

CHAPTER-II
EXECUTIVE SUMMARY

Tax collection	In 2012-13, the collection of taxes on sales, trade, etc. which stood at ₹ 28,414.44 crore, had increased by 13.57 <i>per cent</i> over the previous year.
Recovery by the Department against observations pointed out by us in earlier years	During the last five years, through our Audit Reports, we had pointed out non/short levy, incorrect exemption of tax, non/short levy of interest/penalty on tax, etc with revenue implication of ₹ 339.59 crore in 51 paragraphs. Of these, the Government/Department accepted audit observations in 37 paragraphs involving ₹ 32.14 crore and recovered ₹ 7.02 crore which was 21.84 <i>per cent</i> of the revenue involved in the total accepted cases.
Results of audit conducted by us in 2012-13	We conducted a test check of the records of 161 offices of the Commercial Taxes Department covering VAT, Sales tax, Entry tax, and Professions tax during the year 2012-13, which revealed under-assessments of tax and other irregularities involving ₹ 241.66 crore in 734 paragraphs. Of these, the Department accepted and recovered ₹ 6.92 crore in 309 paragraphs which were pointed out in earlier years in respect of VAT.
What we have highlighted in this chapter	<p>A Performance Audit on “Online Systems in the Commercial Taxes Department” revealed the following:</p> <p>The Commercial Taxes Department (CTD) did not introduce a protocol for deactivation of user accounts after de-registration of dealers.</p> <p style="text-align: right;">(Paragraph 2.8.10.1)</p> <p>System lacked controls to validate tax paid in original returns, resulting in loss of revenue of ₹ 1.98 crore.</p> <p style="text-align: right;">(Paragraph 2.8.11.1)</p> <p>System lacked controls to validate the carryover of excess credit to the subsequent return resulting in erroneous carry forward in 32,846 cases.</p> <p style="text-align: right;">(Paragraph 2.8.11.2)</p> <p>System lacked controls to ensure that hoteliers who opted for composition of tax, are paying taxes at the correct rate, resulting in short levy of ₹ 69.07 lakh.</p> <p style="text-align: right;">(Paragraph 2.8.11.4)</p>

<p>System lacked controls to prevent claim of input tax credit (ITC) on purchases from dealers opting for composition of tax, resulting in excess ITC claim of ₹ 1.18 crore.</p> <p style="text-align: right;">(Paragraph 2.8.11.9)</p> <p>System lacked controls to levy penalty on understatement of tax liability in Original Returns resulting in non-levy of penalty of ₹ 30.12 crore.</p> <p style="text-align: right;">(Paragraph 2.8.11.10)</p> <p>System lacked controls to prevent submission of nil returns by metal crushing units who had opted for composition of tax.</p> <p style="text-align: right;">(Paragraph 2.8.11.12)</p> <p>System lacked controls to compute interest on belated payment of taxes resulting in loss of revenue to the extent of ₹ 1.65 crore.</p> <p style="text-align: right;">(Paragraph 2.8.12.2)</p> <p>System lacked controls to ensure validity period of Delivery Notes issued online.</p> <p style="text-align: right;">(Paragraph 2.8.14)</p> <p>System lacked the necessary output controls to ensure the accuracy of MIS reports.</p> <p style="text-align: right;">(Paragraph 2.8.15)</p> <p>A Performance Audit on “Input tax credit under Karnataka Value Added Tax Act, 2003” revealed the following:</p> <p>Purchase details of only 25 <i>per cent</i> of the ITC claimed in the returns was available in the EFS database indicating laxity on the part of the Department in monitoring the grant of ITC through submission of purchase details as provided in the KVAT Rules.</p> <p style="text-align: right;">(Paragraph 2.9.7.1)</p> <p>The data available in the EFS database was not found correct and reliable for verifying the correctness of the ITC claims. Incorrect Tax payers Identification Number (TIN), absence of TIN in the master table of the database and other mistakes/errors were noticed in purchase invoice involving tax of ₹ 609.95 crore.</p> <p style="text-align: right;">(Paragraph 2.9.7.2)</p> <p>CTD had not initiated action to disallow ITC claims of ₹ 21.54 crore claimed on purchase invoice issued by deregistered dealers.</p> <p style="text-align: right;">(Paragraph 2.9.8)</p> <p>Analysis of the database revealed suppression of</p>
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sales by 4,531 selling dealers involving tax effect of ₹ 86.88 crore in respect of which ITC claims had been availed by the purchasing dealers.

(Paragraph 2.9.9.1)

Loss of revenue of ₹ 1.05 crore was noticed due to non-submission of purchasing invoices and filing of 'Nil' returns by selling dealers.

(Paragraph 2.9.10.1)

In three LVOs the tax declared by 11 sellers in their returns was lesser than that shown in the invoices resulting in loss of revenue of ₹ 53.92 lakh. The selling dealers were also liable to pay penalty of ₹ 5.39 lakh and interest of ₹ 17.08 lakh.

(Paragraph 2.9.10.3)

15 purchasing dealers in 10 LVOs claimed ITC of ₹ 1.03 crore in their returns though no returns were filed by selling dealers. This resulted in incorrect grant of ITC to that extent.

(Paragraph 2.9.10.4)

ITC claims of ₹ 15.58 lakh were incorrectly allowed as the purchases were made either from de-registered dealers or selling dealer had declared turnover less than the ITC Claimed/filed 'nil' returns/had not filed returns for the corresponding tax period.

(Paragraph 2.9.11)

In 260 cases though the dealers had under-declared their tax liability by ₹ 5.19 crore, their annual statements were approved by the LVOs.

(Paragraph 2.9.12.1)

In 24 cases the dealers had neither repaid the excess ITC claimed in the returns nor adjusted it in any of the subsequent returns filed by them. The excess claim of ITC in these cases amounted to ₹ 81.20 lakh.

(Paragraph 2.9.13)

Incorrect grant of refunds aggregating to ₹ 21.52 lakh in 23 cases and excess grant of refund of ₹ 49.41 lakh in one case were noticed during 2010-12.

(Paragraph 2.9.14)

CHAPTER-II: COMMERCIAL TAXES

2.1 Tax administration

The levy and collection of Value Added Tax (VAT) and Sales tax are governed by the Karnataka Value Added Tax Act, 2003 (KVAT Act), the Central Sales Tax Act, 1956 (CST Act), the Karnataka Sales Tax Act, 1957 (KST Act) and other minor Acts and the rules made thereunder. The Commercial Taxes Department (CTD) (consisting of Taxes on Sales, Trade etc, Professions Tax, Entry Tax, Entertainment Tax, Luxury Tax) is under the administrative control of the Finance Department and headed by the Commissioner of Commercial Taxes (CCT). The CCT is assisted by 14 Additional Commissioners and Joint Commissioners (JCCTs) Minor Acts, Enforcement, Vigilance and there are 13 Divisional VAT Offices (DVO) in the State each headed by JCCT and 13 JCCT (Appeals) and 148 Audit Offices headed by Deputy Commissioners (DCCT) and Assistant Commissioners (ACCT). At the field level, VAT is being administered through 95 Local VAT Offices (LVOs) and VAT Sub Offices (VSOs) headed by ACCTs and Commercial Tax Officers (CTOs) respectively. The computer cell of the CTD is headed by an Additional Commissioner.

2.2 Trend of receipts

Budget Estimates (BEs) and actual receipts from taxes on sales, trade etc. during the years 2008-09 to 2012-13 along with the total tax receipts during the same period is exhibited in the following table and graphs.

