

**CHAPTER II**  
**TAX ON SALES, TRADE ETC.**

**2.1 Results of audit**

Test check of sales tax assessments, refund cases, value added tax (VAT) assessments and connected documents of commercial taxes offices conducted during the year 2008-09 revealed underassessment of turnover, non-levy of interest, grant of incorrect exemption, application of incorrect rate of tax etc., amounting to Rs. 459.11 crore in 2,181 cases which fall under the following categories:

(Rupees in crore)

Sl. No.	Category	No. of cases	Amount
<b>A. Sales Tax</b>			
1.	<b>Cross verification of purchase/sale effected under KGST/KVAT/CST Acts (A review)</b>	1	322.73
2.	Grant of irregular exemption	93	8.58
3.	Turnover escaping assessment	164	4.63
4.	Grant of excess credit	31	4.11
5.	Application of incorrect rate of tax	111	2.07
6.	Non/short levy of interest	34	0.80
7.	Incorrect grant of concessional rate of tax	11	0.06
8.	Other lapses	264	23.11
<b>B. VAT</b>			
9.	Application of incorrect rate of tax	270	15.94
10.	Turnover escaping assessment	195	12.12
11.	Grant of irregular exemption	196	8.54
12.	Grant of excess input tax credit	224	8.32
13.	Non/short levy of interest	43	1.53
14.	Incorrect grant of concessional rate of tax	19	0.62
15.	Other lapses	525	45.95
<b>Total</b>		<b>2,181</b>	<b>459.11</b>

During the year 2008-09, the department accepted underassessments and other deficiencies of Rs. 25.17 crore involved in 291 cases of which 73 cases involving Rs. 4.37 crore was pointed out during 2008-09 and the rest in earlier years. The department recovered Rs. 1.28 crore in 203 cases of which 63 cases involving Rs. 65.46 lakh were pointed out during 2008-09 and the balance to the earlier years.

A review of “**Cross verification of purchase/sale effected under KGST/KVAT/CST Acts**” involving Rs. 322.73 crore and few other audit observations involving Rs. 14.22 crore are mentioned in the succeeding paragraphs.

## **2.2 Cross verification of purchase/sale effected under KGST/ KVAT/CST Acts**

### **2.2.1 HIGHLIGHTS**

- Absence of control over movement of goods under transit pass resulted in short levy of Rs. 32.41 crore.

**(Paragraph 2.2.7)**

- Non-conducting of cross verification of declaration in form 25 led to evasion of tax of Rs. 43.94 crore.

**(Paragraph 2.2.9)**

- Short levy of Rs. 172.93 crore due to acceptance of invalid/defective declaration forms.

**(Paragraph 2.2.10)**

- The Government unauthorisedly waived tax, interest and penalty of Rs. 96.87 crore leviable under the Central Sales Tax Act

**(Paragraph 2.2.11)**

- Non-accounting of import purchase/purchase through form 25 resulted in non-levy of tax of Rs. 18.43 crore.

**(Paragraph 2.2.12)**

### **2.2.2 Introduction**

The Kerala General Sales Tax (KGST) Act, 1963 (upto 31 March 2005), Kerala Value Added Tax (KVAT) Act, 2003 (introduced from 1 April 2005) and Central Sales Tax Act, 1956 govern the levy and collection of tax on sale or purchase of goods in the State. Under the KGST Act, tax on the turnover of sale or purchase of goods are leviable only at the specified point and at the specified rate. The sale or purchase of goods at all other points, other than the points specified for levy of tax, are exempt subject to the condition that the dealer claiming exemption shall furnish supporting documents or prescribed declaration/certificate. Under the KVAT Act, tax on the turnover of sale of goods is leviable at all points. The assessing authorities (AA) are required to confirm the genuineness of these declarations or documents through cross verification of records of other dealers/State and utilise the information gathered from check post before finalising the assessment.

A review on 'Cross verification of purchase/sale effected under KGST/KVAT/CST Acts' was conducted by audit which revealed a number of deficiencies as discussed in the succeeding paragraphs.

### **2.2.3 Organisational set-up**

The Department of Commercial Taxes, which administers the levy and collection of sales tax/VAT under KGST, KVAT and CST Acts, is headed by

the Principal Secretary (Taxes) at the Government level and the Commissioner of Commercial Taxes (CCT) at the department level. The CCT functions with the assistance of Joint Commissioners, Deputy Commissioners and Inspecting Assistant Commissioners. Assessment, levy and collection is done by Assistant Commissioners (Assessment) and Commercial Tax Officers (CTO).

#### **2.2.4 Scope of audit**

During the review, records of 34 out of 135 assessment circles and eight out of 57 check posts, spread over 11 revenue districts for the period 2003-04 to 2007-08 were test checked by audit. Selection of offices was made particularly based on the availability of check posts under its jurisdiction, nature of commodity dealt by the dealers registered under these offices etc. Details such as import particulars, check post declarations, transit passes, purchases effected by issuing form<sup>1</sup> 25, and sales/transfers effected by issuing form<sup>2</sup> C/F etc., were collected from the assessment circles/check posts/Cochin Customs House and cross verified with the records of other circles/check posts.

#### **2.2.5 Audit objectives**

The review was conducted with a view to ascertain whether

- the department have introduced an effective system of cross verification of the documents furnished by the dealers;
- claims for exemption on the basis of declarations/documents were allowed after verifying its genuineness through cross verification;
- exemptions/reductions in rate of tax are in accordance with the provisions in the Acts; and
- internal control mechanism existed in the department and was effective.

#### **2.2.6 Acknowledgement**

Indian Audit and Accounts Department acknowledges the co-operation of the Commercial Taxes Department in providing necessary information and records for audit. An entry conference was held with the Principal Secretary (Taxes) who is also functioning as Commissioner of Commercial Taxes and was apprised of the scope, methodology and objectives of the review. The review report was forwarded to the department and to the Government in April 2009. An exit conference was conducted in July 2009, which was attended by the Principal Secretary (Taxes) cum Commissioner of Commercial Tax. The reply of the department/Government has not been received (September 2009).

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<sup>1</sup> Declaration to prove that a dealer is not the last purchaser within the State.

<sup>2</sup> C form – Declaration to prove that the interstate sale was effected to registered dealers and F form is to prove that transfer of goods to other States otherwise than by way of sale.

## **Audit findings**

### **2.2.7 Absence of control over movement of goods under transit pass**

Under section 48 of the KVAT Act, in case where any vehicle carrying goods from any place outside the State and bound for any place outside the State passes through the State, the owner or driver or any other person in charge of the vehicle shall obtain a transit pass in triplicate in form 7B from the person in charge of the check post at the entry point and surrender the original and duplicate copy to the officer in charge of the check post at the exit point. If the owner or driver or person in charge of the vehicle fails to surrender the TP to the designated exit check post, it shall be presumed that the goods have been sold within the State and the driver, owner or any person in charge of the goods shall be assessed to tax and penalty not exceeding twice the amount of such tax shall be levied on him. The officers in charge of the entry and exit check posts shall send the information of entry/exit of goods to the concerned CTO who shall enter such information in a TP register for monitoring.

The CCT in his instructions<sup>3</sup> inter alia, directed that the Sales Tax Inspector who issues the transit pass should pass on such information to the Deputy Commissioner of that district through e-mail/post within 24 hours and the non-receipt of the information of moving of the goods out of the state through the exit check post should be reported to the Intelligence Officer (CI) of the area within one week. Further it has been directed that on receipt of such information, the Intelligence Officer should get the details of transit pass issued and the goods moving out of the states from the Deputy Commissioner's office or from the check posts concerned and cross check these within seven days and make an endorsement in the transit pass register of the check posts weekly.

Audit scrutiny of eight<sup>4</sup> commercial tax check posts (check posts) revealed severe shortcomings in the process of control on movement of goods through the State. Instances of deficiencies noticed are that entries in the TP register were not completed and not authenticated; copies of Transit passes were not forwarded to the CTOs/DCs concerned; details of the exit check posts were not noted, periodical review of the register by the controlling officer were not conducted and non-receipt of exit pass were not reported to the IO(CI)/CTO/DC etc.

Due to these deficiencies, the following observations were made during the review.

**2.2.7.1** Test check of the register of Transit passes in eight check posts revealed that in respect of 2,813 Transit passes<sup>5</sup> covering goods valued at Rs. 100.60 crore issued during the period from August 2003 to March 2008,

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<sup>3</sup> Circular Nos. 8 of 2003 and 13 of 2005.

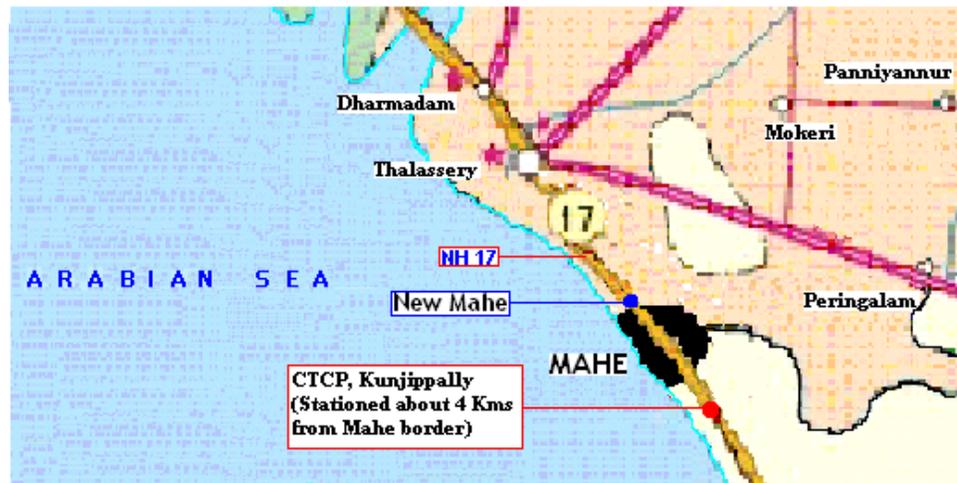
<sup>4</sup> Amaravila, Aryankavu, B. Manjeswar, Gopalapuram, Muthanga, Naduppunni, Walayar and Commercial Tax facilitation centre, Willingdon Island.

<sup>5</sup> Amaravila 94, Aryankavu 17, B. Manjeswar 932, Facilitation centre, W.Island 119, Gopalapuram 741, Muthanga 85, Naduppunni 308 and Walayar 517.

details regarding the surrender of the Transit passes at the exit check post were not available.

In the absence of details of exit of the goods, it is evident that the goods have been sold in the State. Thus, due to failure of the control mechanism devised by the department, timely action could not be taken to detect delivery of goods within the State and consequently there was non-levy of tax of Rs. 31.72 crore (including penalty).

**2.2.7.2** The rate of tax on the sale of goods under the Pondicherry Sales Tax Act is comparatively lesser than that in Kerala. National highway 17 passes through Mahe. Movement of goods to Mahe from southern part of Kerala is mainly regulated through the check post, Kunjippally which is situated about 4 km away from the actual border of Mahe. There are number of pocket roads in between the check posts and the actual border of Mahe through which vehicles can easily be diverted to various places within Kerala after getting clearance from the check post at Kunjippally as shown below.



