Chapter 20
Service Tax Audit

The necessity of conducting service tax audit by the Department emerges out of the fact that the assesses follow the system of self-assessment and file periodic returns in the prescribed form. Though periodic returns are scrutinised by the jurisdictional authorities to elicit cases of short payments but such scrutiny is just limited to checking of arithmetical accuracy. Such scrutiny does not help in plugging the revenue loss which may be caused due to the assessee, with a view to evade tax, disclosing incorrect figures. Audit of the records of the assessee helps the Department to ensure, to a considerable extent, that the Government dues are recovered to its maximum. However, audit is basically a test-checking device and therefore, can not be considered a foolproof method which will detect short payments in toto. At the same time a comprehensive audit may not be useful in terms of expenses incurred and time devoted because revenue loss detected from such audit may be insignificant. Therefore, expenses incurred on conducting audit must match the recoveries affected due to such audit.

1. Services/Assessee under the Scope of Audit

Service tax audit is done by the Department and CAG on selective basis. In the year 2006, the Board has revised frequency norms for audit vide its Letter (F. No. 381/145/2005), dated 06-06-2006. The revised norms for Service Tax are as under:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Quantum of annual duty payment (in cash + CENVAT credit)</th>
<th>Frequency of audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Taxpayers paying more than Rs 50 lakh</td>
<td>Every year</td>
</tr>
<tr>
<td>2.</td>
<td>Taxpayers paying between Rs 25 lakh and Rs 50 lakh</td>
<td>Once in two years</td>
</tr>
<tr>
<td>3.</td>
<td>Taxpayers paying between Rs 10 lakh and Rs 25 lakh</td>
<td>Once in five years</td>
</tr>
<tr>
<td>4.</td>
<td>Taxpayers paying below Rs 10 lakh</td>
<td>2% of the total number every year</td>
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</tbody>
</table>

For the categories mentioned at S. Nos. 2 to 4 the selection of assesses would be based on S1 parameter and local risk parameters mentioned in the Service Tax Audit Manual.

In this regard, CBEC Master Circular No. 97/8/2007-ST, dated 23-08-2007 clarifies that the selective audit of service taxpayers and other assessee like input service distributors, may be done by the jurisdictional Central Excise Officer (authorized for the purpose) or by an audit party deputed by the Comptroller and Auditor General of India. Rule 5 of the Rules makes it mandatory for every assessee to make available the records, on demand, for inspection and examination to such authorized person/audit party.

1 Rule 5A has been introduced to provide access of registered premises of the assessee to the Central Excise Officer and CAG Audit Party. The rule provides that an officer authorised by the Commissioner in this behalf shall have access to any premises registered under service tax for the purpose of carrying out any scrutiny, verification and checks as may be necessary to safeguard the interest of revenue. The rule further provides that every assessee shall, on

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In this regard, the Department, vide its Instruction Letter (F. No. 137/26/2007-CX.4), dated 01-01-2008, clarifies that the audit team or any other officer authorised by the Commissioner to visit the registered premises of an assessee shall give prior intimation to the assessee along with the list of documents that he requires for the purposes of scrutiny, verification or audit. That taxpayer shall provide the records as required by the authorised officer within a period of fifteen days from the date of request. In case, the taxpayer is unable to produce any of the records called for within the stipulated time, he shall intimate the same along with reasons for non-production of records, and the officer may also take further time for production of such records keeping in view the overall facts into account. These amendments have been made in the service tax rules to enable the duly authorised officers to carry out audit or scrutiny as may be necessary to safeguard the interest of revenue. However, it may be ensured that only such records are demanded which are necessary for conducting such audit scrutiny or verification."

In the year 2004, the Board, vide CBEC Instruction Letter 775/8/2004-CX, dated 17-02-2004, has extended the Service Tax Audit to all services which are subject to levy of service tax. It has been clarified that selection of assesses and auditing of selected assesses will be subject to the guidelines and procedures prescribed in the Service Tax Manual.