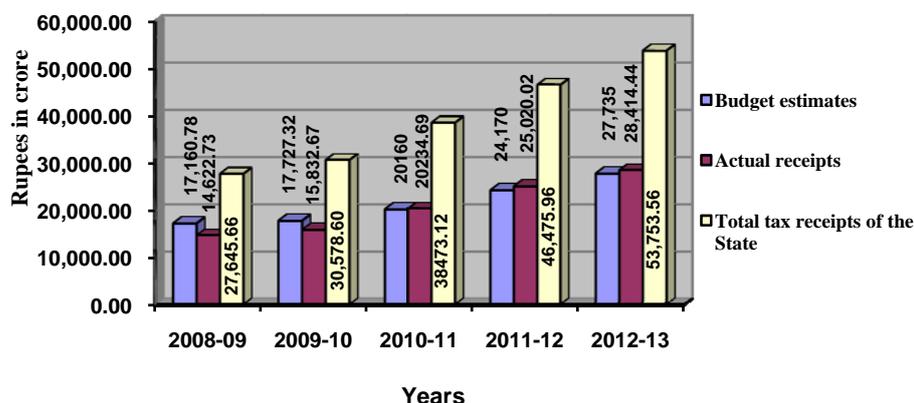
Table 2.1: Trend of receipts

(₹ in crore)						
Year	Budget estimates	Actual receipts	Variation excess(+)/shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
2008-09	17,160.78	14,622.73	(-) 2,538.05	(-) 14.79	27,645.66	52.89
2009-10	17,727.32	15,832.67	(-) 1,894.65	(-) 10.69	30,578.60	51.78
2010-11	20,160.00	20,234.69	(+) 74.69	(+) 0.37	38,473.12	52.59
2011-12	24,170.00	25,020.02	(+) 850.02	(+) 3.52	46,475.96	53.83
2012-13	27,735.00	28,414.44	(+) 679.44	(+) 2.45	53,753.56	52.86

It would be seen from the above that percentage of variation between the budget estimates and actuals except for 2008-09 and 2009-10 was less than four *per cent* indicating that the budget estimates were made on realistic basis.

The percentage of actual receipts of VAT to the total tax receipts ranged between 51.78 and 53.83 *per cent* during five year period from 2008-09 to 2012-13.

Graph 2.1 : Budget estimates, Actual receipts and Total tax receipts



2.3 Cost of VAT collection per assessee

The number of assessees, cost of collection, and the cost of VAT per assessee during 2008-09 to 2012-13 were as follows:

Table 2.2: Cost of collection per assessee

(Amount in ₹)			
Year	Number of assessees	Cost of VAT collection ¹	Cost of VAT collection per assessee
2008-09	4,01,817	1,31,48,20,000	3,272
2009-10	4,16,265	1,48,28,87,000	3,562
2010-11	4,03,639	1,65,43,02,000	4,099
2011-12	4,44,470	1,92,76,01,000	4,336
2012-13	4,67,376 ²	2,48,14,33,000	5,309

The cost of collection per assessee has increased from ₹ 3,272 to ₹ 5,309 i.e. an increase of 62 per cent. Reasons for increase in the cost of collection were not received despite being requested.

2.4 Cost of collection

The gross collection in respect of taxes on sales, trade etc, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2010-11, 2011-12 and 2012-13 along with the relevant all India average percentage of expenditure on collection to gross collection for the respective preceding years were as follows:

¹ The figures in this column varies from those mentioned in the earlier reports. In the earlier reports expenditure booked under the minor head, 101-collection charges only was considered for arriving at the cost of collection. However, this year, the expenditure booked under 001-direction and administration also has been considered as cost of collection.

² This information though called for was not furnished by the Department. Hence the same was obtained from the database of CTD as on 30 September 2012.

Table 2.3: Cost of collection

Year	Gross collection	Expenditure on collection ¹	Percentage of cost of collection to gross collection	All India average percentage for the preceding year
	(₹ in crore)			
2010-11	21,252.97	165.43	0.78	0.96
2011-12	26,203.81	192.76	0.74	0.75
2012-13	29,848.75	248.14	0.83	0.83

2.5 Impact of Audit Reports

During the last five years, through our Audit Reports, we had pointed out non/short levy of tax, incorrect exemption of tax, non/short levy of interest/penalty on tax, etc., with revenue implication of ₹ 339.59 crore in 51 paragraphs. Of these, the Government/Department accepted audit observations in 37 paragraphs involving ₹ 32.14 crore and recovered ₹ 7.02 crore as on 31 March 2013. The details are shown in the following table:

Table 2.4: Compliance with earlier Audit Reports by CTD

(₹ in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ³	Number	Amount
2008-09	09	7.41	07	2.61	06	2.69
2009-10	09	15.29	09	10.79	07	1.32
2010-11	10	79.26	06	0.53	06	0.43
2011-12	09	82.12	06	15.76	04	0.27
2012-13	14	155.51	09	2.45	09	2.31
Total	51	339.59	37	32.14	32	7.02

As seen from the above table, the recovery made by the Department was 21.84 per cent of the revenue involved in the total accepted cases.

We recommend that the Government may direct the Department to take measures for expeditious recoveries at least in those cases which have already been accepted by them.

2.6 Working of Internal Audit Wing (IAW)

IAW 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 environment is a pre-requisite for the efficient functioning of any Department. However, consequent to introduction of VAT with effect from 01 April 2005, the Department abolished the IAW, leaving it vulnerable to the risk of control failure.

³ Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

The Department re-established the IAW with effect from June 2011. The details of number of offices due for audit by IAW during the years 2011-12 and 2012-13 as furnished by CTD are mentioned below:

Table 2.5: Details of inspections by IAW

Year	Total number of offices	Number of Offices audited by IAW	Percentage of offices covered in internal audit
2011-12	373	18	4.8
2012-13	409	30	7.3

As seen from the table, the coverage of offices was less than 8 *per cent*. Further, the Department replied that no annual target was fixed for conducting audit.

The position of observations raised, settled and outstanding is as follows:

Table 2.6: Position of objections raised by IAW

Year	Objections raised		Objections settled		Objections pending	
	No. of cases	Amount in ₹	No. of cases	Amount in ₹	No. of cases	Amount in ₹
2011-12	339	5,798.44	62	704.62	277	5093.82
2012-13	884	12,084.69	0	0	884	12084.69
Total	1,223	17,883.13	62	704.62	1,161	17,178.51

It could be seen from the table that only 3.9 *per cent* of the objections pointed out in audit were settled. The reasons for not settling even a single observation in 2012-13 were not communicated to this office.

Action may be taken to strengthen IAW and increase the coverage of audit, fix annual target for coverage of audits and settlement of observations.

2.7 Results of Audit

We conducted a test check of the records of 161 offices of the CTD covering VAT, Sales tax, Entry tax, and Luxury tax during the year 2012-13, which revealed under-assessments of tax and other irregularities involving ₹ 241.66 crore in 734 paragraphs, which fall under the following categories.

Table 2.7: Results of Audit

Sl. No.	Category	No. of paragraphs	No. of cases	(₹ in crore)
				Amount
	Value Added Tax			
1	Online systems in the Commercial Taxes Department (A Performance Audit)	01	01	65.15
2	Input tax credit under the Karnataka Value Added Tax Act, 2003 (A Performance Audit)	01	01	97.53
3	Non/short levy of output tax	116	116	10.28
4	Incorrect/excess allowance of input tax credit	48	48	5.18

(₹ in crore)				
Sl. No.	Category	No. of paragraphs	No. of cases	Amount
5	Incorrect/excess carried forward of refund	78	78	5.67
6	Non/short payment of tax	116	116	9.17
7	Incorrect adjustment of TDS	18	18	11.81
8	Non/short levy of penalty	87	87	1.31
9	Non/short levy of interest	121	121	1.52
10	Non-forfeiture of tax collected in excess	13	13	22.34
11	Other irregularities	50	50	7.78
	Total	649	649	237.80
	Sales tax			
12	Non/short levy of sales tax, interest, etc.	21	21	1.89
	Luxury tax			
13	Non/short levy of luxury tax, interest, etc.	05	05	0.20
	Entry tax			
15	Non/short levy of entry tax, interest, etc.	59	59	1.83
	Total	85	85	3.92
	Grand total	734	734	241.66

During the year 2012-13, the Department had accepted and recovered an amount of ₹ 6.92 crore in 309 cases which were pointed out in earlier years in respect of VAT, Entry tax and Luxury tax.

