effected from time to time, re-validated provisions and relevant judicial pronouncements.

5. Check whether the Service Provider is the division of a Company. In case it is a division then check the Internal Financial Statements submitted should be checked during verification.
6. Check whether the description of the service has been changed during the past three to four years, without affecting the nature of the service provided. To illustrate, a Management Consultant attracting tax under Section 65 (64) of the Finance Act, 1994 may declare himself as a law practitioner without essentially altering the nature of service provided.

Verification Stage:

1. Mere scrutiny of the records during audit would not be sufficient. Intelligent cross- verification with other records and returns/reports submitted by the taxpayer to other Government Departments or Financial institutions or the Regulatory Authority or his Corporate or other office of Centralised control, is essential. By co-relation it has to be verified whether the entries made in the Books of accounts or other documents in the possession of the taxpayer are correct or whether he has omitted any relevant entry in such books of accounts. This would help in unearthing any evasion of ST.
2. The terms of order/contract for service should be examined to verify the full scope of services rendered and modes and amounts of payment.
3. Check whether the Service Tax on the value of taxable services received during any calendar month is **credited to the Government** account within the prescribed time limit as per Rule 6 of the Service Tax Rules 1994.
4. Check whether the Service Tax is being **deposited in the designated bank** as per Rule 6 (2) of the Service Tax Rules 1994.
5. Check whether **interest** at correct applicable rates is paid by the taxpayer to the designated bank **on delayed payment of ST** in terms of Section 75 of the Finance Act, 1994.

6. Check whether the service provider is claiming any exemption from payment of ST on the grounds that the same was not paid by his client. As per para 9 of instructions contained in Board's Circular F. No. 341/43/96 – TRU dated 31.10.96, the responsibility for payment of Service Tax lies on service provider and he cannot claim any exemption on the ground that the same was not paid by the client.
7. Services rendered by the **Government (Central/State/Local) or the Public Sector Enterprises** are not exempted from the service taxation unless specifically provided for as in case of DAVP under Advertising service category. Similarly no taxpayer can claim exemption from payment of service tax because the service receiver was the Government (Central/State/Local) or the Public Sector Enterprises and/or it has refused to pay the quantum of service tax liability except as specified in any Notification like exemption given to the UN or an International Organisation (vide Notification No. 16/2002-ST dated 2.8.2002).
8. In case of **Provisional Assessment of ST**, check whether the taxpayer has made any written request for the same giving cogent reasons and that the Provisional Assessment is being done after due approval from AC/DC. In case the Provisional assessment has been finalised check whether all the relevant documents were called for from the taxpayer before completing the assessment. Also check whether provisional assessments are finalised expeditiously (atleast within the time limit of Rule 7(3) of Central Excise Rules as applicable under Rule 6 (4) of the Service Tax Rules 1994) without any avoidable delay and differential duty, if any, is paid.
9. (i) Section 67 of Chapter V of **Finance Act, 1994** prescribes payment of Service Tax on Gross amount billed except in few cases like Air Travel Agents and C & F agents where the Service Tax is to be charged on the quantum of commission or remuneration paid to the Service providers. The auditors must check that the tax has been paid on gross amount and

not on the net amount and there is no under-valuation by exclusion of any component of the gross amount (e.g. adjustment, some types of reimbursement or any supplementary receipts).

a. As clarified in Board's Circular F. No. 11/3/98-TRU dated 7.10.98, the abatement in value in respect of statutory levies and taxes can be granted strictly when the same has some direct co-relation with the services rendered to the client. The statutory levies like EPF, ESI contributions, Income Tax deduction at source, payment towards labour welfare funds etc., are not specifically relatable to the services rendered to the client and hence not to be excluded.

b. The auditor should examine the gross amount in the bill vis-à-vis the amount received in case of each taxable event and understand the system followed by the taxpayer in tracking the recoverable amount. Wherever the transaction has reached the final stage and yet there is a difference between the gross amount billed initially and amount realised, it has to be examined whether the taxpayer has issued an amended bill for reduced amount or modified the original bill without involving the flow back of differential amount in any manner. If no amended or modified bill is issued, the auditor has to examine why the tax liability on the original bill is not discharged.

c. Abatement of certain percentage from gross valuation of taxable services is provided for determining the taxable value of the service. For instance in case of a Mandap Keeper who also provides catering services an abatement of 40 % is allowed vide Board's instruction F. No. B.43/3/97-TRU dated 26.6.97. Similarly, an abatement of 60 % is allowed to the tour operators where he provides a package necessarily including accommodation for stay and also other facilities such as food, guide services, as per Board's instruction F. No. B. 43/10/97-TRU dated 22.8.97. The auditor should check whether such Service Tax abatements

claimed by the taxpayer are strictly within the terms & conditions of the Board's relevant Circular.

d. Board's instruction F. No. B 11/3/98-TRU dated 7.10.98 clarifies that the charges billed to the client on account of out of pocket expenses which are reimbursable on actual basis, such as travelling, boarding and lodging expenses are not subject to Service Tax on the condition that the taxpayer provides documentary evidence substantiating his claim for abatement from the gross amount received for service rendered. It is to be noted that in terms of Board's letter F. No. 340/43/96-TRU dated 31.10.96 the aforesaid deduction is not admissible in respect of advertising services.