Due to the difference in rate of tax prevailing in Mahe and Kerala, by availing the facility of pocket roads in between the check posts and Mahe border, unscrupulous dealers transport the goods under the intention for use in Mahe and sell the goods in Kerala thereby evading tax otherwise due to Government of Kerala.

Audit scrutiny of five commodities only revealed that during the period from January to December 2008, taxable goods valued at Rs. 374.02 crore involving tax effect of Rs. 119.02 crore (in Kerala) intended for delivery at Mahe was transported through the check post, Kunjippally and New Mahe<sup>6</sup> as detailed below.

Commodity	Rate of tax		Entry check post in Kerala	Exit check post in Kerala	Quantity	Value	Tax effect
	In Kerala	In Mahe					
Petrol & Diesel	24.69	12.50	(Goods initiated from Kerala)	Kunjippally	7,50,89,000 litre	22,772.66	5,622.57

<sup>6</sup> Check post situated in Kerala, outside Mahe

Commodity	Rate of tax		Entry check post in Kerala	Exit check post in Kerala	Quantity	Value	Tax effect	
	In Kerala	In Mahe						
IMFL	90.00	0.00	Muthanga, B. Manjeswar	Kunjippally & New Mahe	48,11,976 litre	5,743.16	5,168.84	
Chicken	12.50	0.00	Gopalapuram	Kunjippally	94,15,314 Kg	4,499.10	562.39	
Ghee	12.50	4.00	Gopalapuram	Kunjippally	1,02,404 cases	2,837.32	354.67	
Tiles	12.50	8.00	B. Manjeshwar & Koottupuzha	New Mahe	7,90,240 Sqm	1,549.91	193.74	
<b>Total</b>								<b>11,902.21</b>

Mahe is a part of a Union Territory with an area of about 9 sq.km and population of 36,823 (2001 census) with total vehicle strength of 341 and geographically situated within Kerala. Considering the population and vehicles figures it can be easily inferred that such huge quantity of goods cannot be consumed at Mahe. Thus, Mahe is being used as a pocket for evasion of tax legitimately due to the Kerala State exchequer. Leakage of revenue on account of tax on the above commodities transported to Mahe during just one year (2008) works out to Rs. 119.02 crore. During exit conference, the Principal Secretary (Taxes) agreed that Mahe is a problematic point and stated that action was being taken to minimise the loss of revenue by introducing journey pass for petrol and diesel and also by strengthening the intelligence wing.

**2.2.7.3** Commercial tax facilitation centre at Willingdon Island is the exit check post for the goods transported for export through Cochin Port. So, transit pass obtained for transportation of goods for export is required to be surrendered at this point. The commercial tax facilitation centre is stationed within the area of Cochin Port Trust. However, the Commercial Taxes Department has not introduced infrastructural facilities such as barricade etc., for monitoring transportation of goods through the area.

During the year 2006-07, molasses valued at Rs. 49.93 lakh from Tamil Nadu and intended for export through Cochin port was allowed to pass through the State by issuing a total number of 101 Transit passes by check post, Walayar. The last check post before entering Cochin port is commercial tax facilitation centre, Willingdon Island, Cochin and so the Transit passes should have been surrendered at that centre so as to ensure that the goods were not delivered in the State. But, the Transit passes were incorrectly surrendered at the internal check post at Karukutty which is situated about 50 kms before Cochin port.

Similarly, during the years 2006-07 and 2007-08, coffee beans valued at Rs. 15.06 crore from Karnataka and intended for export through Cochin port was allowed to pass through the State by issuing 122 Transit passes from check post, Muthanga. Instead of surrendering the Transit passes at commercial tax facilitation centre at Willingdon Island which is the last check post before Cochin port, the Transit passes were incorrectly surrendered at check post, Kottappuram which is about 25 km before commercial tax facilitation centre, Willingdon Island.

Thus, irregular acceptance of Transit passes by check posts at Karukutty and Kottappuram allowed the transporters the scope to divert/sell the goods within Kerala and evade tax.

In another case, coffee beans valued at Rs. 62.87 lakh intended for export through Cochin port was allowed to pass through check post, Muthanga from Karnataka without issuing Transit passes.

These defeats the basic objective of monitoring movement of interstate goods prescribed for prevention of evasion. In such circumstances the possibility of disposal of goods by way of sale in the State cannot be ruled out.

However, no record was available at commercial tax facilitation centre to show that the goods actually passed through that check posts. So it can be inferred that the goods were actually sold out in the State. Tax effect involved in these transactions worked out to Rs. 69 lakh.

Though a system has been prescribed for sending the details of entry and exit of goods through various check posts to the concerned CTOs and DCs for monitoring and cross verification, the authorities could not detect the defects as mentioned above and initiate remedial measures to plug the scope of leakage of revenue.

### **2.2.8 Non-utilisation of check post declaration**

As per KGST Act and the rules made thereunder, no person shall transport within the State any consignment of goods by any vehicle unless it is accompanied by an invoice or a delivery note or certificate of ownership. According to the instructions in the departmental manual and circulars<sup>7</sup> issued by the CCT, officials in charge of the check posts should collect the declarations and send them to the AAs concerned for verification at the time of assessment. The AAs should cross check the details available in the declaration with the returns filed by the assessee to ensure that there was no evasion of tax by the dealers. Audit scrutiny revealed that there was lack of co-ordination between the check posts and the unit offices. It was noticed that in some cases, the declarations were sent to some other unit offices instead of the respective office, while in other cases, though the check post authorities have sent the copies of check post declarations to the unit offices, neither any action was taken to file them in the respective assessment files, nor did the AAs cross verify the particulars of the declarations while finalising the assessments. Due to the non-observance of the above provisions, the following cases were noticed during the review.

**2.2.8.1** Cross verification of details from five<sup>8</sup> check posts with the assessment records of eight<sup>9</sup> assessment circles revealed that 122 declarations relating to the period from May 2003 to January 2007 covering goods valued at Rs. 6.45 crore were not seen filed in the concerned files. Verification of details available with the respective assessment files revealed that purchase

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<sup>7</sup> Circular Nos. 26 of 1987 and 15 of 2004.

<sup>8</sup> Aryankavu, Amaravila, Gopalapuram, Muthanga and Walayar.

<sup>9</sup> First circle Palakkad, Kalpetta, Punalur, special circle Kottayam, special circle Kollam, special circle III Ernakulam, special circle Kottarakkara and special circle Palakkad.

covered in the declarations were omitted to be accounted for. Short levy of tax due to the unaccounted purchase worked out to Rs. 1.47 crore.

On this being pointed out, the AAs of seven<sup>10</sup> assessment circles agreed (between September 2008 and March 2009) to examine the case. The AA<sup>11</sup> in one assessment circle stated (December 2008) that since the assessment of the dealers were already completed and in the absence of details of consignor, invoice number etc., verification and further action were not possible to substantiate evasion of tax. However, the fact remains that the details of transportation of goods which the dealer had omitted to account is evidenced in audit. Hence, the AA was bound to gather the details and to make good the revenue loss.

**2.2.8.2** Test check of records of check post at Amaravila revealed that 39 declarations pertaining to the period from June 2003 to October 2003 covering goods valued at Rs. 2.44 crore were not properly despatched to the AAs concerned but to some other offices, thereby defeating the purpose of statutory provisions. To test check, audit visited some of the offices and, there the records were not available. Hence audit could not ascertain whether turnover covered by those declarations were properly accounted. The maximum tax effect involved worked out to Rs. 27.88 lakh.

Thus, due to non/improper forwarding of the check post declarations by the check post authorities to the AAs, the system of cross verification of these declarations to ensure non-evasion of tax at the time of finalising assessments got defeated.

### **2.2.9 Non-conducting of cross verification of declarations in form 25**

Under the KGST Act and Rules made thereunder, a dealer who purchases goods taxable at the last purchase point shall not be liable to pay tax, if he proves that he is not the last purchaser within the State. For this, he shall file declaration in form 25 in duplicate issued by the purchasing dealer. The correctness of exemption claimed by a dealer can be ascertained, only if the duplicate copy of the declaration filed by the particular dealer is sent to the assessing circle of the purchasing dealer for cross verification. Rubber and pepper (purchased within the State) were taxable at the last purchase point.

In nine assessment circles, it was noticed that while finalising the assessments of 37 dealers for the years 2002-03 to 2004-05 between January 2005 and February 2008, the AAs allowed exemption on the purchase turnover of rubber and pepper valued Rs. 355.01 crore supported by declaration in form 25 without ascertaining its genuineness by cross verification of records of the AAs of the purchasing dealer. Exemption allowed without ascertaining its genuineness was not in order. Tax effect is worked out to Rs. 43.94 crore as detailed below:

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<sup>10</sup> CTO Kalpetta, first circle Palakkad, Kottarakkara, Kottayam, Palakkad, Punalur and Special circle Kollam.

<sup>11</sup> Assistant Commissioner (Assessment), special circle III, Ernakulam

(Rupees in crore)

Sl. No	Name of Office	Number of dealers	Commodity	Turnover allowed exemption	Tax involved
1.	CTO, Ponkunnam	5	Rubber	106.82	13.51
2.	CTO, Pala	9	Rubber	103.19	13.05
3.	CTO, Aluva	2	Rubber	71.62	9.06
4.	CTO, Nedumangad	7	Rubber	38.47	4.87
5.	CTO, II Circle, Perumbavur	2	Rubber	18.70	2.37
6.	CTO, Nedumkandam	6	Pepper	10.61	0.49
7.	CTO, Neyyattinkara	4	Rubber	3.10	0.39
8.	Special Circle, Kottayam	1	Rubber	1.12	0.14
9.	CTO, Devikulam	1	Pepper	1.38	0.06
<b>Total</b>				<b>355.01</b>	<b>43.94</b>

### 2.2.10 Acceptance of invalid/defective declaration forms

Under section 8(1) of the CST Act, as it stood during the relevant period, turnover of interstate sales of goods to registered dealers, where the rate of tax of which under the State Act is more than four *per cent*, would attract tax at the rate of four *per cent* upto 31 March 2007 and from 1 April 2007 at the rate of three *per cent* or rate of tax under the local VAT Act whichever is lower. As provided under Section 8(4) of the Act read with rule 12(1) of CST (Return and Turnover) Rules 1957, in order to prove that the transactions would fall under Section 8(1), the dealer had to file a declaration in form C duly filled and signed by the registered dealer to whom the goods are sold containing the prescribed particulars in the prescribed form. Declarations not duly filled and not containing the prescribed particulars are to be treated as defective. Besides, under Section 6A of the CST Act read with Rule 12(5) of CST (R&T) Rules, transfer of goods from one State to another other than by way of sale are exempted from tax provided the same is covered by declaration in form F. A single declaration shall cover transactions pertaining to one calendar month only.