A Performance Audit on Input tax credit under the Karnataka Value Added Tax Act, 2003 involving ₹ 97.53 crore and A Performance Audit on “Online Systems in the Commercial Tax Department” involving ₹ 65.15 crore and a few illustrative cases involving ₹ 5.15 crore are mentioned in the following paragraphs.

As a response to our Performance Audit on ‘Input Tax Credit (ITC) under Karnataka Value Added Tax Act, 2003’, the Commercial Taxes Department has formed an internal Committee to deal with the verification of ITC. Terms of reference for ITC committee included adequacy of the format of obtaining purchase details, dealing with the mismatch between details filed by the purchasers and sellers, ensuring compliance with regard to the furnishing of purchase details by the dealers and the modes of furnishing whether online or CD. A report has also been submitted by the Committee to the Commissioner on these lines.

Further, four other teams were constituted for examining and initiating appropriate actions on the draft audit paragraphs of Information Systems audit on Online systems in Commercial Taxes Department. Terms of reference *inter alia* include examination of the observations made in our Performance Audits, recommend specific control mechanisms and action to be taken on non-complying dealers and exploring the possibility of recovery from defaulting dealers without waiting for the reassessment order.

2.8 Performance Audit on “Online Systems in the Commercial Taxes Department”

Highlights

The Commercial Taxes Department (CTD) did not introduce a protocol for deactivation of user accounts after de-registration of dealers.

(Paragraph 2.8.10.1)

System lacked controls to validate tax paid in original returns, resulting in loss of revenue of ₹ 1.98 crore.

(Paragraph 2.8.11.1)

System lacked controls to validate the carryover of excess credit to the subsequent return resulting in erroneous carry forward in 32,846 cases.

(Paragraph 2.8.11.2)

System lacked controls to ensure that hoteliers who opted for composition of tax, are paying taxes at the correct rate, resulting in short levy of ₹ 69.07 lakh.

(Paragraph 2.8.11.4)

System lacked controls to prevent claim of input tax credit (ITC) on purchases from dealers opting for composition of tax, resulting in excess ITC claim of ₹ 1.18 crore.

(Paragraph 2.8.11.9)

System lacked controls to levy penalty on understatement of tax liability in Original Returns resulting in non-levy of penalty of ₹ 30.12 crore.

(Paragraph 2.8.11.10)

System lacked controls to prevent submission of nil returns by metal crushing units who had opted for composition of tax.

(Paragraph 2.8.11.12)

System lacked controls to compute interest on belated payment of taxes resulting in loss of revenue to the extent of ₹ 1.65 crore.

(Paragraph 2.8.12.2)

System lacked controls to ensure validity period of Delivery Notes issued online.

(Paragraph 2.8.14)

System lacked the necessary output controls to ensure the accuracy of MIS reports.

(Paragraph 2.8.15)

2.8.1 Introduction

The VAT was introduced in Karnataka with effect from 1 April 2005 under the administration of the CTD. From 2010, the CTD has been implementing web enabled systems for online filing of VAT returns, e-Payment of taxes, online dealer registration and issue of delivery notes and statutory forms of local and interstate trade. These have been introduced under the National e-Governance Plan (NEGP) as a State level Mission Mode Project (MMP). The main e-initiatives introduced by the CTD are:

- E-Vardan – Online registration request and processing
- E-Varadi – Online submission of tax returns
- E-Payment – Online payment of taxes
- E-Sugam – Online request and download of delivery notes in Form VAT 505 for goods movement
- E-CST forms – Online request and issue of CST forms
- E-Suvega – Online request for Transit Pass for movement of goods through State
- E-Grahak – Provision for common citizens to file complaints against dealers

The online systems were introduced in phases from April 2010 onwards. At present the CTD has done away with manual filing of returns or issue of forms. Payment of tax amounts less than ₹ 25,000 only are being accepted through modes other than e-payment. Reconciliation of e-payments has also been enabled online. Thus from ensuring the accuracy of tax information filed by the dealers in their VAT returns to the realization of government revenue, the CTD currently depends on the soundness of its online systems.

2.8.2 Information System Setup

The CTD, headed by the CCT, is under the administrative control of the Finance Department, Government of Karnataka. Administration of the Information System setup is vested with the Adcom (Goods and Service Tax), who is assisted by his staff consisting of DCCT and ACCT dealing with e-Payment and Helpdesk operations.

The web enabled services were developed by the National Informatics Centre (NIC), Bangalore. It is implemented across 170 locations including LVOs, audit offices, check posts and central office under client server architecture with Windows Server 2008 and Windows 7 on clients. Oracle 11g and PostgreSQL Database Management Systems are used at the back end with browser based front end interfaces for users.

2.8.3 Audit Objectives

- To ensure that the system has achieved the intended objectives, supports the business processes, ensures compliance with applicable rules and regulations and maintains data integrity.

- To ensure that the necessary organisational controls are in place for effective and efficient management of the system.
- To ensure that the necessary controls are in place for ensuring the security of information system assets.
- To ensure that the necessary controls are in place to guarantee continuity of operations.

2.8.4 Scope of Audit

Data generated by the online systems from the time of implementation of e-Vardan, e-Varadi, e-Payment, e-CST forms, e-Suvega, e-Sugam, e-Grievances and e-Grahak upto October 2012 was obtained and analysed. Documentation pertaining to implementation of the systems was reviewed.

2.8.5 Audit Criteria

- The Karnataka Value Added Tax Act, 2003 and Rules made there under.
- The Central Sales Tax Act, 1956 and Rules made there under.
- Information Technology Audit Manual of SAI India.

2.8.6 Audit Methodology

- Analysis of database using computerized audit tools (IDEA⁴, SQL⁵).
- Review of documents.
- Survey using questionnaire to assess effectiveness of service delivery.

2.8.7 Acknowledgement

We acknowledge the co-operation of the Finance Department, Government of Karnataka and the CTD in arranging for entry conference (March 2013) and exit conference (October 2013) and in providing necessary information and records for audit. We acknowledge the co-operation extended by the National Informatics Centre in the conduct of this audit and the dealers who participated in our survey.

⁴ Integrated Data Extraction and Analysis

⁵ Structured Query Language

Our Findings

2.8.8 Achievements of CTD through e-Governance initiatives

CTD introduced e-Vardan for online registration of dealers. The registration module has captured data relating to over 6.68 lakh dealers registered between April 2005 and October 2012 of which 2.01 lakh dealers got deregistered. After April 2010, 1.44 lakh dealers registration was done online through e-Vardan. With effect from June 2010 all the registered dealers are filing their monthly/quarterly returns online and as of October 2012 over 1.01 crore monthly/quarterly returns were received and acknowledged online. Payments above ₹ 25,000/- is being ensured through e-Payment which is ensuring immediate realisation of revenue to Government and helping speedy reconciliation with Treasury. As of October 2012, 14.26 lakh payments involving ₹ 43,453.48 crore were received through e-payments. During the same period the Department could also capture details of 94.40 lakh movements of goods through e-sugam and m-sugam.

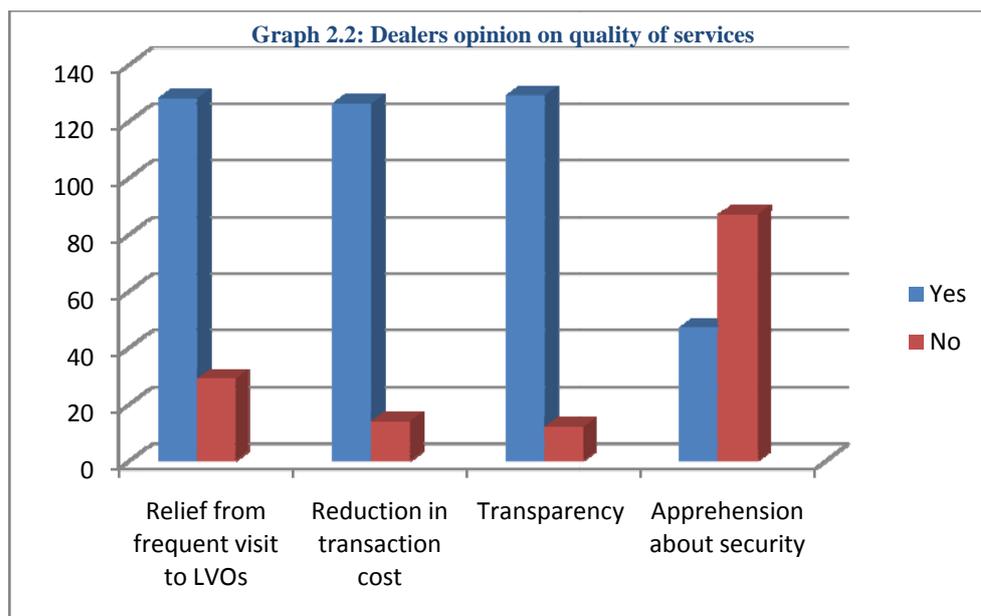
2.8.9 Response of dealers on computerisation

We conducted a survey among a statistically drawn sample of dealers using a questionnaire of 22 questions eliciting dealer responses relating to quality of services, ease of use and inviting specific suggestions for improvement.