10. The auditor should examine whether the taxpayer has received any payment in India for the taxable service in convertible foreign-exchange attracting exemption under Notification No. 6/99-ST dated 9.4.99. It has also to be examined whether the said amount is repatriated because in that case aforesaid exemption will not be admissible.
11. Prior to 16.8.2002 the Service Tax in relation to the service provided by a person who is a non-resident or is from outside India and who did not have any office in India, was required to be paid by such person or on his behalf by any other person authorised by him. Since 16.8.2002, Service Tax in aforesaid cases is to be paid by the person receiving taxable service in India in terms of Clause (d) (iv) of Rule 2(1) of the Service Tax Rules 1994 as amended. In such cases it has to be ensured that correct Service Tax liability is discharged and no inadmissible exclusion towards elements like technical assistance or consultancy or a part of taxable events is made.
12. The auditor has to be specially watchful that any amount collected by the service provider in excess of the Service Tax assessed or determined and paid on any taxable service from his client in any manner as representing Service Tax has to be paid forthwith to the credit of Central

Government. This is required under Section 11 D of Central Excise Act, 1944 as made applicable to Service Tax under Section 83 of Chapter V of Finance Act, 1994 under Finance Act, 2002 (w. e. f. 20.8.2002).

13. If an taxpayer is providing both taxable and non-taxable services, the auditor has to check as to whether the ambits including accounting and receipts of payments towards such different streams are clearly distinguished. In such cases the auditor has to be specially vigilant towards possibility of under-declaration of the value of taxable service and corresponding over billing for non-taxable service.
14. In cases where the taxpayer sub-contracts a service within the same service category, no Service Tax is required to be paid by the sub-contractor, but the taxpayer has to discharge full liability on the value of service including the charge for service rendered by the sub-contractor. In cases where the sub-contracting is to a different service-category, the Service Tax on the appropriate service is also required to be paid by the subcontractor. The compliance of these provisions must be specially checked by auditors.
15. Prior to the enforcement of the relevant provisions of the Budget 2003, the credit of tax paid on input service was admissible for discharge of tax-liability by the service provided that both the input and output services fall in the same service category. When the Budget, 2003 is implemented, this benefit will be available for the tax paid on input service of any category as long as the duty is paid on any goods used in relation to rendering the service. The auditor must closely examine the relevant provisions in the Finance Act and relevant Rules and check against misuse of this facility. The invoice of input service must be carefully examined. Checks should be exercised whether such input credit is taken only in respect of services and goods actually used in relation to taxable output service or also towards those that are fully exempted or are non-taxable. It has also to be ensured that Service Tax credit can be utilized

only to the extent such credit is available on the last day of a month for payment of Service Tax relating to the month or in case of an individual or proprietary or partnership on the last day of the quarter for payment of Service Tax relating to the quarter. The records and documents maintained by the output service provider in terms of Rule 5 of the Service Tax Credit Rules, 2002 should be appropriately examined with all relevant records, documents and correspondence to check correct availment of the benefit.

Annexure F

Proforma of Audit Plan

Sl. No .	Subject	Specific Issue	Records Document	/	Coverage Period	Selection Criteria

Annexure G
FORMAT OF AUDIT REPORT

Part – I

1.	Name & Address of the Taxpayer	M/s. ABC-----
2.	Its. HO, Regional/Branch offices etc	
3.	Status of the taxpayer	
4.	Jurisdictional Commissionerate / Division/Range/ Name of the Range Supdt./Inspector	Comm'te _____ Division _____ Range _____ Shri _____
5.	Name of taxable services provided to clients	
6.	Registration No.	
7.	Exemption Notification No. and its effective date alongwith gist of exemption notification	
8.	Date of last audit	
9.	Period for which current Audit undertaken	
10.	Dates on which audit undertaken	
11.	Unconfirmed demand, if any	
12.	Confirmed demand, if any	
13.	Appeal filed, if any	
14.	Tax, Interest and penalty paid during the current audit period	
15.	No. of Revenue Paras	
16.	No. of procedural Paras	
17.	Total Revenue involved in audit paras	

SUMMARY OF AUDIT RESULTS

[PROVIDE AN OUTLINE OF IMPORTANT AND MATERIAL NON COMPLAINE ISSUES IDENTIFIED DURING THE AUDIT. INDICATE IF THE TAXPAYER HAS AGREED TO IMPROVE]

The important and material non compliance issues identified and reaction of the taxpayer is indicated in the table given below:-

Audit Para No.	Gist Of Objections	Revenue Implications, If Any (In Rs.)	Tax Payer's Agreement Yes / No, If No Reasons For Disagreement	Department's Conclusion With Reasons
TOTAL REVENUE INVOLVED		RS.		

(XYZ)

Suggestions to improve tax compliance

Assistant Commissioner (Service Tax Audit)