SERVICE TAX AUDIT, SEARCH, SEIZURE AND RECOVERY OF TAX

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Introduction

1. The present note covers the following topics:
   1. Service tax Audit
   2. Search and Seizure
   3. Recovery of tax

   Each of the above topics are dealt with below.

Service tax Audit

Introduction

2. Once a return is filed the process of assessment of the tax by the department begins. Under the service tax law there are currently no provisions for assessment unlike under section 143 of the Income-tax Act. Section 73 only provides for issue of show cause notice for recovery of service tax short-paid, not paid, not levied or erroneously refunded and thereafter passing an order. However, the process by which the department ascertains whether there is a default is either by way of investigation (letters, summons, etc. leading to an issuance of a Show Cause Notice) or by audit.

Maintenance and Preservation of Records

3. Under the service tax law there are no particular records (apart from Cenvat Credit Rules) which are mandatorily to be kept. The nature of records required is given in Rule 5(1) which provides that records (including computerised data) as maintained by an assessee in accordance with various laws in force from time to time shall be acceptable. Thus, the records as required under other laws applicable to an assessee will be the records required for service tax.

4. Under Rule 5(2) of the Service Tax Rules, 1994 the assessee is required to intimate to the Superintendent of Central Excise, at the time of filing their first return, a list in duplicate of–
   (i) all the records prepared or maintained by the assessee for accounting of transactions in regard to, -
      (a) providing of any service, whether taxable or exempted;
      (b) receipt or procurement of input services and payment for such input services;
      (c) receipt, purchase, manufacture, storage, sale, or delivery, as the case may be, in regard of inputs and capital goods;
      (d) other activities, such as manufacture and sale of goods, if any.
   (ii) all other financial records maintained by him in the normal course of business.

5. The above provisions (para 4) were introduced w.e.f. 28.12.2007. However, existing assessees as on that date were given time upto 31.1.08 to submit the aforesaid documents.

6. All the records have to be preserved atleast for a period of five years immediately after the financial year to which such records pertains [Rule 5(3) of the Service Tax Rules, 1994]. However, subject to any other statute which may require a longer period of retention it would be advisable to maintain the records for a period of seven years.

Availability of Records

7. Rule 5A(1) of the Service tax Rules, 1994, empowers the Commissioner to authorise any Central Excise officer to have access to any of the registered premises of the assessee for carrying out any scrutiny, verification and checks as it may deem necessary in order to safeguard the interest of the revenue. Rule 5A(2) of the Service Tax Rules, 1994, provides that the assessee has to make the records available to the -

   (i) person authorised by the Commissioner as aforesaid; or
   (ii) audit party deputed by the Commissioner; or
   (iii) audit party deputed by the Comptroller and Auditor General of India (CERA auditor)

   within 15 working days from the date of the demand or such further period as may be allowed by the audit party. The said Rule provides that the following are the records that should be made available:

   (a) the records as mentioned in the list which he has submitted to the department under Rule 5(2); [Refer para 3]
   (b) trial balance or its equivalent; and
   (c) the income-tax audit report, if any, under section 44AB of the Income – tax Act, 1961.

   In this regard it must be noted that in many cases the software which generated the original document may have undergone a change and if the hard copy of the document is not available then a similar document may not be available in the new software. Hence in such cases the assessee should not only preserve the old records / documents in electronic form but also the software so as to retrieve data/ information.

Details usually asked /Documents examined

8. In addition to the above the records, the details or documents usually called for by the audit party are as follows:

   (i) Copies of ST-3 returns, Income Tax Returns alongwith 3CD, Balance sheet and Profit and loss accounts;
   (ii) Details of annual turnover bifurcated into taxable turnover year-wise, service wise;
   (iii) Details of exempted turnover alongwith justification for claiming exemption under notifications if any or on account of Export of services;
   (iv) Reconciliation of ST-3 returns with financial statements or bank statements;
   (v) Details of pending SCNs and appeals;
   (vi) Break up of Other Income so as to determine whether any item thereof would come within the ambit of service tax;
   (vii) Details of various expenses so as to determine non-payment of service tax by the assessee as a recipient of services e.g. GTA, reverse charge mechanism;
   (viii) Details of Foreign expenses incurred as mentioned in the notes to the accounts to the financial statements.