We received responses from 166 dealers. The trend of dealer responses is compiled in the paragraphs below:

2.8.9.1 Quality of Services

On the whole, the responses to questions on the quality of services show that the dealers are appreciative and satisfied with the initiatives. 81.53 *per cent* of the dealers who responded to the question opined that there is substantial reduction in their need to directly approach employees in the Department. Ninety *per cent* of the dealers confirmed that, after introduction of the web based services their transaction costs with regard to submission of returns, payment of taxes etc has come down significantly. Further 91.49 *per cent* of the dealers have affirmed that the introduction of the systems has resulted in greater transparency and accountability in the Department.



However, 35.07 per cent of the respondents stated that features in the website have made them apprehensive about the security of their transactions.

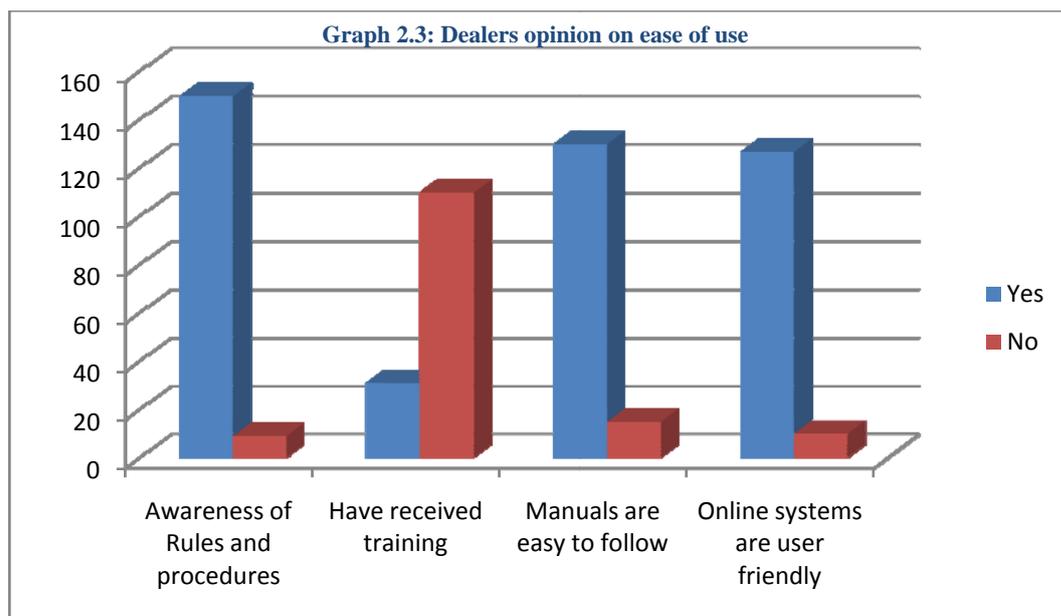
Dealers have also expressed satisfaction over the reduction in the response time for various services. They recorded an average reduction of up to 11 days for e-registration and three days for online issue of statutory forms in comparison with the erstwhile manual system. The issue of delivery notes in form VAT 505 has become 'immediate', which marks a savings of 4 days. The time for processing of appeals, though not online, has come down by about 6 months.

However, the dealers have recorded that the processing of refunds has been delayed by an average of about 6 months after the introduction of the online systems.

2.8.9.2 Ease of use

94.34 per cent of the dealers expressed awareness of rules and procedures for registration, de-registration, filing of returns, payment of taxes, etc. online. Though 78.32 per cent of the respondents recorded not receiving training for the use of the services, 89.66 per cent felt that the user manuals for the services available online were easy to understand and follow and 92.33 per cent felt that the online systems were user friendly.

63.36 per cent of the respondents stated that uploading of sales and purchase invoices is easy and convenient while 83.10 per cent felt that online requests for statutory forms were 'processed promptly' and their online submission was hassle free and fast.



However, several respondents recorded specific problems like slow system response due to excess load (49.28 *per cent*), inability to complete transactions (37.31 *per cent*), error messages without any apparent error (34.56 *per cent*) and problems while quoting of payment reference number (23.08 *per cent*).

2.8.9.3 Selection of Banks for e-payment

Most of the dealers (64.63 *per cent*) expressed satisfaction with the current selection of banks from which e-payment of taxes could be made through the internet banking facility. However a number of dealers wanted all public sector and nationalised banks and also leading private banks like HDFC, ICICI, AXIS and Karnataka Bank to be included.

2.8.9.4 Incorrect debits

Only 9.49 *per cent* of the respondents experienced instances where payments made online were debited from their account but not acknowledged as paid due to error in the system. Those who did experience such problems stated that these were settled within 48 hours.

2.8.9.5 Need for online account

67.03 *per cent* of the respondents felt the need for an online dealer ledger for their transactions. At present, any excess payments during a period cannot be adjusted against payment due for a subsequent period and the only recourse is to claim refund. If an online account for individual dealers could be introduced, credit balances can be adjusted against subsequent periods.

2.8.9.6 Specific suggestions

In their responses to the questionnaire, the dealers have come up with the following complaints/suggestions for improvement:

- After uploading and sending for scrutiny of export details, no data is available in the web.
- Facility for automatic generation of penalty and interest should be introduced.
- Facility for saving a copy of form VAT 240 prior to submission should be introduced.
- Procedure for requesting statutory forms should be simplified. After uploading the request it is now required to follow up the request manually. Hence introduction of online approval of forms would be beneficial.
- Proper training to field office level staff is necessary as the dealers are not getting sufficient guidance from the LVOs.
- The system needs upgradation as processing speeds are low.
- Facility for showing credit notes separately should be introduced.
- Mechanism for online tracking of the status of their refund requests and appeals
- When e-sugam is accessed through alternate servers, the same does not get updated immediately due to poor interlinking.

2.8.10 System Security

2.8.10.1 Failure to deactivate accounts after deregistration

Best practices require management to establish procedures to ensure timely action relating to requesting, establishing, issuing, suspending and closing of user accounts.

On introduction of online systems, facilities like e-sugam and e-filing of returns were made available to dealers based on individual user accounts. However, we observed that the protocol for deactivation of the

user account of a dealer after his deregistration was not established. As a result our analysis of data revealed:

- Existence of 765 cases where Form VAT 505 has been generated by deregistered dealers, and
- 65,536 cases where VAT 100 returns were being filed by de-registered dealers.

2.8.11 Online Filing of VAT Returns

e-Varadi or 'VAT Return and Data Through Internet' is a facility provided to the dealers to submit tax returns electronically without visiting the field offices every month for the purpose. The objective of the facility is to obtain returns free of data inaccuracies and to ensure that the same is enabled for submission only if it accompanies the proof of payment of tax. The system incorporates several controls that minimise errors in returns. However, our analysis of the database of tax returns revealed the following control inadequacies and non-mapping of the relevant rules of the business.