The frequency for audit of Service Tax assesses, currently prescribed in the Audit Manual is as under:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Quantum of annual duty payment (in cash + CENVAT credit)</th>
<th>Frequency of audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Taxpayers paying more than Rs 10 lakh</td>
<td>Every year</td>
</tr>
<tr>
<td>2.</td>
<td>Taxpayers paying below Rs 10 lakh</td>
<td>Not prescribed</td>
</tr>
</tbody>
</table>

The selection of taxpayers at S. No. 2 above is to be done on the basis of risk parameter S1 and Local Risk Parameters listed in the Service Tax Audit Manual. However, in the absence of adequate data for their computation, it has been prescribed in the Manual that the top 2 assesses from the top 20 duty paying services in each Commissionerates should be selected for audit each year, as an interim measure.

In the year 2002, the Board decided to extend the coverage of Service Tax Audit to other services also on selective basis. In this regard, detailed instructions were issued vide CBEC Circular No. 38/1/2002-ST2, dated 07-02-2002. The circular provided that only those assesses were to be taken up for audit who were registered in the Metropolitan cities of New Delhi, Mumbai, Chennai and Kolkata and whose names were given in the Annexure I attached to the circular. However, in respect of three services, earlier selected for audit, the instructions given by CBEC Circular No. 19/13/96, dated 21-11-1996 continued to be applicable and audit of these services was not confined to Metropolitan cities only.

In the year 1996, for the first time, instructions were issued vide CBEC Circular No. 19/13/96-ST3, dated 21-11-1996 for conducting of audit on yearly basis in respect of three services i.e. telephone, insurance and stock broking. The said circular prescribed the following norms for selective audit of accounts/records of stock-brokers:

"(a) Stock-brokers who pay service tax not exceeding Rs five lakhs per annum—10% of such registered stock brokers shall be selected and 10% selective check of their documents be conducted.

(b) Stock brokers who pay service tax exceeding Rs five lakhs but not exceeding Rs fifty lakhs per annum—20% of such stock brokers shall be selected and 10% selective check of their documents be conducted.

(c) Stock brokers who pay service tax exceeding Rs fifty lakhs per annum—50% of such brokers shall be selected and 20% selective check of their documents be conducted."

It may be noted that CBEC Circular No. 113/07/2009-ST, dated 23-04-2009, has provided parameters for scrutiny of service tax returns of the assesses based on the Return Scrutiny

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2. This circular has been withdrawn w.e.f. 10-05-2007 vide Circular No. 93/4/2007-ST.
3. This circular has been withdrawn w.e.f. 10-05-2007 vide Circular No. 93/4/2007-ST.
Manual for Service Tax (RSMST) prepared by the Board, which is different from service tax audit, and has been discussed in detail in the Chapter 12 on “Filing of Service Tax Return”.

2. Service Tax Audit Manual

Taking into account the peculiarities of service tax law, book-keeping practices of service providers and the experiences gained during the course of auditing of selected service tax categories, the Directorate General (Audit) has come out with a comprehensive Service Tax Audit Manual in the year 2003. The Manual is meant for use by the Department and the audit shall be conducted as per the guidelines/procedures stated in the Manual.

Salient features of the Manual: Following are the salient features of the Manual as per CBEC Instruction Letter 742/58/2003-CX, dated 03-09-2003:

(i) Legal provisions for levy and collection of service tax are indicated in one place.
(ii) Principles of auditing of service tax payers based on modern methodology are enumerated.
(iii) Guidelines are provided for selection of tax payers for auditing based on risk assessment technique.
(iv) Detailed guidelines are provided for preparation of audit plan before the commencement of the actual audit.
(v) Various techniques of auditing such as “walkthrough”, ABC Analysis, Revenue Risk Analysis and Trend Analysis are explained.
(vi) Specific guidelines are provided for conduct, preparation, reporting and follow up of audit.
(vii) Formats for collection and compilation of data on service providers and maintenance of master files have been prescribed.
(viii) Checklist for service tax auditing has been provided.
(ix) Detailed profiles for three major services namely, telephones, non-life insurance and stock brokers are made as part of the Manual for effective audit.