Under the CST (R&T) Rules, as amended by Union Finance Act 2005 (with effect from 1 April 2005), the declaration in form C or F should be furnished within three months after the end of the period to which the declaration relate. As provided under Section 8(2) of the CST Act, tax on the turnover of goods not covered by valid declaration in form C, were taxable at the rate of ten *per cent* or the rate of tax under the local Act whichever is higher upto 31 March 2007 and from 1 April 2007 at the rate applicable under the KVAT Act.

It was, however, noticed during the review that the department has not devised a regular system of cross verification of declaration forms to ensure its genuineness. Also, the department has not issued any instruction regarding the checks to be carried out before accepting declaration forms before allowing reduction/exemption of tax.

**2.2.10.1** During scrutiny of records in CTO, special circle I, Ernakulam it was observed that while finalising the assessments of 10 dealers for the assessment years 2005-06 and 2006-07, turnover of Rs. 309.98 crore returned without declarations in form C was accepted. Since the turnover was not supported by valid declaration in form C, the turnover was to be assessed at the higher rate specified under section 8(2) of the CST Act. Omission in this regard resulted in short levy of tax, interest and penalty of Rs. 103.14 crore.

**2.2.10.2** During scrutiny of records in CTO, special circle, Mattancherry at Aluva, it was observed that though a dealer had not filed valid declaration in form C, the turnover was shown as taxable at two *per cent* and tax due was paid accordingly. The returns were summarily accepted by the AA and thereby the assessments were deemed to have been completed under Section 9(2) of the CST Act read with Section 21 of the KVAT Act 2003. Omission in this regard had resulted in short levy of tax, interest and penalty of Rs. 37.62 crore.

**2.2.10.3** Test check of records of six<sup>12</sup> assessment circles revealed that while finalising the assessments of seven dealers for the years 2002-03 to 2004-05, the AAs accepted 69 declarations of form C covering a turnover of Rs. 103.43 crore, which were defective for the reasons that the same were not duly filled and not containing the prescribed particulars such as date of issue, to whom issued, registration number etc.. This showed that the forms were not scrutinised properly before accepting them. Acceptance of defective form C resulted in short levy of tax of Rs. 27.63 crore including interest and penalty.

**2.2.10.4** Test check of assessment records of four dealers in four<sup>13</sup> assessment circles revealed that while finalising the assessments for 2004-05 and 2005-06 during March 2007 and September 2008, the AAs accepted form F declarations for Rs. 45.36 crore covering transactions for more than one month in violation of the provisions in the statute. Thus, allowance of exemption without verification of the declaration forms resulted in short levy of tax of Rs. 4.54 crore.

### **2.2.11 Incorrect waiver of central sales tax**

The CST Act and the rules made thereunder govern the levy, collection and distribution of taxes on sales of goods in the course of interstate trade or commerce. Under the Act, State Governments are empowered to assess, reassess, collect and enforce payment of tax payable by a dealer under the Act and the proceeds in any financial year of any tax levied on behalf of Government of India shall be assigned to State and retained by it. Further, Section 8(5) of the Act empowers the State Government, if it is satisfied in public interest, to issue notification in the official gazette to exempt any dealer from payment of tax or reduce the rate of tax etc. Since the CST Act is enacted by the Parliament, only Parliament can make any amendment in the Act. As such, State Government has no power to issue an executive order waiving the tax, interest and penalty due and levied under the CST Act.

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<sup>12</sup> Mattanchery at Aluva, Palakkad First circle, Palakkad, Perumbavoor, Special circles Ernakulam II and Thiruvananthapuram.

<sup>13</sup> Special circles Ernakulam I, Kollam and Kozhikode II and CTO Punalur.

The cashew dealers in the State dispose off huge quantity of cashew kernel by way of interstate sales/branch transfer and claimed concessional rate of tax/turnover exemption by filing declarations in form C/F. On getting information that most of the declarations filed by cashew dealers were bogus or issued by bogus dealers (dealers not in existence), the intelligence wing of the department conducted interstate investigation and detected dealers who issued bogus form/name of bogus dealers. Details so gathered were made available to the assessing officers for information.

Cross verification of records of two<sup>14</sup> assessment circles revealed that in respect of 220 dealers, the turnover of interstate sales/stock transfers made during the years 2002-03 to 2005-06 were supported by bogus forms/forms issued by bogus dealers.

It was further noticed that based on representations made by certain organisations of cashew dealers, the Government vide a notification<sup>15</sup> ordered waiver of penalty, interest and all amount in excess of four *per cent* which were due and leviable under the Act on the turnover involved in the bogus C/F form. Such unauthorised and arbitrary order issued by the State Government not only extended moral support to the dealers who willfully evaded legitimate tax due to the State but also resulted in minimum loss of revenue of Rs. 96.87 crore in the two circles test checked by audit.

#### **2.2.12 Non accounting of import purchases**

Cross verification of details of import of selected goods viz., timber and ceramic tiles gathered from Cochin Customs House (CCH) with assessment files of 25 dealers in 14 assessment circles revealed that during the years 2003-04 to 2006-07, the dealers did not account for import purchase of goods valued at Rs. 33.82 crore which escaped the notice of the AAs also. This resulted in non-levy of Rs. 18.43 crore towards tax, interest, and penalty worked out on its corresponding sales turnover of Rs. 40.24 crore estimated by adding admitted gross profit rate where accounts are available and by adding a minimum gross profit of 10 *per cent* in other cases.

#### **2.2.13 Grant of irregular exemption**

**2.2.13.1** Cross verification of details gathered from three<sup>16</sup> assessment circles with the assessment records of five purchasing dealers in three other assessment circles revealed that purchase of rubber effected during the years 2003-04 & 2004-05 by issuing 10 numbers of form 25 declarations covering a total purchase value of Rs. 1.16 crore were not accounted for by the purchasing dealers. The unaccounted purchase resulted in short levy of tax of Rs. 49 lakh including interest and penalty.

**2.2.13.2** In Neyyattinkara assessment circle, it was noticed that while finalising the assessment of a dealer for the year 2004-05 in June 2007, purchase turnover of rubber worth Rs. 31 lakh was allowed exemption without

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<sup>14</sup> Special circle II Ernakulam and special circle Kollam.

<sup>15</sup> G.O.(MS) dated 7 July 2008.

<sup>16</sup> CTOs Aluva and Pala and Special circle Kottayam.

form 25 declarations. This resulted in short levy of tax of Rs. 13.28 lakh including interest and penalty.

#### **2.2.14 Internal audit**

Internal audit is intended to examine and evaluate the level of compliance with the rules and procedures so as to provide a reasonable assurance on the adequacy of the internal control. Effective internal audit system both in the manual as well as computerised environments are a pre-requisite for the efficient functioning of any department. However, in the department there is no internal audit wing with the introduction of VAT with effect from 1 April 2005.

#### **2.2.15 Conclusion**

The review revealed a number of deficiencies in the system of cross verification of purchase/sales. Departmental directions and instructions regarding co-ordination between the entry and exit check posts to monitor the movement of goods meant for other States through Kerala to ensure non-delivery of goods within the State causing evasion of tax were not adhered to. Due to defect in the system of information sharing between the check post and the assessing authorities, in many cases assessments were finalised without considering the check post declarations. There is evasion of tax by dealers using Mahe as a pocket. There was no system of regular cross verification of declaration forms to verify the genuineness of the forms. Also, there was no guidelines on checks to be conducted before allowing exemption/reduced rate of tax. Irregular waiver of tax, interest and penalty of CST in excess of four *per cent* by the State Government resulted in loss of revenue. The internal control mechanism was weak as evidenced by absence of an internal audit wing due to which the department remained unaware of the deficiencies pointed out in this review.

#### **2.2.16 Recommendations**

The Government may consider implementing the following recommendations for rectifying the system and compliance deficiencies.

- Issue strict orders for compliance of departmental orders regarding monitoring of movement of goods on transit pass through the State. Targets may also be fixed for the intelligence officers for carrying out cross verification of records of the entry and exit check posts;
- Shift the check post at Kunjippally to a more strategic location closer to the actual border with Mahe to arrest scope of evasion of tax. Besides, matter may be taken up with the central Government for ensuring uniform floor rate of tax between Kerala and Mahe to safeguard revenue of the State;
- prescribe a system of carrying out regular cross verification of declaration forms and issuing guidelines for checks to be conducted before accepting declaration forms for allowing exemption/reduced rate of tax;

- issue immediate orders withdrawing the waiver of tax, interest and penalty above four *per cent* under the CST Act with retrospective effect and taking steps to realise the dues from the defaulting dealers who have submitted bogus declaration forms; and
- make the internal audit wing functional and effective.

### **2.3 Other Audit observations**

*Scrutiny of assessment records of sales tax/value added tax (VAT) in Commercial Taxes Department revealed several cases of non-observance of provisions of Acts/Rules, non/short levy of tax/penalty/interest, incorrect determination/classification/turnover and other cases as mentioned in the succeeding paragraphs in this chapter. These cases are illustrative and are based on a test check carried out in audit. Such omissions on the part of assessing authorities (AA) are pointed out in audit each year, but not only the irregularities persist; these remain undetected till an audit is conducted. There is need for Government to improve the internal control system including strengthening of internal audit to ensure that such omissions are detected and rectified.*

### **2.4 Non-observance of provisions of Acts/Rules**

*The Kerala General Sales Tax/Kerala Value Added Tax/Central Sales Tax Acts and Rules made thereunder provide for:*

- (i) levy of tax/interest/penalty at the prescribed rate;*
- (ii) allowing exemption of turnover subject to fulfillment of the prescribed conditions; and*
- (iii) allowance of input tax credit as admissible.*

*It was noticed that the AAs while finalising the assessment did not observe some of the provisions which resulted in non/short levy/non realisation of tax/interest/penalty of Rs. 14.22 crore as mentioned in the paragraphs 2.4.1 to 2.4.11.*

#### **2.4.1 Non/short levy of tax due to grant of irregular exemption**

**2.4.1.1** Under the Central Sales Tax (CST) Act, 1956, sale or purchase of goods shall be deemed to take place in the course of inter state trade or commerce if the sale or purchase occasions the movement of goods from one State to another. Every dealer shall be liable to pay tax on all such sales effected by him in the course of inter state trade or commerce. By a notification issued under the Act, the Government have exempted inter state sales turnover of rubber from tax, provided that tax has been levied under the Kerala General Sales Tax (KGST) Act, 1963 on the purchase turnover.

During scrutiny of records of the inspecting assistant commissioner (IAC), Kattapana in June 2008, it was noticed that while finalising the assessment of a dealer in centrifuged latex and cream rubber for the year 2002-03, the AA irregularly exempted the interstate sales turnover of Rs. 15.90 crore related to centrifuged latex and cream rubber eventhough tax had not been levied on the purchase turnover. This resulted in non-levy of tax of Rs. 2.01 crore.

After the case was reported to the department in July 2008 and Government in August 2008, the Government stated in March 2009 that notice had been issued to revise the assessment. Further report has not been received (September 2009).