Inadequacy of Input Controls

2.8.11.1 Excess representation of tax paid in original returns

When a dealer files a revised return, the net amount of tax payable is arrived at after deducting any amounts paid by way of tax at the time of filing the original return. The e-filing system of tax returns provides a separate box for the dealer to enter the amount paid in the original return. Then the system automatically deducts the amount to arrive at the revised liability.

On a comparison between revised and original returns, we observed that the system did not have any control to check the amount mentioned in the revised return as tax paid in the original return. Thus they

were allowed, in 12,203 out of 3,12,205 revised returns, to quote amounts in excess of what has been paid in the original returns. In all these cases deductions were allowed to the extent of the tax claimed to have been paid in terms of the revised return and not with reference to what was actually paid. Of these 12,203 cases, the differential amount was less than ₹ 500 in 8,165 cases and hence not considered for further analysis.

Our analysis of the remaining 4,038 revised returns in which the amount wrongly quoted was ₹ 500 or above revealed that in 982 cases, the excess deduction included amounts paid towards interest and other liabilities in the original returns. As such they were not eligible for adjustment against the liability in the revised returns. The excess claim amounted to ₹ 1.98 crore.

Such excess deductions have happened due to the lack of a control to retrieve the amount of net tax liability from the original return. However the system at present allows the dealer to enter an amount as tax paid in the original return. The above deductions were inadmissible and resulted in loss of revenue. It also attracts mandatory interest at 1.5 per cent per month and penalty at 10 per cent.

In the remaining 3,056 cases, the excess deductions amounted to ₹ 93.43 crore which were not supported by payments in the original returns. However, on our enquiry with LVO, in a few cases, it was stated that the dealers included amounts paid to enforcement wing or audit offices in their revised returns. However excess deduction claimed needs further verification in all the cases.

2.8.11.2 Incorrect amounts brought forward from previous period

We observed that the application does not have controls to ensure that the amount brought forward in the current return is not in excess of the credits carried forward from the previous return. Out of the 72,12,639 VAT 100 returns filed for the period audited, 27,459 monthly returns and 5,387 quarterly returns showed that amounts brought forward were in excess of what was available for carry forward in the respective previous period.

For instance, TIN 29450747974 has filed his monthly VAT Return for March 2012 in which he has brought forward an amount of ₹ 29,14,572/- from his previous return (February 2012). However his VAT return for February 2012 shows an available carried forward of ₹ 4,40,494/- only. Due to absence of control to validate the carry over of credits, his excess carry forward of ₹ 24,74,078/- is not detected.

Of the above, in 3,668 monthly and 145 quarterly returns, the dealers were found to have adjusted the excess amount brought forward in their net tax payable. This amounts to a revenue loss of ₹ 5.29 crore and ₹ 8.03 lakh respectively.

2.8.11.3 Negative Values for Tax Payable in Returns submitted under Karnataka Tax on Entry of Goods (KTEG) Act

Box 12.1 of the e-Varadi module for tax returns under KTEG Act captures value of total purchases which is liable for entry tax including local, interstate and imports. Exempted turnovers like local area purchases, purchases against Form 40, purchase returns and re-exports or any other are to be entered in boxes 12.2 and 12.3. In Box 12.4, the taxable turnover after deducting the exempted turnover is arrived at. In case of re-export of goods against which entry tax paid at the time of import shall be refunded. This is the basis for calculation of entry tax payable at different rates of tax.

We observed that there is no input control in the system that prevents dealers from entering a figure of exempted turnover which is higher than the total turnover. Out of the total 6,12,154 KTEG returns filed online, in 5,943 returns, values appearing in the boxes for

exempted turnover were higher than the total turnover. This has resulted in negative values for taxable turnover and tax payable. Of these, in 4,423 cases, the dealers have carried forward the same to the tax returns of the subsequent periods to the extent of ₹ 5.16 crore and to that extent reduced the amount of tax payable.

However, there was no mapping of the deductions claimed on account of re-export of goods with the returns in which entry tax was paid previously on such goods.

2.8.11.4 Short payment of tax by Hoteliers opting for composition

Section 15 of the KVAT, 2003 enables certain classes of dealers to pay in lieu of the net amount of tax payable by them, an amount by way of composition, at specified rates on their total turnovers. As per notification No. FD 116 CSL 2006(13), Dt.31/3/2006, hoteliers are not eligible for composition at one *per cent*.

The registration status (VAT/ Composition) and the category of composition (dealer/hotelier) is made out in the registration module of the application (e-Vardan). The monthly/ quarterly return format for both

classes of dealers is the same (VAT 120 P2), having options for 1 or 4 *per cent* computation on the total turnover as the case may be.

In this scenario it is important to prevent Hoteliers/bakers etc, from incorrectly opting for composition at one *per cent* as ordinary dealers (Cot-D), and to ensure payment of tax at 4 *per cent* (cot-H) through application controls that integrate registration and return filing modules.

Our analysis of the database of e-Vardan revealed that 1,333 hoteliers had incorrectly opted for Composition as Dealers – Cot-D, instead of Cot-H. Out of these 194 dealers had filed 1,447 returns, paying tax at 1 *per cent* of their turnovers instead of 4 *per cent* as applicable to Cot-H. This inadmissible concession resulted in short levy of tax of ₹ 49.16 lakh.

Further, there were 529 returns filed by hoteliers/caterers/bakers who have opted to pay tax under the composition scheme Cot-H, and still paid tax at the lower rate of 1 *per cent*. The resultant short levy works out to ₹ 19.91 lakh.

The above instances show that, there were no built in control to prevent hoteliers from opting for composition as Cot-D in the first place, and, to disallow tax at one *per cent* from Cot-H dealers.

2.8.11.5 Inaccuracies in VAT Returns and possible non-forfeiture of excess collection of tax by dealers

Section 47 of the KVAT Act states that “where any amount is collected by way of tax from any person by any dealer, such dealer shall pay the entire amount so collected, to the prescribed authority within twenty days after the close of the month in which such amount is collected, notwithstanding that the dealer is not liable to pay such amount as tax or that only a part of it is due from him as tax under this act.”

Dealers are required to enter the actual amounts of VAT and CST collected in the VAT 100 return. The tax collected are exempted from the total turnover for calculation of taxable turnover. In compliance with

the provision quoted above, it has to be ensured that in cases where the

total output tax liability of a dealer (reflected in Box 4.1) is less than the total of the VAT and CST collected, the excess amount so collected by the dealer is paid alongwith that return. In case of non-payment of the same, a notice for forfeiture of the excess amount of tax collected shall be generated and returns filed to be accepted only on clearance of the dues. This control is not built into the system.

As a result, we observed that, out of the 72,12,639 VAT 100 returns analysed, 57,407 showed higher amounts of tax collected of ₹ 600.18 crore than the output tax liability declared in the returns. These cases needs further investigation and follow up action by the Department.

2.8.11.6 Incomplete data relating to adjustment of tax for purchase/sales returns

The electronic format for filing of tax returns in form VAT 100 provide the facility to reverse input tax credit claimed on purchase returns and output tax payable on sales returns provided the purchase/sales returns are within six months of the relevant tax period. Provision of such facility would necessitate input controls to ensure that, where the dealers declare purchase returns, they must reverse the input tax credit claimed on the same, and where output tax is reversed there should be corresponding sales returns.

We observed that in 4,894 out of the 72,12,639 returns analysed, the dealers have declared purchase returns within the previous six months (box 9.12.1 of VAT 100) but failed to reverse the input tax credit claimed in the field provided for the

same (Box no.4.6).

Similarly in 24,394 returns out of the 72,12,639 analysed, the dealers have reversed output tax paid on sales returns within the previous six months (in box 4.6) without declaring the turnover related to the sales return (in box 2.1.1).

Due to absence of relevant controls, the tax returns contain material errors that might result in potential loss of revenue to the Government.

2.8.11.7 Inability of the System to Ensure Continuity in the Filing of Tax Returns

Section 38(2) of the KVAT Act states that “where a registered dealer fails to furnish his monthly or final return on the due date, the prescribed authority shall issue an assessment to the registered dealer to the best of its judgement”. Further, failure to furnish returns for any tax period also attracts penalty under Section 72(1) of the Act.