3. Audit Report

Visiting audit team is required to submit audit report in respect of audit conducted in specific format to the concerned Assistant Commissioner with copies marked to the Deputy Commissioner, Central Excise Headquarters and the Superintendent, Central Excise range. Format of the Audit Report was provided by the CBEC Circular No. 38/1/2002-ST, dated 07-02-2002 in its Annexure–II. However, since a comprehensive Audit manual has been issued by the Department subsequently, it also must be containing a pro forma audit report.

4. Instructions to the Officers

The Department intends to make the administration of service tax provisions friendly to the tax payers. In order to avoid inconvenience to the tax payers when service tax audit is conducted, the Department has issued instructions to its officers from time to time. Following are some of such instructions:

(i) Visits by the Authorities: Unnecessary visits by the Central Excise Officers to the premises of service tax assessees have not been not liked by the Department. Madurai Commissionerate has clarified that many irritants such as routine visits to the assessees” premises and calling for documents are not encouraged. The CBEC earlier desired that no visits should be made to the premises of the assessees for carrying out any routine checks. Therefore, no visits should be made without giving a clear notice of 15 days to the assessees explaining therein the purpose of such visit and all such visits shall be only with the prior approval of the Commissioner. Further, the officers should clearly indicate the documents which may be required by them during their visits. However, this would not apply in the case where the Department has received any specific information/intelligence regarding evasion of service tax or contravention of law by any assessees.

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4. Vide Trade Notice No. 103/99, dated 01-10-1999. Trade Notice No. 61/99-ST (GEN), dated 04-10-1999, on similar lines has been issued by the Mumbai Commissionerate-I.
(ii) Audit team should ensure that normal working of the assessee is not disturbed: Before proceeding with the audit the teams should familiarise themselves properly with the law and procedures relating to Service Tax. The teams should ensure that during the course of audit there is minimum hindrance in the normal working of the assessee.

(iii) Timings of audit should be well chosen: Attempt should be made to conduct such audits during the remaining months of the current financial year so that short levies detected, if any, can be realised during this year itself.

5. Computer Aided Audit Programme

Part III of Chapter 6 of the CBEC’s Central Excise Manual provides that any person may electronically maintain or generate all or any of the records, returns, invoices and other documents prescribed under the rules made under Central Excise Act, 1944, using a computer, in electronically readable format. No specific permission from the Central Excise Department is required for this purpose. Such person is also not required to give any intimation to the Department. In line with this rule, for the purpose of conduct of audit in respect of the assessee using a computer to record their business transactions/activities and keeping the data in electronic form, the Government has introduced Computer Assisted Audit Programme (CAAP for the sake of brevity) The Departmental Audit under CAAP will involve examination and analysis of business (private) records that are maintained electronically. Under CAAP, all or a part of audit could be completed using electronic records. For this, a Centre has been set up in the Headquarters Audit Section, supported by the trained officers in auditing of electronic records, and commercial and custom software for facilitation of such audit detailed guidelines are enumerated in Aurangabad Trade Notice No. 16/2008, Sr.No.14/GEN/2008, dated 13-10-2008, reproduced in Chapter 9 of Part D of this book.

It may be noted that though the above discussion pertains to the Central Excise records and audit, however, service tax assessee also maintain electronic records for the purpose of accounting and recording business data. Thus the above position becomes relevant for service tax assessee also.

6. Preparation for Audit by Assessees

The assessees, selected for service tax audit will do well if they prepare sufficiently in advance and provide all type of assistance to the visiting audit team. Since service tax provisions do not require any specific records to be kept, the existing accounts and records of the assessee should be so maintained that they provide the required information for the smooth conduct of the audit. Treatment of transactions relating to service tax must be transparent in the books. Revised/cancelled bills should give a true picture without indicating any concealment of revenue generated from the provision of services. It is better if separate set of records are maintained for taxable services and exempted/non-taxable services. Now, since CENVAT credit is available across goods and services for utilisation towards payment of service tax on output services, records must provide a transparent picture of credit availed and utilised. A list may be prepared in respect of prominent clients as well as high value transactions so that audit is confined to these aspects. Assessee who are subjected to service tax audit for the second time onwards may prepare taking cue from the first audit.