**2.4.1.2** By a notification issued in November 1993 under the KGST Act, Government have exempted SSI units from payment of tax on sales turnover of goods manufactured by them subject to certain conditions. Further, as per

the Act, spectacles, glasses, goggles, rough blank lenses, framed attachments, parts and accessories thereof are taxable at the rate of eight *per cent*. It was judicially held<sup>17</sup> by the High Court of Andhra Pradesh that sale of lens and frames separately or as spectacles after lenses were put in the frames, makes no difference as all are included in the same entry.

During scrutiny of the records in commercial tax office (CTO), third circle, Thiruvananthapuram between March 2007 and March 2008, it was noticed that a dealer registered as a small scale industry unit was allowed sales tax exemption for the years 2000-01 to 2004-05. As per the registration certificate, he was a wholesaler supplying lens/spectacles etc., to its branches and not a manufacturer. Further, as per the court decision conversion of optical blanks to lenses or fixing of lens into framed attachments would not tantamount to manufacture. Hence the exemption granted to the dealer as SSI unit was irregular. This resulted in short levy of tax of Rs. 70.34 lakh.

After the case was pointed out to the department between May 2007 and April 2008 and reported to the Government in February 2008, the Government stated in May 2008 that the exemption granted was in order as the unit was registered as an SSI unit and goods produced by them were eligible for exemption and the dealer had manufactured spectacles as evidenced by the sales effected to 'Kalluvellil Opticals', Amburi. However, on further verification, it was found that there is no dealer as 'Kalluvellil Opticals' at Amburi. As manufacture of lenses and spectacles by a whole sale dealer was not possible and the legislature had intended to levy tax on optical blanks, lenses, frames and spectacles under a single entry, the reply was not correct. Further reply has not been received (September 2009).

**2.4.1.3** Under the KGST Act, note book was taxable at the rate of four *per cent*, five *per cent* and eight *per cent* with effect from April 1992 to December 1999, January 2000 to 30 December 2001 and from 31 December 2001 onwards respectively. As per the explanation thereunder, where tax is levied on note books, the tax, if any, paid on the purchase of paper out of which note book is manufactured shall be deducted. Under the amended provision of section 23 (3A) of the Act effective from 1 April 2004, where any dealer has failed to include any turnover or taxable turnover of his business or to pay the tax due thereon, or where any turnover or tax due has escaped assessment, interest shall accrue on the tax due on the turnover with effect from such date on which the tax would have fallen due. Interest due on the taxable turnover is calculated at the rate of one *per cent* per month.

During scrutiny of records in CTO, Kunnankulam between January 2008 and January 2009, it was noticed that while finalising the assessments of 16 dealers, sales turnover of note books manufactured were irregularly exempted resulting in short levy of tax and interest of Rs. 65.07 lakh as mentioned below:

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<sup>17</sup> State of AP Vs Deccan optical and allied industries in 98 STC 114 (AP)

Sl. No.	No. of dealers	Assessment year	Turnover exempted (Rupees in crore)	Tax effect (Rupees in lakh)
1.	1	1994-95 to 2001-02	10.28	35.39
2.	15	2004-05	7.91	29.68
<b>Total</b>			<b>18.19</b>	<b>65.07</b>

After the case was reported to the department between February 2008 and February 2009 and Government between August 2008 and April 2009, the Government stated in December 2008 that it was judicially held<sup>18</sup> that paper and note book were one and the same and hence exemption granted was in order. The reply was not correct as the decision related to the assessment years 1985-86 to 1988-89, when there was no specific entry for note book in the Act. Further reply has not been received (September 2009).

**2.4.1.4** By a notification issued under the KGST Act, in November 1993, the Government have exempted levy of tax on sale of industrial input, plant and machinery etc., to industrial units in Cochin Export Processing Zone (CEPZ). The notification does not provide for exemption of tax on purchase by units in CEPZ. Rubber is taxable at the point of last purchase in the state. By another notification issued in November 1993, Government have reduced the rate of tax payable, by rubber based industrial units, on the purchase of rubber for use in the manufacture of rubber products within the State to five *per cent* from 1 April 1994 and by a subsequent notification issued in December 1999 Government have fixed the rate as six *per cent* from 1 April 2000.

During scrutiny of the records in CTOs Second circle, Kalamassery and Special circle III, Ernakulam during May 2008 and June 2008, it was noticed that while finalising the assessments of one industrial unit in CEPZ, for the years 1997-98 and 1998-99 and another unit in the Cochin Special Economic Zone (CSEZ) for the years 2002-03 and 2003-04, the AAs incorrectly exempted the purchase turnover of rubber, valued at Rs. 3.92 crore, used in the manufacture of rubber gloves. This resulted in short levy of tax of Rs. 23.31 lakh.

After the case was reported to the department in June 2008 and Government in September 2008, the Government stated in April 2009 that as per the notification<sup>19</sup>, exemption is available for tax payable under the Act for industrial undertakings in the CEPZ. However, the fact remains that the assessee had claimed exemption on the purchase turnover of rubber, whereas the exemption is available only for the sale to the industrial units in CEPZ ie, the seller of industrial raw materials to the industrial unit in CEPZ shall alone be eligible for exemption. Further, the Government have exempted the purchase tax from 1 July 2003 only vide another notification<sup>20</sup>, from which it is clear that the purchase turnover of industrial units in CEPZ was not eligible for exemption upto June 2003.

<sup>18</sup> M/s Kunnankulam book company Vs State of Kerala in the Honourable High Court of Kerala – 9 KTR 400

<sup>19</sup> SRO 1727/93 dated 3 November 1993

<sup>20</sup> SRO 151/2004

**2.4.1.5** By a clarification issued by the CCT, computer paper is taxable at eight *per cent* under entry 106 (ii) of first schedule to the KGST Act.

During scrutiny of records in CTO, Chalakkudy in February 2008, it was noticed that while finalising the assessments of a dealer engaged in the manufacture of computer stationary for the years 2002-03 and 2003-04, the AA incorrectly exempted the sales turnover of computer stationary (paper product), valued at Rs. 2.13 crore, treating it as second sales. This resulted in short levy of tax of Rs. 19.32 lakh.

After the case was reported to the department in March 2008 and Government in August 2008, the Government stated in March 2009 that as per the decision of the Sales Tax Appellate Tribunal (STAT), the assessee was eligible for exemption as the dealer was purchasing paper and other raw materials and converting it after printing into computer stationery and no manufacturing process was involved. However, the fact remains that the SSI exemption on manufacture of computer paper acquired in 1996-97 got exhausted during 1999-2000 and from 2000-01 onwards the assessee was claiming the sales as second sales of paper.

**2.4.1.6** Under the KGST Act, oil palm kernels are taxable at the rate of eight *per cent* under entry 177 of schedule I.

During scrutiny of records in CTO, special circle, Kottayam, in November 2007, it was noticed that while finalising the GST and CST assessments of an assessee for the year 2004-05, the AA irregularly exempted the local sales turnover of oil palm kernel of Rs. 64.34 lakh and interstate sales turnover of Rs. 41.85 lakh treating them as fruits. This was not correct as oil palm kernel is not a fruit. The grant of incorrect exemption resulted in short levy of tax of Rs. 10.10 lakh.

After the case was pointed out, the AA replied in January 2009 that the case would be examined. Further reply has not been received (September 2009).

The matter was reported to the department in February 2009 and Government in April 2009; their reply has not been received (September 2009).

**2.4.1.7** Under Section 7 of the KGST Act, a contractor in works other than civil works, may opt to pay tax on the whole amount of contract at the rate of seventy *per cent* of the rates shown in the fourth schedule if the contract amount exceeds Rs. 50 lakh and at the rate of five *per cent* on the whole amount of contract if the contract amount does not exceed Rs. 50 lakh.

During scrutiny of records in CTO, fourth circle, Ernakulam in July 2008, it was noticed that the assessment of a dealer, who had opted for payment of tax under Section 7 in respect of aluminium joinery works for the year 2002-03 was finalised in November 2007. The turnover in respect of each contract was less than Rs. 50 lakh. However, the AA irregularly exempted the turnover of Rs. 1.11 crore relating to aluminium joinery work and Rs. 3.61 lakh relating to labour charges respectively from the total contract receipt of Rs. 1.56 crore. The balance turnover of Rs. 40.83 lakh was assessed at the rate of two *per cent* instead of correct rate of five *per cent*. This resulted in short levy of tax of Rs. 8.02 lakh including additional sales tax (AST).

After the case was pointed out, the AA stated in July 2008 that the case would be examined. Further development in the matter has not been reported (September 2009).

The matter was reported to the department in October 2008 and Government in December 2008; their reply has not been received (September 2009).

**2.4.1.8** By a notification issued in June 2007 under the KGST Act, the Government have made a reduction in the rate of tax payable by khadi and village industries units recognised by the Kerala Khadi and Village Industries Board and the Khadi and Village Commission of India to four *per cent* if the annual turnover of the unit exceeds Rs 50 lakh. The rate was effective during the period from 1 April 2000 to 31 March 2004.

During scrutiny of records in CTO, Chathannoor in August 2008, it was noticed that, while finalising the assessment of a khadi and village industries unit having an annual turnover exceeding Rs. 50 lakh for the year 2003-04, the AA irregularly exempted the entire sales turnover of Rs. 1.50 crore. This resulted in non-levy of tax of Rs. 6.69 lakh.

After the case was reported to the department in October 2008 and Government in February 2009, the Government stated in June 2009 that the assessment had been revised and tax and interest demanded. The report on recovery has not been received (September 2009).

**2.4.1.9** Under the KGST Act, 'taxable turnover' means the turnover on which a dealer shall be liable to pay tax after making the prescribed deductions from the total turnover. Under Section 5 (2C) (c) of the Act, manufacturer of distillery, brewery or winery or other manufactory established under *Abkari* Act, 1977, is liable to pay turnover tax at five *per cent* on the sales turnover of liquor.

During scrutiny of records in CTO, special circle II, Kozhikode in January 2008, it was noticed that while finalising the assessment of a dealer, engaged in manufacture and sale of Indian made foreign liquor for the year 2004-05, the AA incorrectly allowed exemption of Rs. 1.03 crore, relating to prompt payment discount, on the assessment of turnover tax. This resulted in short levy of turnover tax of Rs. 5.14 lakh.

After the case was reported to the department in February 2008 and Government in August 2008, the Government stated in April 2009 that as per the contract, two *per cent* discount is allowable and hence it was deducted from the total turnover and taxable turnover was arrived at accordingly. The reply was not correct as the assessee himself had disclosed the total turnover as taxable and turnover tax on the total turnover was paid accordingly. However, while finalising the assessment the AA had incorrectly given two *per cent* discount on the turnover, which was shown as selling expenses in the P&L accounts, and turnover tax was short demanded resulting in excess credit to the assessee.

#### **2.4.2 Short levy due to application of incorrect rate of tax**

Under the KGST Act, rate of tax depends on the nature of sale, point of sale and also on the kind of commodity.