We observed that the e-filing system does not have controls to prevent dealers from defaulting in the filing of returns. As a result, during the period from June 2010 to August

2012, 18,118 returns were not filed by dealers for intervals ranging from one to eleven months and then continued to file returns for subsequent periods, which was allowed by the system.

In these cases, the system does not prompt for best judgement assessments or invoking of penal clauses as provided under the Act.

Inadequacy of Processing Controls

2.8.11.8 Inability of the system to validate exceptions on subcontract turnover

In the online Form VAT 120 (P4) filed by works contractors who opted for composition scheme, facility has been provided to give the TIN of subcontractors and the corresponding amounts for which exemption under the above section has been claimed in the return. As per the database exemptions claimed on account of payment to sub-contract amounted to ₹ 3,041.12 crore.

According to Section 15(5)(b) of the KVAT Act, 2003, “in the case of a dealer executing works contracts and opting for composition of tax, no tax by way of composition shall be payable on the amounts payable or paid to a sub-contractor as consideration for execution of works contracts and such amounts shall be deducted from the total consideration of the works contracts subject to production of proof under the Act and that such amounts are included in the return filed by such sub-contractor.”

We observed that there is no facility in the system to validate such turnovers against the turnovers declared by the subcontractors in the returns filed by them. Out of 10,538 cases of exemption claimed for amounts purported to be paid to subcontractors, a comparison with the returns filed by the subcontractors for the corresponding periods revealed lower declaration

in 6,556 cases.

For instance, for July 2012, two contractors declared a total of 6 payments made to a subcontractor and claimed exemption for a turnover of ₹ 1.01 crore. The subcontractor, on the other hand has declared a total turnover of only ₹ 74.50 lakh in the return filed for the same period leaving a balance of ₹ 26.70 lakh.

Due to failure to incorporate a processing control of automated cross verification of information readily available with the database, the CTD has failed to take advantage of the potential system efficiencies offered by computerisation.

2.8.11.9 Inadequacy of Controls to prevent ITC on purchases from Composition Dealers

Rules 138, 139 and 140 of the KVAT Rules 2005, restrict all dealers who have opted for composition of tax (except works contractors) from collecting tax on their sales.

We observed that the module for uploading details of purchase invoices permit entry of bills issued by composition dealers (other than works contractors) and

do not prevent entry of tax amount for invoices/bills issued by such dealers.

Out of the 3,03,00,545 purchase invoices uploaded by dealers during the period under analysis, 51,392 were found to be issued by dealers (other than works contractors) who had opted for composition. Out of the above, 46,916 invoices have positive tax values amounting to ₹ 7.07 crore.

It was also found that the dealers have claimed ITC amounting to ₹ 1.18 crore in 2,027 VAT 100 returns filed for the periods corresponding to the invoices. This represents potential loss of revenue caused by inadequacy of the required controls in the system.

Non-Mapping of Business Rules

2.8.11.10 Levy of Penalty for understatement of tax liability in Original Returns

Under Section 72(2) of the Karnataka Value Added Tax Act, 2003 a dealer who for any prescribed tax period furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five *per cent* of his actual liability to tax or his actual tax credit, be liable to a penalty equal to ten *per cent* of the amount of such tax under or overstated.

Section 35(4) of the Act provides for submission of revised returns subject to 'sub-section 2 of Section 72(2).

Audit Analysis of 3,12,205 revised returns showed that in 38,682 returns, the dealers made changes resulting in a final increase of output tax liability or decrease in input tax by more than five *per cent*. Application of Section 72 (2) would yield penalty

of ₹ 30.12 crore.

Of these, one case involving non-levy of penalty of ₹ 6.28 lakh was pointed out in Compliance Audit in May 2012 that was accepted and recovered by the Department.

In the absence of the necessary controls in the system to identify, compute and communicate the penal amount, the department is unable to take advantage of the opportunity offered by computerisation in the interest of greater efficiency in tax administration.

2.8.11.11 Dealers Opting for Composition

Section 15(1) of the KVAT, 2003 read with Notification No.FD 116 CSL 2006(11), Dt.31.3.2006 any dealer other than a hotelier, works contractor or a mechanised crushing unit and whose total turnover in a year does not exceed an amount of 15 lakh rupees, may opt to pay, an amount by way of composition at a percentage rate on his total turnover, in lieu of the tax payable by him. The rate of tax on total turnover was fixed at 1 *per cent* vide Notification No.FD 116 CSL 2006(13), Dt.31/3/2006.

Rule 142 of the Karnataka Value Added Tax Rules, 2005 specifies that every dealer who has opted for the above scheme and whose total turnover in a year exceeds the threshold specified therein, shall report to the jurisdictional officer, surrender his certificate for composition of tax and be liable to pay tax under section 3 for the period starting from the first day of the month succeeding the month in which he exceeded the threshold.

We observed that out of the 3,56,633 returns filed by dealers who opted for composition of tax, 3,921 returns showed that the turnover had exceeded the threshold for the year and yet the dealers had continued to avail the benefit of composition of tax by filing composition returns instead of regular VAT returns. This has happened owing to the relevant business rules not being mapped into the system. All these cases need to be individually verified and assessed.

2.8.11.12 Submission of 'Nil' returns by Mechanized Crushing Units under Composition of Tax

According to the provisions of Section 15(d) of the KVAT Act, 2003, a dealer who is a mechanized crushing unit may elect to avail the facility of composition of tax at a rate to be notified by the Government not exceeding ₹ 2 lakh for each crushing machine per annum. The amounts of tax to be paid per machine were fixed between ₹ 16,500 and ₹ 3,000 per month (depending on size and type of the machine) by notification (the latest being notification No.FD 116 CSL 2006(13), Bangalore dt.31/3/2006).

It is thus evident that the tax liability of a mechanized crushing unit opting for composition of tax is on the basis of the number, size and type of machines. We observed that the computerised system does not incorporate the following controls that are necessary for effective administration

of transactions of this kind:

1. The system does not have a database of the number, size and type of machines employed by the mechanised crushing unit. Hence it is incapable of validating the information furnished by the dealers in the monthly returns.
2. Since the amount of tax is determined not on the turnover or employment of machines, but on their number only, the question of nil returns do not arise. However we observed that there are no controls in the system to prevent this and the dealers were filing nil returns as well. Out of 25,455 composition returns filed by mechanised crushing units, 5,154 were nil returns.
3. A conservative estimate of potential loss of revenue to Government:
 - a. Dealers who had filed only nil returns - Assigning an amount of ₹ 3000 (being the lowest rate of tax per machine per month) to 2,478 returns amounted to ₹ 74.34 lakh, and
 - b. Dealers who had filed nil returns for some periods - Assigning the most frequent value of tax declared in the returns of the respective dealers for the remaining 2,676 nil returns amounted to ₹ 2.24 crore.

2.8.11.13 Refund approved in excess of request

The refund module of the online system does not have controls to restrict the approved amount of refund to the amount requested. We observed 36 cases where amounts equal to or more than ₹ 1,000/- in excess of the requests were approved. The excess amount approved works out to ₹ 14.48 crore.

2.8.12 Online payment of taxes

The CTD introduced the facility of e-Payment of taxes through internet banking since April 2010, initially for large tax payers. The scheme was later extended to payment of taxes under all the Acts administered by the CTD and was made mandatory for all payments above ₹ 25,000/-. Online reconciliation is carried out amongst the CTD, banks and the treasury.

The procedure provided for e-payment requires a dealer to make e-payment of his tax liability. On making the payment, a reference number is generated, which is entered while filing the return.

Inadequate Input Controls

2.8.12.1 Deemed Acknowledgment for returns even when entire liability is not discharged by e-Payment

The dealers on making online payment of taxes are provided a reference number. Subsequently, at the time of filing of VAT returns for the period, the dealer can quote the reference number in proof of having paid the tax and the return is accorded the status of 'deemed acknowledged'. However if, the liability is in excess of the amount paid through e-payment, the return will be manually acknowledged as and when the entire amount is paid vide cheque or any other mode.