Reconciliation statements that could be prepared

9. In accounting, 'reconciliation' maybe defined as a *"calculation that demonstrates how one figure (such as a balance) is derived from another"*. A reconciliation statement serves the purpose of ensuring compatibility and consistency of figures and balances generated and reported by an enterprise. For example, a bank reconciliation statement ensures that the bank balance as per the entity's books are tallied with the bank balance as per the bank's books and if there are any discrepancies they are for genuine legitimate reasons. Thus, a 'reconciliation' ensures a consistency in reporting.

10. In the current scenario the service tax returns and assessment is based on the records of the assessee such as invoice, sales register etc. In order to ensure a full and complete compliance and avoid errors or queries the returns must be 'compared' and tallied with the financial statements and accounts of the enterprise during the course of finalizing the accounts or the returns whichever is earlier. From a service tax perspective, 'reconciliation' statements could serve a useful tool to compare the figures reported in the financial statements and in the service tax returns which in any case would be asked by the department. Certain reconciliation statements that could be generated from the financial statements and records are explained in the ensuing paragraphs.

11. There are several statements which should be examined to ensure compatibility and consistency in the reporting of figures in the service tax returns. Some of the documents which should be examined are as follows:
    (i) Financial statements i.e. Balance Sheet and Profit and Loss Account;
    (ii) Tax Audit Report - Form No. 3CD attached alongwith the income tax return;
    (iii) VAT returns.
    (iv) TDS returns under the Income Tax Act, 1961.
    (v) Records – Sales register, input credit register, etc.

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

    Thus there should be consistency in reporting of figures in all the above documents.

12. The following reconciliation statements could be prepared –
    (a) Reconciliation of value of taxable services provided – charged and collected with financial statements. The reconciliation starts with the turnover as per accounts to arrive at the turnover on which service tax is paid.
    (b) Reconciliation of service tax paid on overseas payments with financial statements.
    (c) Reconciliation of service tax paid on freight with financial statements.
    (d) A reconciliation statement similar to (c) above can be prepared for service tax payments made in other cases where reverse charge mechanism is applicable e.g. sponsorship services.

13. Input credit balances can be checked from the financial statements as follows:
    (i) The Cenvat credit balance unutilised at the end of the year as per the service tax returns should tally with the amount shown under the head "current assets" in the balance sheet;
    (ii) Details of Cenvat credit maybe prepared in the format mentioned in Annexure 4 attached.

Cost Audit

14. Section 14AA of Central Excise Act is made applicable to service tax to empower the Commissioner of Central Excise to direct cost audit in cases of abnormal availment or utilization of Cenvat Credit or availment or utilization on account of fraud, collusion or any wilful mis-statement or suppression of facts.

15. ***Significant Points to be noted at the time of audit***

(i) Any information / detail, which is being furnished to the audit party, should always be furnished along with a covering letter and if possible an acknowledgment of the audit party should be obtained on such covering letter. Similarly, the audit party should also be requested to furnish any audit objections raised by them in writing.

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

(iii) Verify the facts and figures before submitting the same to the department. It is advisable to get the same validated from the relevant operations personnel where required. **The presentation of details (facts and figures) to the audit party of the department is extremely important since it would form the basis of future litigation, if any.** Furnishing of correct/ relevant facts and figures helps focus the dispute, if any, only on points of law rather than on facts.

Search & Seizure

16. Section 82(1) of the Finance Act, 1994, states that where the Commissioner of Central Excise has reasons to believe any document, books or things which in his opinion will be useful for or relevant to any proceeding under this Act are secreted in any place he may authorise the Assistant Commissioner of Central Excise ("AC") or the Deputy Commissioner of Central Excise ("DC") or may himself search for and seize such documents, books or things. It is to be noted that in case of service tax it is only the Commissioner, AC or DC (authorised by the Commissioner) who can search the premises.

17. Further, Sub-section (2) of s. 82 provides that for the purposes of carrying out the searches the provisions of the Code of Criminal Procedure (Cr. P. C) relating to searches shall apply. Section 100 of the Cr. P. C is a relevant provision that may apply to service tax. It provides for the general procedure for search. A brief summary of section 100 as applicable to service tax is explained below:

(i) The searches made by AC/DC must be under an authorisation by the Commissioner. The AC/DC is required to produce the said authorisation at the time of conducting search.

(ii) Every person residing in or in charge of the premises searched shall allow free ingress and afford all reasonable facilities for search in the premises.

(iii) Search should be made in presence of two or more persons as witness.

(iv) if the officer executing the search seizes any thing from the searched premises, he shall prepare a list of all the things seized in the course of such search and get it signed by the witness. Further, the executing officer is also required to give a copy of the said list to the occupant of the premises searched.