Scrutiny of records revealed that while finalising the assessment, the AAs levied tax at incorrect rates resulting in short levy of tax of Rs. 2.90 crore as mentioned below:

Sl. No.	Assessment circle Assessment year	Commodity/ contract	Rate applicable Rate applied	Turnover (Rs.)	Short levy (Rs.)
1.	CTO, Spl. circle, <u>Palakkad</u> 2002-03 to 2004-05	Goods manufactured by large and medium scale industry (CST assessment)	$\frac{4}{2}$	84.66 crore	1.69 crore
The matter was pointed out to the department and reported to the Government in April 2009; their reply has not been received (September 2009).					
2.	CTO, Works Contract and Luxury Tax (WC & LT), <u>Ernakulam</u> 2001-02 to 2003-04	Electrical contract	$\frac{12}{8}$	16.49 crore	74.05 lakh
After the case was pointed out, the AA stated in January 2008, that supply of shunt capacitor, lightning arresters etc. would not come under entry 6 but under the residuary entry 22. The reply was not correct as the contract, according to the work order, included design, manufacture, testing, supply cum erection including all associated works and commissioning of 110 KV class current transformer and CT mounting structure, current transformers, voltage transformers and the indoor control panel duly forming cable ducts etc., and hence can only be considered under entry 6 of schedule IV to the Act taxable at 12 per cent. The matter was reported to the department in March 2008 and Government in August 2008; their reply has not been received (September 2009).					
3.	AIT and CTO, <u>Kuthiyathodu</u> 2001-02 to 2004-05	Biscuits	$\frac{12}{8}$	2.79 crore	12.66 lakh
After the case was reported to the department in February 2008 and Government in August 2008, the Government stated in December 2008 that the assessments were revised and short levy demanded. The report on recovery has not been received (September 2009).					
4.	CTO, Spl. circle, <u>Mattancherry</u> 2004-05	Coconut oil (CST assessment)	$\frac{3}{2}$	8.36 crore	10.95 lakh
After the case was pointed out, the AA stated in December 2008 that the assessee being a manufacturer of coconut oil, the interstate sales turnover was eligible for the concessional rate of two per cent available under the KGST Act. The reply was not correct as the sale being an interstate sale the rate of tax is three per cent. The matter was reported to the department in February 2009 and Government in April 2009; their reply has not been received (September 2009).					
5.	<u>CTO, Ettumanur</u> 2003-04	Rubber products (CST assessment without C form)	$\frac{12}{10}$	1.82 crore	5.52 lakh
After the case was pointed out, the AA stated in December 2008 that the matter would be examined. Further reply has not been received (September 2009). The matter was reported to the department in January 2009 and Government in February 2009; their reply has not been received (September 2009).					

Sl. No.	Assessment circle Assessment year	Commodity/ contract	Rate applicable Rate applied	Turnover (Rs.)	Short levy (Rs.)
6.	CTO, Spl. circle I, <u>Ernakulam</u> 2001-02	White oats	$\frac{12}{4}$	59.25 lakh	5.23 lakh
<p>After the case was pointed out in April 2008, the department stated in November 2008 that the assessment records were submitted to the Deputy Commissioner for <i>suo motu</i> revision and on receipt of the same the assessment would be revised. Further developments have not been reported (September 2009).</p> <p>The matter was reported to the Government in August 2008; their reply has not been received (September 2009).</p>					
7.	CTO, Spl. circle III <u>Ernakulam</u> 2000-01 to 2004-05	Interior contract work	$\frac{8.4}{5}$	1.13 crore	4.19 lakh
<p>After the case was pointed out in May 2008, the AA stated in June 2008 that the case would be examined. Further development has not been reported (September 2009).</p> <p>The matter was reported to the Government in September 2008; their reply has not been received (September 2009).</p>					
8.	CTO, Spl. circle I, <u>Ernakulam</u> 2000-01	Yeast	$\frac{12}{8}$	96.33 lakh	3.85 lakh
<p>After the case was pointed out in April 2008, the department stated in November 2008 that the assessment was completed on the basis of a decision existing at the time of the assessment and action has been initiated to re-open the assessment. Further development has not been reported (September 2009).</p> <p>The matter was reported to the Government in December 2008; their reply has not been received (September 2009).</p>					
9.	CTO, Spl. circle I, <u>Ernakulam</u> 2001-02	Heart brand flavours	$\frac{25}{12}$	17.39 lakh	2.49 lakh
<p>After the case was pointed out in April 2008, the department stated in November 2008 that the assessment records were submitted to the Deputy Commissioner for <i>suo motu</i> revision and on receipt of the same the assessment would be revised under Section 34 of the Act. Further development has not been reported (September 2009).</p> <p>The matter was reported to the Government in August 2008; their reply has not been received (September 2009).</p>					
10.	CTO, second circle, <u>Thrissur.</u> 2004-05	Packing materials (interstate sales to unregistered dealers)	$\frac{10}{4}$	41.78 lakh	2.41 lakh
<p>After the case was reported to the department in October 2008 and Government in December 2008, the Government stated in June 2009 that the assessment had been revised based on the audit objection. However, the appeal of the assessee was accepted and the department was planning to file second appeal against it. Further development has not been reported (September 2009).</p>					

### **2.4.3 Short levy of tax and interest due to non-appropriation of payment**

Under the KGST Act, where any dealer has failed to include any turnover in the return filed by him, or any turnover has escaped assessment or if the tax is not paid by him within the time prescribed, the dealer shall pay interest at the rate of one *per cent* per month for the first three months and at the rate of two *per cent* per month for subsequent months of delay. Further any tax or any other amount due or demanded is paid by the dealer, the payment so made shall be appropriated first towards interest accrued on such tax or other amount under sub section 3 of Section 23 on such date of payment and the balance available shall be appropriated towards principal outstanding. Under the Act, tax leviable on goods is to be enhanced by additional sales tax (AST) at the rate of 15 *per cent*.

**2.4.3.1** During scrutiny of records in CTO, special circle II, Kozhikode in January 2008, it was noticed that while finalising the assessments of a dealer for the years 2002-03 and 2003-04, the AA incorrectly appropriated the amount paid by the assessee towards tax due instead of first appropriating it towards interest. This resulted in short levy of tax and interest of Rs. 1.35 crore.

After the case was pointed out, the department stated in March 2008 that notice has been issued to revise the assessments. Further development has not been reported (September 2009).

The matter was reported to the Government in August 2008; their reply has not been received (September 2009).

**2.4.3.2** During scrutiny of records in CTO, Payyannur in January 2008, it was noticed that while finalising the assessments of a dealer for the year 2003-04 and 2004-05, the AA failed to levy AST, interest on the tax conceded but not paid in time and to appropriate the amount paid subsequently towards interest. This resulted in short levy of tax and interest of Rs. 6.11 lakh.

After the case was pointed out, the department stated in October 2008 that the assessments were revised. However, levy of interest on admitted tax and appropriation of payment towards interest were not seen done in the revised assessments also. Further development has not been reported (September 2009).

The matter was reported to the Government in April 2009; their reply has not been received (September 2009).

### **2.4.4 Short levy due to turnover escaping assessment**

**2.4.4.1** Under the KGST Act, 'taxable turnover' means the turnover on which a dealer is liable to pay tax after making the prescribed deductions from the total turnover. As per section 59(4) of the KGST Act, goods which were liable to tax at the point of last purchase in the State and are held as closing stock on the date preceding the date of coming into force of the Kerala Value Added Tax (KVAT) Act, 2003, shall be deemed to have acquired the quality of last purchase in the State on such date and tax is to be levied at the rate of four *per cent*. Under the KGST Act, where any dealer has failed to include any turnover in any return

filed by him or any turnover has escaped assessment, interest shall accrue on the tax due on such turnover with effect from such date on which the tax would have fallen due for payment had the dealer included it in the return relating to the period to which such turnover related. The interest payable shall be at the rate of one *per cent* per month.

- During scrutiny of records in CTO, WC & LT, Ernakulam in January 2009, it was noticed that while finalising the assessment of an assessee for the year 2004-05, the value of the closing stock of raw rubber for Rs. 5.23 crore was not assessed to tax. This resulted in short levy of tax of Rs. 21.55 lakh.

After the case was pointed out, the AA stated in February 2009 that the matter would be examined. Further reply has not been received (September 2009).

The matter was reported to the department in March 2009 and Government in April 2009; their reply has not been received (September 2009).

- During scrutiny of the records in CTO, special circle (produce), Mattancherry in May 2008, it was noticed that while finalising the assessments of 14 dealers for 2004-05, closing stock value of goods taxable at the last purchase point was not assessed to tax. This resulted in non-levy of tax of Rs. 11.70 lakh.

After the case was pointed out, the AA stated in May 2008 that action would be taken to revise the assessments. Further development has not been reported (September 2009).

The matter was reported to the department in July 2008 and Government in September 2008; their reply has not been received (September 2009).

- During scrutiny of records in CTO, special circle, Alappuzha in April 2008, it was noticed that while finalising the assessment of a dealer in sea food and spices for the year 2004-05, the AA did not include the closing stock as on 31 March 2005 of pepper valued at Rs. 1.94 crore in the total turnover. This resulted in non-levy of tax of Rs. 7.76 lakh.

After the case was reported to the department in July 2008 and Government in August 2008, the Government stated in December 2008 that the stock held by the assessee as on 31 March 2005 is the stock in the course of export in order to fulfil the export order and hence not taxable at the point of last purchase under the KGST Act. The reply was not correct as Section 59 (4) does not provide for exemption in such circumstances. Moreover, exemption under Section 5(3) of the CST Act would be available only after actual export of the goods and the dealer would get the refund of tax paid. If exemption was granted on the closing stock on the plea of sale in the course of export and export was not effected, the turnover would escape assessment.

- During scrutiny of records in AIT & CTO, Nedumkandam in March 2008, it was noticed that while finalising the assessments of five dealers in pepper for the year 2004-05, the AA did not include the closing stock as on 31 March 2005 of pepper valued at Rs. 1.64 crore in the total turnover. This resulted in non-levy of tax of Rs. 6.58 lakh.

After the case was reported to the department in April 2008 and Government in August 2008, the Government stated in March 2009 that in all the cases

assessments were revised. A report on recovery has not been received (September 2009).

- During scrutiny of records in the CTO, Chathannoor in August 2008, it was noticed that while finalising the assessment of a dealer engaged in the business of timber, for the year 2003-04, the AA though levied tax on the suppressed turnover of Rs. 94.08 lakh, did not levy interest under section 23(3A) on the tax due on the suppressed turnover. Non-levy of interest worked out to Rs. 5.76 lakh.

After the case was reported to the department in August 2008 and Government in December 2008, the Government stated in June 2009 that the assessment had been revised and entire amount demanded. The report on recovery has not been received (September 2009).