In our analysis, we found five cases of part payment of taxes through e-payment, and still the returns were accorded the status of deemed acknowledged.

Inadequate processing controls

2.8.12.2 Inability of the system to compute interest on belated payment of taxes

Section 36 (a) of the KVAT Act, 2003 provides for levy of simple interest in case of failure to furnish returns or to pay tax declared on returns. The rate of interest payable was stipulated as 1.25 per cent per month.

We noticed that e-Payment system introduced in the CTD does not have the provision for automatic computation of interest on belated payment of taxes as provided under

the sections quoted above.

Our analysis of database has shown in 26,126 VAT 100 returns that, payments were made belatedly with delay ranging from two days to 846 days. However, the dealer paid only the exact amount of tax liability as brought out in the returns, omitting to pay the interest leviable. Loss of revenue by way of interest in the above cases amounts to ₹ 1.65 crore.

2.8.12.3 Short payment of tax

The dealers declare modes of payment like e-payment, demand drafts or cheques, with details thereof in their VAT returns. A comparison of the total liability of a dealer for a given tax period and the tax payment details revealed that in 1,264 cases, the amount of tax paid was short of the declared net tax liability at least by ₹ 1,000. The underpayment of dues amounted to ₹ 21.23 crore.

2.8.13 Online issue of statutory forms for interstate trade

Section 8(1) of the CST Act, 1956 provides for concessional rate of tax on interstate sale of goods to registered dealers on submission of a declaration (Form C) obtained from the buying dealer. Where the dealer claims exemption from tax liability on the ground of interstate transfer of goods other than by way of sale, the proof for the same may be submitted in Form 'F' u/s 6-A of the Act.

Traditionally, the dealers had to obtain printed forms of statutory forms from the LVOs and later submit utilization certificate for the same. Online issue of C forms with self printing option

was introduced by the CTD for selected dealers from April 2009. The scheme was later enabled for all dealers. Electronic issue of other forms was introduced from May 2012. Our review of the online processes revealed the following control inadequacies:

2.8.13.1 Lack of integration between modules resulting in reduced efficiency

The Karnataka Tax on Entry of Goods (KTEG) Act, 1979 stipulates that tax shall be levied and collected on entry of specified goods into a local area for consumption, use or sale therein. The dealers causing such entry are required to file returns giving details of their purchases of KTEG liable goods.

Since the online facility for downloading 'C' forms for interstate purchase of goods requires the dealers to specify the commodities and their respective turnover, the module

contains information that can be meaningfully correlated to monitor the filing of returns and payment of tax under the KTEG Act.

We observed that the modules for administration of KTEG and that for issue of CST forms have not been integrated towards this end. For instance, the module for issue of C forms include 12,987 invoices for 'machinery' which is a commodity liable for KTEG for which the dealers had not filed returns for the corresponding periods.

2.8.13.2 Inadequacy of input controls

After the introduction of online systems, the dealers are provided with the facility of uploading the 'C' and 'F' forms received by them from the buying dealers from other states, as well as the invoice particulars in justification for claiming of exemption/concessional rate of tax.

Our analysis of the above database tables for the period between 1 April 2010 and 31 October 2012 has revealed the following:

1. Out of the 95,608 VAT returns filed during the period, only 14,374 were found to be adequately supported by C forms uploaded. In 37,950 sales returns the value of C forms uploaded was in excess of the turnover declared in the return and in 43,284 returns the value was less than the same. This indicates lack of integration between different modules (CST and Return filing modules) of the same system.
2. **Incomplete Data:** due to lack of input controls to ensure that complete data in respect of all submitted forms are captured in the database, 32,642 out of 4,47,799 forms submitted do not mention the value. This limits the efficiency of the system in aiding the authorities in ensuring that the declarations cover the entire amount of exemption/concession.
3. Due to absence of an input control to ensure complete and correct uploading of all the invoices in support of each form, in 2,468 forms, the number of invoices uploaded is less than the number represented in the form itself, and the value of the form is higher than the total value of invoices.
4. Due to absence of uniqueness controls for input values, in 41,258 instances, dealers appear to have entered the same invoice information for different forms submitted by them.

Thus inadequacy of the application controls and the resultant lack of data integrity has undermined the utility of the system in effectively focusing managerial attention to cases:

- Where filing of forms is inadequate/in excess of the turnovers declared in the returns.
- Where filing of invoices is inadequate with reference to the value represented by the forms.
- Where invoices have been repeated for different forms.

2.8.14 Online issue of delivery notes

Section 53 (2)(a) of the KVAT Act requires dealers to notify to the Department of the details of movements of certain specific goods and carry proof of the same in the form of delivery notes (Form VAT 505) to be produced to the proper authorities.

The process of applying for, obtaining and producing delivery notes has been simplified and made citizen friendly through the introduction of e-Sugam⁶, an e-Governance initiative of the CTD, however, our analysis of the e-Sugam module of the system has revealed the

following control inadequacies.

⁶ Simple Uploading of Goods Arrival and Movement

2.8.14.1 Inadequacy of controls to enforce validity period

There is a risk of misuse of the e-Sugam note if dealers use the same note for several transactions. To address this, Paragraph 9 (vii) of Notification No. Adcom(I&C)/AC/CR-22/2010-11 dt. 9/1/2011, sets down the validity period of 'e-Sugam' (based on the distance between points of origin and destination) upto a maximum of 7 days "in order to ensure that there are no instances of misuse of the facility".

As per the notification cited above, the validity of a delivery note is not more than 4 days upto a distance of 1,000 kilometers and 7 days beyond that. This implies that delivery notes for all transactions within the state should not have a validity of more than 4 days and the maximum validity of the note is not more than 7 days.

We however observed that the above limitation is not mapped into the system. Out of the 94,39,776 delivery notes submitted during the period under audit, 53,251 notes had a validity beyond 7 days of their submission. Of these about 2,350 notes relate to transactions within the state which had validity beyond 4 days.

The dealers are required to produce the delivery notes to the proper authorities for verification. With the introduction of the online application the verification of such notes has also been expedited. However, in 21,872 cases, it is observed that the notes have been inspected and cleared even after the expiry of 7 days (i.e. well beyond the maximum prescribed validity of the forms).

Further, there are 19,984 cases where the same delivery note appears to have been presented at the same check-post/office on different dates. The cases are to be individually examined to rule out possibility of misuse.

2.8.14.2 Lack of validation controls

The e-Sugam system for issue of delivery notes requires the dealers to upload the relevant details as required in Form 505 of the KVAT Rules 2005. However it is observed that the system does not incorporate the necessary input/validation controls to ensure that the details entered are complete, accurate and valid. The following are a few cases:

1. PAN details are not available for 2,24,764 forms out of the total of 6,85,084. Further, it was observed that validation controls to ensure that the values entered adhere to the format of PAN viz. 5 alphabets followed by 4 numerals and another alphabet has not been incorporated in the system. As a result the total numbers of characters are less than 10 in 2,248 cases and more than 10 in 1,461 cases.
2. Goods vehicle number, LR number and LR date are not available for 39,02,653 cases out of 97,56,182 transactions.
3. Invoice number is missing in 6,558 transactions and the Invoice date is missing for 77,169 transactions.

2.8.14.3 m-sugam

The CTD introduced m-Sugam⁷ by which the dealers were empowered to upload details of goods movements through SMS⁸. After validation, the system communicates a reference number to the dealer. The system has effectively addressed the need for validation and cross verification and obviated the necessity for printed forms. Further, the whole process has been expedited and made dealer friendly.

However, the following details are not captured in m-sugam transactions.

1. Number and particulars of the Goods Vehicle
2. Quantity of individual commodities
3. Value of individual commodities
4. Date of dispatch

Information on quantity of goods is necessary for verification of stock during reassessment or enforcement proceedings. Date of dispatch is necessary to limit the validity of the forms. Hence, lack of the above details limits the amount of information that the CTD has at its disposal and weakens the level of control against misuse of the system.