Further section 165 of the Cr. PC may also apply for recording the reasons for belief by the Commissioner. Under section 165, the reasons must be recorded in writing and such writing so far as possible must specify the thing for which search is to be made

18. Here it may be noted that no time limit has been specified for returning of the documents seized by the department during the course of a search conducted under Section 82 of the Act. The Legislature has not laid down any period as to when the

documents are to be returned. However, it is expected that the authorities would only retain it so long as they require for the investigation or other purposes as required under the Act but could not retain the same for inordinate long period.[1]

19. In *CCE vs. Bindra Tent Service* (2010) 17 STR 470 (Tri-Del.) the assessee, a Pandal or Shamiana contractor, had during a survey conducted by the Income tax Department declared certain undisclosed incomes which they stated pertained prior to 10.9.2004. The Service tax department sought to tax the entire undisclosed income under the category of Pandal or Shamiana Services which was liable for service tax only w.e.f. 10.09.2004. However, on appeal the Tribunal held that the demand cannot be sustained without enquiry as to whether the undisclosed income is earned post 10.9.2004. Thus any money or undisclosed income discovered during the course of a search operation does not *ipso facto* become a consideration for provision of taxable output services.

Recovery of Tax

20. Where 'any amount' is payable by a person under the provisions of the Act fails to pay the same to the credit of Central Government, the Central Excise Officer is empowered to recover the said amounts payable by any of the modes specified u/s. 87 of the Finance Act, 1994. It may be noted that, under section 87 of the Finance Act, 1994 recovery can be made by the Central Excise Officer in respect of 'any amount' payable by such person which may include service tax, cess, interest, penalties and also amount collected as service tax payable u/s. 73A of the Finance Act, 1994. However, the above recovery proceedings can be initiated only after the assessment order has been passed and the liability of such person to pay the determined amount has been crystallized [*O.N.G.C. Ltd. vs. DyCCCEST* (2010) 19 STR 164 (A.P.)].

21. However, a question often arises whether the recovery proceedings can be initiated by the department -
    (i) Where the statutory time limit for filing an appeal against the order determining the amount payable itself has not expired; or
    (ii) Where appeal has been filed alongwith a stay application but the stay application is pending disposal by the appellate authorities?

22. In the first case, where the Central Excise Officer has passed an order determining any amount as payable by any person by u/s. 73 or 73A of the Finance Act, the person against whom such an order is passed has a statutory right to appeal against the order to the appellate authorities i.e. Commissioner (Appeals) where the order is passed by any Central Excise Officer subordinate to the Commissioner of Central Excise and to the Appellate Tribunal if the order is passed by Commissioner of Central Excise. The statutory time limit for filing the appeal in both the cases is three months. Where the statutory time limit for filing such appeal has not expired it has been held that the

[1] *Shyam Metal Industries vs. UOI* (1987) 27 ELT 600 (All)

department cannot initiate the recovery proceedings against the assessee[2]. In *Castrol India Ltd. vs. UOI* (2007) 208 ELT 490 (Bom) the High Court went on to observe that "*the Central Excise Officer must be vigilant in collecting dues but they should not take steps which will nullify the remedy which are otherwise available under the statute.*"

23. In the second case, i. e. where an appeal has been filed alongwith a stay application but the stay application is pending disposal by the appellate authorities the question of recovery can arise in two types of situations:

   (a) Where the application for stay is pending disposal by the Commissioner (Appeals)/ Appellate Tribunal in a first stage appeal i.e. appeal against an order-in-original passed by an adjudicating authority

   (b) Where the application for stay is pending in a second stage appeal i.e. appeal is before the Appellate Tribunal against the order passed by the Commissioner (Appeals).

24. In case (a) above, the CBEC Manual of Supplementary Instructions para 1.3 of Part III of Chapter 18 provides as follows:

> "1.3 If the stay application is filed by the assessee against the Order – in – Original confirming the duty demand, no coercive action should be taken to realise the dues **till the disposal of the stay application by the Commissioner of Central Excise (Appeal) or the Appellate Tribunal as the case maybe**. However, this instruction is only for first stage appeals, in the cases where the appeal lies before the Appellate tribunal. The Commissioner (Appeal) shall dispose of the stay application where it is possible to do so, within one month of its filing."

On a reading of the above instructions it can be observed that, in respect of first stage appeals i.e. where the application for stay is pending disposal before the Commissioner of Central Excise (Appeals) and the Appellate Tribunal, the departmental officers are prohibited from initiating recovery proceedings.