- During scrutiny of records in CTO, special circle, Kottayam, in November 2008, it was noticed that the assessment of a dealer in rubber for the year 2004-05 was originally completed in November 2007 and was revised under Section 19 of the KGST Act in February 2008 to assess the closing stock of rubber held on 31 March 2005. The assessee was engaged in the sales of rubber collected from their own estate and rubber purchased from other dealers. While revising the assessment, the closing stock was determined at Rs. 31.11 lakh instead of Rs. 1.04 crore. This resulted in short levy of Rs. 4.47 lakh by way of tax and interest.

After the case was pointed out, the AA stated in January 2009 that the case would be examined. Further report has not been received (September 2009).

The matter was reported to the department in February 2009 and Government in April 2009; their reply has not been received (September 2009).

- During scrutiny of records in CTO, special circle, Palakkad in March 2008, it was noticed that while completing the assessment of a dealer for the year 2004-05, although additional demand of Rs. 18.11 lakh was created on the basis of suppression detected, interest due on the additional demand created was not levied. This resulted in non-levy of interest of Rs. 4.16 lakh.

After the case was pointed out in March 2008, the AA issued notice to levy interest. Further development has not been reported (September 2009).

The matter was reported to the department in May 2008 and Government in August 2008; their reply has not been received (September 2009).

- During scrutiny of records in the office of the IAC, Kattapana in June 2008, it was noticed that while finalising the assessment of a dealer for the year 2004-05, the AA though levied tax on the suppressed turnover of Rs. 65.16 lakh relating to rubber cess, did not levy interest under section 23(3A) on the tax due on the suppressed turnover. Non-levy of interest worked out to Rs. 3.13 lakh.

After the case was pointed out, the Government stated in December 2008 that notice had been issued to rectify the mistake. Further report on the matter has not been received (September 2009).

- During scrutiny of records in CTO, second circle, Palakkad in March 2008, it was noticed that while completing the assessment of a dealer in rubber for

the year 2004-05, the closing stock of rubber valued at Rs. 65.35 lakh was not assessed to tax. This resulted in short levy of tax of Rs. 2.61 lakh.

After the case was pointed out, the AA stated in April 2008 that notice had been issued to revise the assessment. Further report on recovery has not been received (September 2009).

The matter was reported to the department in May 2008 and Government in August 2008; their reply has not been received (September 2009).

**2.4.4.2** Under the KGST Act, if goods liable to tax under the Act are purchased in circumstances in which no tax is payable and used in the manufacture of other goods for sale or disposed off otherwise than by way of sale, the turnover relating to such purchase is liable to tax. By a notification issued under the Act, Government have reduced the rate of tax payable on the purchase turnover of ayurvedic herbs, firewood and other articles for consumption or use in the manufacture of ayurvedic medicines to four *per cent*.

During scrutiny of records in CTO, fourth circle, Kozhikode in August 2008, it was noticed that while finalising the assessments of a dealer for the years 2002-03 and 2003-04, the purchase turnover was incorrectly estimated at 50 *per cent* of intra state sales turnover only instead of the total sales turnover. Non-inclusion of inter state sales turnover valued at Rs. 5.26 crore and forming part of the total turnover, in estimating the total purchase turnover, resulted in short levy of tax of Rs. 11.92 lakh.

After the case was pointed out, the AA stated (August 2008) that 50 *per cent* of the local sales was only a criterion adopted to arrive at the purchase turnover as no material evidence was available before the AA and it was estimated based on the total local sales effected for both the years. The reply was not correct as while arriving at such a criterion, the AA was bound to consider the total sales turnover, as the purchase was for the total production.

The matter was reported to the department in October 2008 and Government in January 2009; their reply has not been received (September 2009).

**2.4.4.3** Under the KGST Act, as it stood prior to 1 April 2004, the taxable turnover of a dealer in respect of transfer of property involved in the execution of works contract shall be arrived at after deducting labour charges and cost of establishment and profit earned to the extent it is relatable to the supply of labour.

During scrutiny of records in CTO, WC and LT, Thrissur in August 2007, it was noticed that while finalising the assessments of two dealers for 2001-02 and 2002-03, exemption of Rs. 40.78 lakh on account of labour, interstate purchase, river sand etc., was granted irregularly, thereby incorrectly computing the taxable turnover as Rs. 1.02 crore instead of Rs. 1.43 crore. This resulted in short levy of tax of Rs. 4.08 lakh.

After the cases were reported to the department in September 2007 and Government in August 2008, the Government stated in April 2009 that the assessments were revised and revenue recovery certificate issued for collection of arrear. A report on recovery has not been received (September 2009).

### **2.4.5 Non/short levy due to incorrect computation**

**2.4.5.1** Under the KGST Rules, after making final assessment, the AA shall, examine whether any and if so, what amount is due from the dealer towards the final assessment after deducting any tax already paid. Instructions in this regard have been issued by the erstwhile Board of Revenue (Taxes) laying down departmental procedures for verifying and checking all calculations and credits given in an assessment order.

- During scrutiny of records in CTO, Payyannur in January 2008, it was noticed that while finalising the assessments of two dealers for the year 2004-05, the AA erroneously computed the tax due in one case as Rs. 94,525 against Rs. 9,42,526 and in the other case tax due was worked out as Rs. 2.58 lakh against Rs. 3 lakh. This resulted in short levy of tax of Rs. 8.90 lakh.

After the case was pointed out, the department stated in October 2008 that the assessment had been revised in one case and in the other case it would be examined. Report on recovery in the first case and further development in the other case have not been received (September 2009).

The matter was reported to the Government in September 2008; their reply has not been received (September 2009).

- During scrutiny of records in CTO, second circle, Kollam in June 2008, it was noticed that while finalising the assessments of a dealer in vehicles, the sales turnover of spares for 2003-04 and 2004-05 was assessed to tax on a turnover of Rs. 45.66 lakh and Rs. 41.79 lakh respectively instead of Rs. 63.41 lakh and Rs 68.57 lakh respectively. This resulted in short levy of tax and AST of Rs. 4.04 lakh.

After the case was pointed out, the department stated in November 2008 that the assessment for the year 2003-04 was revised and notice issued to revise the assessment for the year 2004-05. Further report has not been received (September 2009).

The matter was reported to the Government in September 2008; their reply has not been received (September 2009).

- During scrutiny of records in CTO, special circle, Thrissur in April 2008, it was noticed that while finalising the assessments of a dealer in pharmaceuticals for the years 2002-03 to 2004-05, the AA arrived at the balance tax due for the three years as Rs 3.32 lakh. However, after setting off an excess credit of Rs. 1.01 lakh for the year 2001-02 against the balance tax due for the years 2002-03 to 2004-05, the AA arrived at the balance tax due as 'Nil'. This resulted in short levy of tax and interest of Rs. 2.84 lakh.

After the case was pointed out, the Government stated in December 2008 that the assessments were revised. A report on recovery has not been received (September 2009).

- During scrutiny of records in CTO, second circle, Palakkad in March 2008, it was noticed that while finalising the assessment of a dealer engaged in manufacture and sale of cotton yarn for the year 2004-05, the AA incorrectly computed tax due on the taxable turnover of Rs. 1.36 crore as

Rs. 31,000 instead of Rs. 3.12 lakh. This resulted in short levy of tax of Rs. 2.81 lakh.

After the case was pointed out, the Government stated in December 2008 that the mistake had been rectified and revenue recovery certificate issued for realisation of arrears. A report on recovery has not been received (September 2009).

**2.4.5.2** Under the KGST Act, any dealer in gold or silver ornaments or wares, may at his option instead of paying tax on his taxable turnover at the rates shown in the schedule to the Act, pay compounded tax at two hundred *per cent* of tax payable by him as conceded in the return or accounts or the tax paid for the immediate preceding year whichever is higher. Further, if an assessee paying tax in accordance with the provisions of section 7(1) (a) of the Act, opens a new branch during a year, such branch shall be treated as an independent place of business and these provisions shall also apply to it.

During scrutiny of records in CTO, special circle I, Ernakulam in February 2008, it was noticed that while finalising the assessment for the year 2003-04, of a dealer in jewellery of gold who was paying tax under the KGST Act for his principal place of business and had not opted for compounding, the AA incorrectly allowed the assessee to pay compounded tax for their newly opened branches. This resulted in short levy of tax of Rs. 22.66 lakh.

After the case was reported to the department in April 2008 and Government in August 2008, the Government stated in July 2009 that the assessment had been set aside for fresh disposal. Further report on the matter has not been received (September 2009).

#### **2.4.6 Non/short levy in fast track assessments**

Under the KGST Act, a fast track method of completion of assessment was introduced vide Kerala Finance Act 2007, whereby all KGST assessments upto 2004-05 were to be completed by a team of officers. Under the provisions of the Act, no assessment completed by the teams shall be reopened unless there is fresh receipt of material pertaining to tax evasion and in other case the assessment may be reopened with the prior permission of CCT.

The deficiencies noticed in three CTOs while finalising fast track assessments were as mentioned below.

Sl. No.	Assessment circle Year of assessment	Nature of objection	Turnover (Rs.)	Tax effect (Rs.)
1.	CTO, Spl. circle (Produce), <u>Mattancherry</u> 2001-02 to 2004-05	Taxable turnover pertaining to electrical contract exceeding Rs. 50 lakh was assessed to tax at the rate of five <i>per cent</i> instead of at the correct rate of 5.6 <i>per cent</i> .	14.24 crore	9.82 lakh
	2002-03 to 2004-05	While finalising the assessments of a dealer in foreign liquor, surcharge was not levied on the total tax due for the three years.	48.16 lakh	4.82 lakh

Sl. No.	Assessment circle Year of assessment	Nature of objection	Turnover (Rs.)	Tax effect (Rs.)
	2002-03 to 2004-05	While finalising the assessments of a dealer in foreign liquor, the tax collected on the sale of imported spirit and wine was omitted from the levy of turnover tax.	48.15 lakh	4.82 lakh
	2001-02	The AA incorrectly exempted the sales turnover of tea, claimed by the assessee as export sales, not covered by declaration in form H and other supporting documents, and thus taxable at 10 <i>per cent</i> .	37.93 lakh	3.79 lakh
	2003-04	Tax due on sale of rubber was incorrectly computed as Rs. 4.75 crore instead of Rs. 4.79 crore.		3.65 lakh
	2001-02 to 2004-05	The AA incorrectly applied the rate of 10 <i>per cent</i> instead of the correct rate of 11 <i>per cent</i> plus AST, on the inter state sales turnover of rubber not covered by declaration in form C.	1.05 crore	2.77 lakh
	2001-02	The AA incorrectly appropriated the remittances amounting to Rs. 7.25 lakh paid by the assessee during the months of October 2003 and March 2007 towards tax due instead of first appropriating it towards interest. As a result, instead of granting credit of Rs. 1.43 crore, the assessee was allowed an incorrect credit of Rs. 1.46 crore.		2.69 lakh
<p>After the cases were pointed out, the AA stated in June 2008 that the assessments were revised and short levy made good. It was however, noticed that the assessments were completed under the fast track scheme. Revision of assessment could be made only with the prior permission of CCT and hence the assessments revised at the lower level would be null and void.</p> <p>The matter was reported to the department in July 2008 and Government in September 2008; their reply has not been received (September 2009).</p>				
2.	<u>IAC, Kattappana</u> 2003-04 and 2004-05	The AA failed to levy tax on the purchase turnover of raw materials purchased from unregistered dealers for the manufacture of <i>ayurvedic</i> soaps, even though the assessee had returned it as taxable.	76.85 lakh	3.54 lakh
<p>After the case was reported to the department in July 2008 and Government in August 2008, the Government stated in April 2009 that as the assessments were completed under fast track scheme, the AA had requested the permission of CCT to revise the assessments. Further development in the matter has not been reported (September 2009).</p>				
3.	<u>CTO, special circle III, Ernakulam</u> 2003-04 and 2004-05	The AA incorrectly levied tax on the sales turnover of water purifier at the rate of eight <i>per cent</i> instead of at the correct rate of 12 <i>per cent</i> .	51.45 lakh	2.35 lakh