25. However, in case of second stage appeal i.e. where appeal and stay petition has been filed before the Appellate Tribunal against the order passed by the Commissioner (Appeals) the above instruction would not be applicable. However, para 1.4 of the Manual states as follows:

> "1.4 A period of 3 months from the date of communication of the order-in-original / order –in-appeal should be normally provided (one month for filing appeal and stay application and two months for obtaining orders on the stay application), before taking coercive measures to recover the dues. However, if a stay application of an assessee is rejected by an appellate authority even before the lapse of the time limit of three months, recovery proceedings should be initiated immediately thereafter."

Thus, recovery cannot be made at least for 3 months from the date of communication of the order which is also the statutory time limit to file an appeal before the Tribunal. But after that period if the stay remains un-disposed of the Central Excise Officers

[2] *Castrol India Ltd. vs. UOI* (2007) 208 ELT 490 (Bom.); *Noble Asset Company Ltd. vs. UOI* (2005) 187 ELT 438 (Bom.); and *Ocean Driving Centre vs. UOI* (2005) 180 ELT 313 (Bom.)

may be justified in initiating the recovery proceedings. Hence in these cases it maybe advisable to apply for an out of turn hearing and get the stay heard by the Tribunal.

26. Under Section 35C(2A) of the Central Excise Act, 1944, the Tribunal is required to dispose of the appeal, in cases where stay has been granted, within a period of 180 days from the date of granting stay of the disputed order and if the Tribunal fails to dispose of the appeal within the said period, the stay order granted by the Tribunal would automatically stand vacated at the expiry of 180 days. Hence a question may arise as to whether the assessee is required to renew the stay order before the expiry of the above period of 180 days?

27. In this context in *CCE vs. Indian Oil Corporation* (2010) 20 STR 458 (Kar.) the Hon'ble High Court while determining the issue of renewal of stay u/s. 35C(2A) made the following observations:
    (i) Even in the absence of express provisions conferring power to the Tribunal to pass stay order the power of granting stay is incidental and ancillary to its appellate jurisdiction.
    (ii) Under the first proviso to section 35C(2A) of the Central Excise Act, where in an appeal, the Tribunal has granted a stay, it is obligatory on the Tribunal to dispose the appeal within 180 days from the date of the stay order. If the appeal is not so disposed, the second proviso to section 35C(2A) provides that the stay order shall stand vacated. However, even in the absence of express provisions, the Tribunal has the power to extend the stay order beyond 180 days.
    (iii) But, the extension of stay order is not automatic. The assessee has to make proper application before the Tribunal for extension of stay order otherwise the stay order granted comes to an end at the expiry of 180 days.
    (iv) When an application is filed for extension of stay, the Tribunal has to apply its mind to find out for what reasons, the appeal is not disposed within statutory period of 180 days. If the assessee's conduct is not the cause for the appeal not being disposed of, then the assessee cannot be denied the benefit of extension of the stay order.

28. Further, the CBEC vide its Circular No. 925/15/2010/CX. dated 26.05.2010 has clarified as follows:

    > "A harmonious reading of the statutory provision and judicial pronouncements in the matter would mean that while the Tribunals are expected to dispose of the cases as stipulated in the above Section, nothing prevents them from granting stay beyond six months. However, the extension of stay has to be applied for by the party. Thus the outcome of the above interpretation would be that, wherever stay period is over and the final decision has not been pronounced, the Department may by a simple letter ask the party to pay and the party would be at liberty to go back to the Tribunal for seeking extension of stay. Coercive measures, without giving an opportunity to the party to seek further extension of stay should be avoided."

29. Thus on a reading of the above decision and the Board Circular it can be concluded that the party desiring extension of stay is required to make a proper application to the Tribunal and where the non-disposal of appeal within the stipulated period is not on account of the conduct of the assessee, he cannot be denied the benefit of extension of stay.

Modes for Recovery

30. Section. 87 provides for 4 modes of recovery:
    (i) Deduction of the amount payable from any amount due to such person from the department.
    (ii) Collection from persons who owe money to the assessee (Garnishee proceedings).
    (iii) Distraint and sale of any movable or immovable property of the defaulter.
    (iv) Arrear of Land revenue.

    Each of the above modes of recovery is explained below

Deduction of the amount payable from any amount due to such person from the department

31. Where any amount is due to the person from the Government, under the service tax law or Central Excise Act, 1944 or Customs Act, 1962, the Central Excise Officer recovering the dues u/s 87 may deduct or require the concerned Central Excise Officer or the Customs Officer, to deduct therefrom the amount recoverable from the said person.