After the case was pointed out, the AA stated in June 2008 that detailed reply would be furnished immediately. Further reply has not been received (September 2009). The matter was reported to the department in July 2008 and Government in September 2008; their reply has not been received (September 2009).
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#### **2.4.7 Non-levy of additional sales tax**

**2.4.7.1** Under the CST Act, inter state sale of goods, other than declared goods, if not supported by declaration in form C, is liable to tax at the rate of 10 *per cent* or at the rate applicable to the sale or purchase of such goods under the KGST Act, whichever is higher. Under the KGST Act, tax leviable on goods is to be enhanced by additional sales tax at the rate of 15 *per cent*.

During scrutiny of records in CTO, fourth circle, Kozhikode in August 2008, it was noticed that while finalising the assessments of a dealer in fairness oil and *ayurvedic* soap for the year 2002-03 to 2004-05, the AA levied tax at the rate applicable under the KGST Act i.e. 20 and 12 *per cent* respectively, on the inter state sales turnover of goods, not covered by form C but omitted to enhance the tax by additional sales tax leviable under the KGST Act. This resulted in short levy of tax of Rs. 14.03 lakh.

After the case was pointed out, the department did not furnish any specific reply (September 2009).

The matter was reported to the Government in January 2009; their reply has not been received (September 2009).

**2.4.7.2** During scrutiny of records in CTO, special circle I, Kozhikode in November 2008, it was noticed that while finalising the assessment of a dealer in jewellery of gold for the year 2004-05, tax at compounded rate was fixed at Rs. 40.69 lakh. But AST leviable at 15 *per cent* on the tax was not levied. This resulted in non-levy of AST of Rs. 6.10 lakh.

After the case was reported to the department in January 2009 and Government in March 2009, the Government stated in July 2009, that AST was included in the compounded tax determined. The reply was not tenable as under Section 5 D of the KGST Act, tax payable should be increased by an additional sales tax at the rate of 15 *per cent*. Besides, the High Court of Kerala in its judgment<sup>21</sup> has held that additional tax was also leviable on compounded tax.

#### **2.4.8 Non-levy of tax due to misuse of Form 18 declaration**

Under Section 5(3) of the KGST Act, tax payable by a dealer in respect of any sale of industrial raw materials, component parts, containers or packing materials which are liable to tax at a rate higher than three *per cent* when sold to any industrial unit for use in the manufacture of finished products inside the State for sale or for packing of the finished products inside the State for sale shall be three *per cent*, provided declarations in form 18 are filed. Under sub clause (ii) of the above section and under section 45A (1) (f) of the Act, where any dealer after purchasing any goods by furnishing form 18 declarations, fails

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<sup>21</sup> M/s Bhima Jewellery Vs The Assistant Commissioner (Assessment) and ANR in 12 KTR 80.

to make use of the goods for the purpose for which it was furnished, shall be liable to pay the tax that would have been payable by him, had the declaration not been furnished less tax, if any, paid by him and penalty not exceeding double the amount of tax sought to be evaded. The dealer is also liable to pay interest on the tax evaded.

During scrutiny of records in CTO, special circle, Kollam in August 2006, it was noticed that a dealer in aluminium/stainless steel utensils, pressure cooker etc., had purchased zinc using form 18 declarations which was not used inside the State for the manufacture of finished products but was used only as a consumable in the galvanization process of electrical line materials, on behalf of Kerala State Electricity Board, during 2000-01 to 2002-03. The AA however, did not levy tax on the aforesaid item. This resulted in a short levy of tax, interest and penalty of Rs. 13.73 lakh.

After the case was pointed out, the department revised the assessments in December 2008 creating an additional demand of Rs. 16.76 lakh by way of tax, interest and penalty. A report on recovery has not been received (September 2009).

The matter was reported to the Government in April 2009; their reply has not been received (September 2009).

#### **2.4.9 Non-forfeiture of tax**

Under the KGST Act, any sum collected by any person by way of tax in contravention of Section 22 of the Act shall be liable to be forfeited to the Government by an order issued by the AA.

During scrutiny of records in CTO, special circle I, Ernakulam in March 2008, it was noticed that while finalising the assessment of a dealer in drugs for the year 2002-03, the AA levied tax on the turnover of Rs. 41.63 lakh at the rate of eight *per cent* even though the assessee had collected tax and returned it as taxable at the rate of 12.5 *per cent*. However, the excess tax collected was not forfeited to Government. This resulted in non-forfeiture of tax of Rs. 2.15 lakh.

After the case was pointed out, the department stated in November 2008 that report would be furnished separately. Further development has not been received (September 2009).

The matter was reported to the Government in August 2008; their reply has not been received (September 2009).

#### **2.4.10 Non/short raising of demand**

The KGST Rules and the instructions issued in February 1992 by the erstwhile Board of Revenue (Taxes), lay down departmental procedures for verifying and checking of all calculations and credits in an assessment order as well as in issuing demand notice and revenue recovery certificate.

**2.4.10.1** During scrutiny of records in CTO, second circle, Thiruvananthapuram in March 2008, it was noticed that while reopening the assessments, completed under section 17(4) of the KGST Act, of a dealer, on detection of suppressed turnover for the years 2001-02 and 2002-03, the AA

levied tax, interest and penalty of Rs. 55.72 lakh for the years 2001-02 and 2002-03 and demand notice was issued for that amount. But RRC was issued for Rs. 40.73 lakh only leaving a balance of Rs. 14.99 lakh. This has resulted in short demand of Rs. 14.99 lakh in the revenue recovery certificate issued.

After the case was reported to the department in April 2008 and Government in August 2008, the Government stated in December 2008 that the mistake has been rectified and the short demand has been advised for revenue recovery. A report on recovery has not been received (September 2009).

**2.4.10.2** During scrutiny of records in the CTO, WC and LT, Ernakulam in January 2008, it was noticed that while finalising the assessment of a dealer in works contract for the year 2002-03, the AA exempted the turnover of works contract valued at Rs. 76.49 lakh executed on sub-contract basis as the turnover was assessed on the principal contractor. However, credit for tax paid on this turnover was afforded both to the principal contractor as well as to the assessee. This resulted in incorrect grant of credit of Rs. 7.39 lakh.

After the case was reported to the department in March 2008 and Government in July 2008, the Government stated in December 2008 that the assessment had been revised withdrawing the credit and the balance dues was advised for revenue recovery. A report on recovery has not been received (September 2009).

### Value Added Tax

#### 2.4.11 Misclassification of goods

During scrutiny of records in nine CTOs<sup>22</sup> between August 2008 and January 2009, it was noticed that in 15 cases the dealers misclassified the goods and tax was paid at rates ranging between zero and four *per cent* instead of four and 12.5 *per cent* as mentioned below:

Sl. No.	Name of Office Returned year	Commodity	Rate applicable Rate applied	Turnover (Rs.)	Short levy of tax and interest (Rs. in lakh)
1	Special circle, Thiruvananthapuram 2005-06 and 2006-07	Modem	$\frac{12.5}{4}$	4.93 crore	52.73
After the case was pointed out in January 2009, the department revised the assessments in February 2009, levying tax and interest as pointed out in audit. A report on recovery has not been received (September 2009).					
	2006-07	Set top box	$\frac{12.5}{4}$	62.98 lakh	7.82
After the case was pointed out in January 2009, the department revised the assessment in March 2009 levying tax on set top boxes at 12.5 <i>per cent</i> along with interest. A report on recovery has not been received (September 2009).					

<sup>22</sup> Cherthala, Karunagappally, first circle Kollam, Kunnankulam, Manjeri, Punalur, Nedumangad, spl. circle Thiruvananthapuram and second circle Thrissur.

	2005-06 and 2006-07	Pigments and preparation based on iron oxide	$\frac{12.5}{4}$	71.17 lakh	7.60
	After the case was pointed out in December 2008, the AA stated in December 2008 that the matter would be examined. Further report has not been received (September 2009).				
	2005-06	Rubber trees	$\frac{12.5}{4}$	31.02 lakh	3.48
	After the case was pointed out, the AA stated in December 2008, that the case would be examined. Further reply has not been received (September 2009).				
2.	<u>CTO, Kunnankulam</u> 2005-06	Harpic and Lizol	$\frac{12.5}{4}$	1.17 crore	21.49 lakh
	2006-07	Dettol	$\frac{4}{0}$	54.78 lakh	
	After the case was pointed out, the AA stated in January 2009 that the case would be examined. Further reply has not been received (September 2009).				
	2005-06 and 2006-07	Ayurvedic tooth powder	$\frac{12.5}{4}$	47.34 lakh	5.00
	After the case was pointed out, the department stated in June 2009 that notice had been issued to revise the assessment. Further development has not been reported (September 2009).				
	2005-06 and 2006-07	Harpic	$\frac{12.5}{4}$	31.50 lakh	3.40
	After the case was pointed out, the AA stated in January 2009 that the case would be examined. Further reply has not been received (September 2009).				
	2006-07	Vicks	$\frac{12.5}{0}$	22.05 lakh	3.34
	After the case was pointed out, the AA stated in January 2009 that the case would be examined. Further reply has not been received (September 2009).				
3.	<u>Second circle, Thrissur</u> 2006-07	PVC doors and frames	$\frac{12.5}{4}$	95.01 lakh	8.08
	After the case was reported to the department in October 2008 and Government in January 2009, the Government stated in July 2009, that the PVC profiles were taxable at four <i>per cent</i> vide clarification of the CCT. The reply was not correct as the entry 99(1)(l)(iii) relates to pipes, channels, profiles made of plastic/PVC, while, doors, windows, ventilators, partitions made of any material including plastic were included in residuary schedule taxable at the rate of 12.5 <i>per cent</i> .				
4.	<u>CTO, Cherthala</u> 2005-06	Mosquito repellent, Harpic, Lizol etc.	$\frac{12.5}{4}$	42.99 lakh	4.65
	After the case was pointed out, the AA stated in December 2008 that the matter would be examined. Further reply has not been received (September 2009).				
5.	<u>CTO, Punalur</u> 2005-06 and 2006-07	Expeller variety of Ground nut and coconut oil cake	$\frac{4}{0}$	98.29 lakh	3.93

	After the case was reported to the Government in January 2009, the Government stated in June 2009 that the assessment had been revised. A report on recovery has not been received (September 2009).				
6.	<u>CTO, Nedumangad</u> 2005-06 and 2006-07	Expeller variety of Gingilly oil cake	$\frac{4}{0}$	74.91 lakh	3.00
	After the case was pointed out, the Government stated in January 2009 that the escaped turnover was brought to assessment creating an additional demand of Rs. 3 lakh. A report on recovery has not been received (September 2009).				
7.	<u>CTO, Manjeri</u> 2005-06 and 2006-07	Warranty replacement charges of vehicles	$\frac{12.5}{0}$	21.62 lakh	2.70
	After the case was pointed out, the AA stated in August 2008 that the case would be examined. Further reply has not been received (September 2009).				
8.	<u>CTO, Karunagappally</u> 2005-06	Coconut oil cake	$\frac{4}{0}$	46.72 lakh	2.39
	After the case was pointed out, the department stated in January 2009 that the assessment was revised, creating an additional demand of Rs. 1.94 lakh and interest of Rs. 0.56 lakh. A report on recovery has not been received (September 2009).				