Collection from persons who owe money to the assessee (Garnishee proceeding)

32. The Central Excise Officer is empowered to issue notice to any person from whom money is due or may become due to the assessee or any person who holds or may subsequently hold money for or on account of the assessee to pay to the credit of the Central Government an amount, out of the money due to the assessee, sufficient to satisfy the claim of the Revenue. Every person to whom such a notice has been issued and who does not deny his liability to the assessee, is required to comply with the said notice and in case of failure the said person shall be deemed to be an assessee in default and recovery proceedings may be taken against him for realisation of the amount as if it were an arrear of tax due from him. Here it may be noted that, where the person to whom the notice is issued is a post office or a banking company or insurance company it would be required to make the payment without requiring production of documents like passbook, deposit receipt or insurance policy for the purpose of any entry, endorsement or the like being made before payment.

Recovery by distraining any movable or immovable property:

33. Under clause (c) of Sec 87 of the Finance Act, 1994, the Central Excise Officer is empowered to lawfully seize any movable or immovable property belonging to or under the control of any person who has defaulted in payment of service tax and against whom recovery proceedings have been initiated under the Act. The Central Excise Officer is empowered to retain the property seized till such time the amount payable by the said person has been paid. However, in case if the said amount (including any costs of distress or keeping the property) is not paid within a period of 30 days after the date of seizure the Central Excise Officer may cause the property to be sold and appropriate the proceeds of sale towards the amounts due from the said person. The surplus remaining after the above appropriation and meeting the costs of sale shall be repaid to the assessee.
34. For exercising the above power, the Central Excise Officer is required to obtain a prior authorisation from the Commissioner of Central Excise. The powers of the Central Excise Officer under this section are in addition to his powers under Section

73C of the Finance Act, whereby he is empowered only to provisionally attach any property of assessee for the purpose of protecting the interests of revenue. A distraint and sale u/s 87(c) is required to be made in accordance with the rules made in this behalf. However no rules have been prescribed as yet unlike the Customs (Attachment of Property of Defaulters for Recovery of Government Dues) Rules, 1995. Presumably the said rules may also apply for service tax.

Recovery as arrears of Land Revenue

35. Under clause (d) of Section 87 of the Finance Act, the Central Excise Officer can recover the amount payable by any assessee by issuing a certificate signed by him specifying the amount of tax due from the said assessee and send it to the Collector of the district where assessee owns any property or resides or carries on any business. The Collector shall then proceed to recover the amount of tax due from such assessee as an arrear of land revenue.

Provisional attachment of property

36. If during the pendency of any proceeding under Section 73 or Section 73A of the Finance Act, the Central Excise officer is of the opinion that in order to protect the interest of the revenue it is necessary to provisionally attach any property of the assessee, he may with the prior approval of the Commissioner of Central Excise pass an order attaching any property of the assessee in accordance with the Service tax (Provisional Attachment of Property) Rules, 2008 (Section 73C). However, it appears that as per rule 3(2) of the said Rules it is the Commissioner who would pass the order. The procedure under the said Rules is explained below :

   (i) The Central Excise officer shall forward a proposal to the Commissioner who would before passing an order serve a notice on the assessee, giving him an opportunity to make submissions within 15 days of service of such notice. The Commissioner, after considering the representation may pass an order for provisional attachment. [Rule 3(2)]

   (ii) The value of property attached must, as far as possible, be equal to the pending revenue. Movable property would be attached only if immovable property is not sufficient to protect the interest of revenue. [Rule 4]

   (iii) Personal property of Proprietor or Partners or Directors cannot be provisionally attached under this section. [Proviso to Rule 3(3)]

   (iv) The person whose property has been attached shall not mortgage, lease, transfer, deliver or deal in any manner with the property except with the previous approval of Commissioner of Central Excise [Rule 5]

   (v) The provisional attachment shall to cease to have effect after the expiry of 6 months from the date of order for provisional attachment of property. However, the Chief Commissioner of Central Excise is empowered to extend the period of attachment for such further period as he deems fit for reasons to be recorded in writing. In no case the period of attachment can exceed two years. Further, if the assessee makes the payment of pending revenue alongwith interest then the provisional attachment of property shall cease to have effect. [Rule 6]

37. It is to be noted that no appeal lies before the Tribunal u/s 86 against a provisional attachment order. The only remedy is perhaps a writ before the High Court.