The cases were reported to the Government in April 2009; their reply has not been received in respect of cases other than the three cases<sup>23</sup> mentioned in the table (September 2009).

### **Miscellaneous observations**

#### **2.4.12 Non/short levy of output tax**

**2.4.12.1** Under the KVAT Act, in the case of transfer of goods involved in the execution of works contract, where transfer is not in the form of goods, but in some other form, the contractor shall pay tax at the rates applicable to the goods used in the work upto 30 June 2006 and at 12.5 *per cent* thereafter irrespective of the nature of goods.

During scrutiny of records in CTO, WC & LT, Ernakulam in February 2009, it was noticed that while scrutinising the self assessment of a contractor who transferred goods in some other form for the year 2006-07 was incorrectly assessed to tax on the goods so transferred at the rate applicable to the goods instead of 12.5 *per cent* from July 2006. Besides this, output tax was also assessed for a turnover less than that revealed in the accounts. This resulted in short assessment of tax of Rs. 85.55 lakh.

After the case was pointed out, the AA stated in February 2009 that the case would be examined. Further reply has not been received (September 2009).

The matter was reported to the department in March 2009 and Government in April 2009; their reply has not been received (September 2009).

<sup>23</sup> CTO Nedumangad, Punalur and second circle Thrissur.

**2.4.12.2** Under the KVAT Act, any discount allowed after the sale is over by issuing credit notes, which is not reflected in the invoice, shall not be exempted from the turnover.

During scrutiny of records in CTO, special circle I, Kozhikode in November 2008, it was noticed that a dealer in cement during 2005-06 excluded from his turnover, trade discount of Rs. 2.16 crore allowed through credit notes subsequent to sale which were not reflected in the sales invoice. Failure to take action to get the defect rectified resulted in short levy of output tax and interest of Rs. 35.12 lakh.

After the case was pointed out, the AA stated in December 2008 that notice had been issued. Further reply has not been received (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

**2.4.12.3** Instructions issued by the erstwhile Board of Revenue (Taxes) lay down departmental procedures for verifying and checking all calculations and credits given in an assessment order.

During scrutiny of records in CTO, special circle, Thiruvananthapuram in December 2008, it was noticed that a dealer in cooked food, soda/soft drinks and ice cream for the year 2006-07, assessed output tax on sales turnover of the above items for Rs. 15.54 crore as conceded in the return instead of at the actual sale of Rs. 15.75 crore disclosed in the certified annual accounts. Short levy of output tax and interest on the differential turnover of Rs. 21.49 lakh works out to Rs. 3.60 lakh.

After the case was pointed out, the AA stated in December 2008 that the matter would be examined. Further report has not been received (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

### **2.4.13 Excess/incorrect allowance of input tax**

**2.4.13.1** Under the KVAT Act, input tax credit on stock transfer of goods outside the state is not permitted. However, in such cases input tax paid in excess of four *per cent* can be refunded while input tax of four *per cent* already allowed shall be assessed as reverse tax.

- During scrutiny of records in CTO, special circle I, Kozhikode in December 2008, a dealer in palmolein/palmoil availed input tax credit of Rs. 1.33 crore on entire purchase of palmolein/palmoil and duty entitlement pass book (DEPB) licenses during 2005-06. The dealer did not assess input tax proportionate to the turnover of consignment sale of palmoil as reverse tax. Failure to take action to get the defect rectified resulted in short levy of output tax and interest of Rs. 45.53 lakh.

After the case was pointed out, the AA stated in December 2008 that notice was issued. Further report has not been received (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

- During scrutiny of records in CTO, special circle, Kannur in December 2008, it was noticed that an assessee engaged in manufacture and sale of furniture/treated rubber wood, transferred products valued at Rs. 5.40 crore to outside the State otherwise than by way of sale during the years 2005-06 and 2006-07. However, the assessee availed input tax credit on the entire tax paid, on purchase of raw materials, instead of limiting it to tax paid in excess of four *per cent*. This resulted in excess input tax credit of Rs. 9.20 lakh. Even after adjusting the excess input tax credit of Rs. 6.21 lakh, tax due but not demanded worked out to Rs. 2.98 lakh.

After the case was pointed out, the AA stated in December 2008 that since the assessee had availed of input tax credit fully, reverse tax under Section 11(7) and other tax liability would be ascertained after gathering details. Further developments have not been reported (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

**2.4.13.2** Under the KVAT Act, no input tax credit shall be allowed for the purchases of goods which are used in the manufacture, processing or packing of goods specified in the First or Fourth Schedule. Under the KVAT Rules, if taxable goods are used partly in relation to taxable and exempted transaction, input tax/special rebate should be apportioned in the ratio of taxable and exempted turnover and input tax pertaining to exempted turnover should be disallowed.

- During scrutiny of the records in CTO, special circle I, Kozhikode in November and December 2008, it was seen that three assessees engaged in the manufacture and sale of wheat and wheat products during 2005-06 and 2006-07, availed entire input tax credit on tax paid on purchase of wheat, though input tax credit proportionate to turnover of wheat bran included in Schedule I as well as consignment sale of wheat products were to be disallowed. Failure to get the defects rectified resulted in grant of excess input tax credit and interest of Rs. 15.32 lakh.

After the case was pointed out, the AA stated between November 2008 and December 2008 that in one case an amount of Rs. 8.12 lakh has been collected and notice issued in respect of the other two cases. Further development has not been reported (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

- During scrutiny of records in CTO, special circle, Kannur in December 2008, it was noticed that input tax on raw materials to be disallowed on non-taxable sale of coir product and consignment sale of fibre foam mattress was incorrectly arrived at by a manufacturer at Rs. 2.61 lakh and Rs. 3.48 lakh instead of Rs. 6.28 lakh and Rs. 7.40 lakh for the years 2005-06 and 2006-07. Failure to rectify the defects resulted in short levy of tax and interest of Rs. 9.55 lakh.

After the case was pointed out, it was stated in December 2008 that the case would be examined. Further report has not been furnished (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

**2.4.13.3** Under the KVAT Act, no input tax credit shall be allowed for the purchases from a dealer paying compounded tax under the Act.

During scrutiny of records in CTO, special circle I, Kozhikode in November 2008, it was noticed that during the year 2006-07, a dealer in medicine who opted for payment of compounded tax availed input tax credit of Rs. 4.03 lakh for purchases aggregating Rs. 31.32 lakh from dealers who had also opted for payment of tax under compounding. No action was taken to disallow the input tax credit. This resulted in short levy of tax of Rs. 4.03 lakh.

After the case was pointed out, the AA stated in November 2008 that notice had been issued. Further report has not been received (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

**2.4.13.4** Under the KVAT Act, a dealer can avail input tax credit of tax paid on the purchases made by him.

During scrutiny of records in CTO, special circle I, Kozhikode in November 2008, it was noticed that a dealer in cement in his return for 2005-06 claimed input tax credit of Rs. 3.91 lakh against advance payment of KGST for 2004-05 and special rebate of Rs. 3.22 lakh which actually pertained to provision for discount, which were not allowable under the Act. The omission to rectify the defects resulted in granting of excess input tax credit of Rs. 7.13 lakh.

After the case was pointed out in November 2008, the AA issued notice to rectify the defect. Further report has not been received (September 2009).

The matter was reported to the department in January 2009 and Government in April 2009; their reply has not been received (September 2009).

#### **2.4.14 Turnover escaping assessment**

Under the KVAT Act, if any part of the turnover of business of a dealer escaped assessment to tax, the AA can proceed to determine to best of his judgment, turnover which has escaped assessment to tax and where any dealer has failed to include any turnover of his business in any return filed or any turnover or tax has escaped assessment, interest shall accrue on the tax due on such turnover or tax with effect from such date on which the tax would have fallen due for payment. The defaulter shall pay simple interest at the rate of 12 *per cent* per annum on the tax or other amount defaulted. Further, accessories of motor vehicles are taxable at the rate of 12.5 *per cent* and used vehicles at the rate of four *per cent*. It has been judicially held<sup>24</sup> by the Apex Court that payment received by the assessee from the manufacturer, on account of replacement of defective parts as a result of the warranty agreement between manufacturer and customer, is sale of goods and liable to tax.

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<sup>24</sup> M/s Mohd. Ekram Khan & Sons Vs Commissioner of Trade tax of UP in 12 KTR 572 (SC)

**2.4.14.1** During scrutiny of records in CTO, special circle, Thiruvananthapuram in November 2008, it was noticed that a dealer claimed exemption for an amount of Rs. 1.67 crore towards labour charges during the year 2005-06 but failed to include the sales turnover on account of warranty claims estimated at 50 *per cent* of the warranty charge in respect of replacement of defective parts valued at Rs. 87.89 lakh in the taxable turnover. This resulted in short levy of tax and interest of Rs. 14. 61 lakh.

After the case was pointed out, the AA stated in December 2008 that the assessment had been revised and balance tax demanded. A report on recovery has not been received (September 2009).

The matter was reported to the department in January 2009 and Government in March 2009; their reply has not been received (September 2009).

**2.4.14.2** During scrutiny of records in CTO, special circle, Thiruvananthapuram in November 2008, it was noticed that during the year 2005-06, a dealer in automobiles, did not include the sales turnover on account of 'Offer-Accessories' valued at Rs. 37.69 lakh and income derived from exchange of old vehicles valued at Rs. 4.23 lakh, in the taxable turnover. This resulted in short levy of tax and interest of Rs. 6.49 lakh.

After the case was pointed out, the AA stated in December 2008 that the assessment had been revised rectifying the mistake. Report on recovery has not been received (September 2009).

The matter was reported to the department in January 2009 and reported to the Government in March 2009; their reply has not been received (September 2009).