2.8.15 Management Information System (MIS) Reports

MIS reports of the e-Governance initiatives of the Commercial Taxes Department envisaged to provide the officials of the Department with firsthand information on the day to day activities of the VAT process. Accuracy and reliability of MIS reports is key to enabling administrative effectiveness through provision of meaningful information for executive action.

2.8.15.1 Inadequacy of Output Controls – Reliability of MIS Reports

From our scrutiny of the dash board MIS reports, the following observations are made.

1. On a verification of the MIS Reports – Dealer file - Payment details we noticed that “e_payment_summary_report_bankwise” ‘datewise’ report of LVO 035 reflects a payment of ₹ 67,061/- relating to TIN No. 29470016389, paid through e_payment mode on 31-12-2012. However, in the dealer file ‘payments’ menu this payment is not reflected indicating a lack of integration among two different modules displaying the same information.

⁷ Mobile based Simple Uploading of Goods Arrivals and Movements

⁸ Short Message Service

2. The details displayed under the menu “Report on e-returns’ vis-a-vis number of returns submitted and number of returns acknowledged for a particular period does not match with the details displayed in the module ‘LVO – Dash board’.
3. The details displayed under the module “e-sugam summary report” vis-a-vis, office wise/monthwise/No.of forms downloaded does not match with the details displayed in the module “LVO-Dash Board”.
4. The total displayed in the module “e-sugam summary report/officewise” data does not tally with any of the other sub-modules vis-a-vis commodity wise, transaction wise, tin-wise.
5. In the e-returns module a payment was made through cheque. But correspondingly the payment made is shown as partial payment in the “short payment report” module.
6. In the e-returns for the month of September 2012 in respect of TIN 29070645072, the tax liability worked out is shown as ₹ 27,098 paid vide challan nos. 3779532 & 37670781 for ₹ 13,778/- and ₹ 13,320 respectively. However, the challan no. 37670781 pertains to 7-12-2011 whereas the return is for the period 8-10-2012.
7. The total tax liability of TIN 29180026491, for the month of September 2012 worked out to ₹ 1,37,520/-. Though the entire amount is shown as paid in the returns, the mode of such payment is not mentioned. Further, in the short payment Report Module, the entry shows a part payment of ₹ 40,000/-.

2.8.16 Online Complaint Redressal

The e-Grahaak System introduced by the CTD provided the citizens with an opportunity to register complaints against dealers through SMS and to track the progress of their complaints online. This measure was aimed at obtaining inputs for vigilance and enforcement action through which tax evasion could be controlled.

2.8.16.1 Underutilisation due to inadequate publicity measures

The CTD has not provided wide publicity on the facility and as a result it remains underutilised and the purpose of its introduction largely unfulfilled. The following observations are made:

1. There was a need to give wide publicity about the availability of such a facility to the public through repeated advertisements in print and visual media, internet etc.
2. Information on the facility is available in the website of the Department (www.ctax.kar.nic.in). However search engine optimization would ensure that the web site presents itself prominently in web searches for common taglines like “complaint against shopkeeper”, “shop keeper not issue bill” etc. As a result, unless a

citizen knows the exact term 'e-grahak' and what the service provides, it is unlikely to be used to its full potential.

3. As a result of the lack of publicity, the facility is not being actively used by the citizens. In addition to the 117 transactions that were registered by the Department officials for test or demonstration, there were only 435 requests from the citizens during the period under analysis (February 2013 to October 2013).
4. CTD attended to 112 cases after a delay of more than a month, and 63 cases after two months.

2.8.17 Conclusion

The introduction of web enabled System in the CTD had gone a long way towards achieving the objectives set out for state level MMPs under the NeGP. Survey results show significant improvements in reducing direct interaction with departmental officials, transaction costs and response times and brought about greater transparency and accountability in the CTD. However, the respondents have aired the need for a greater selection of banks for e-payment, online tracking mechanism for status of services, online ledger account for individual dealers, better network speeds and more active response to grievances addressed to local offices. Though the material errors have been addressed to a large extent through automatic computation of figures in electronically submitted tax returns, there is still scope for introduction of application level controls particularly: a) in the direction of integration between various modules to ensure better administrative efficiency and stemming loss of revenue as and when it occurs without dependence on the audit process, b) better and complete capturing of data for strict enforcement of validation period through computerised controls in the issue of delivery notes through e-Sugam and c) introduction of input level validation controls to ensure greater accuracy and integrity of data compiled in the System. The e-Grahaak module, though in its initial stages of introduction, has greater potential to be of assistance to the vigilance and intelligence operations of the CTD if properly publicised. Care also needs to be taken to ensure reliability of the MIS reports as the same is central to the ability of the top management to effective tax administration.

2.8.18 Recommendations

We make the following recommendations on the basis of our findings:

- Online tracking mechanism for status of appeals, refund requests etc. and online ledger account for individual dealers may be introduced for greater convenience to the dealers.
- Departmental staff should receive more extensive training in the use of web enabled System to be of greater assistance to the users.
- The CTD should establish a protocol for user account management and ensure automatic deactivation of accounts of deregistered dealers.

- Application level controls to ensure integrity of amounts represented in revised returns as paid in original returns and of amounts brought forward from previous returns, should be introduced to prevent loss of revenue.
- Additional controls to ensure accuracy of tax return information particularly with respect to amount of tax collected by dealers, by limiting it to the amount as per data provided in the purchase and sales returns.
- Application controls to prevent entry of non-verified values under taxable turnover and subsequent carried forward of inadmissible credit in respect of tax returns under KTEG should be established.
- Application controls to ensure conversion of composition dealers to regular scheme on exceeding turnover limit should be introduced.
- Application level controls for integration between tax return and registration modules to ensure correctness of tax returns and payments by hoteliers opting for composition should be established.
- Better integration within the tax return module to validate subcontractor turnovers should be established.
- Registration and Tax Return modules should be integrated for better administration of payments by mechanized crushing units under composition scheme of tax.
- Facility for automatic computation of interest on belated payment of taxes should be established.
- MIS reports to flag cases of incomplete payments against liabilities may be introduced.
- Input controls for prevention of duplication of invoices and completeness of information should be established in the module for online issue and submission of statutory forms.
- System controls to enforce validity provision in the use of delivery notes should be established.
- Output controls should be strengthened to ensure reliability of MIS reports.
- Greater publicity should be given to online complaint redressal system, e-Grahak to effect more active participation by the public.

2.8.19 Response of the Department

The Department acknowledged that the report “brings out several areas for improvement in the existing system” and that the audit efforts “will form important inputs for continuing efforts of the Department to improve the system”. The Department, however, also stated that “some of the suggestions seem relevant for the granularity at micro level of individual transactions”. However, no reply was received from the Government.

This report, while acknowledging the efforts and achievements of the Department in propagating e-governance in the Commercial Taxes microcosm, brings out the areas of lack of robustness of the System, as well as inadequacies of controls. The recommendations aim at optimising the efforts of revenue collection by highlighting individual instances of lapses as well as System deficiencies.

2.9 Performance Audit on "Input tax credit under Karnataka Value Added Tax Act, 2003"

Highlights

Purchase details of only 25 per cent of the ITC claimed in the returns were available in the EFS database indicating laxity on the part of the Department in monitoring the grant of ITC through submission of purchase details as provided in the KVAT Rules.

(Paragraph 2.9.7.1)

The data available in the EFS database was not found correct and reliable for verifying the correctness of the ITC claims. Incorrect Tax payers Identification Number (TIN), absence of TIN in the master table of the database and other mistakes/errors were noticed in purchase invoices involving tax of ₹ 609.95 crore.

(Paragraph 2.9.7.2)

CTD had not initiated action to disallow ITC claims of ₹ 21.54 crore claimed on purchase invoice issued by deregistered dealers.

(Paragraph 2.9.8)

Analysis of the database revealed suppression of sales by 4,531 selling dealers involving tax effect of ₹ 86.88 crore in respect of which ITC claims had been availed by the purchasing dealers.

(Paragraph 2.9.9.1)

Loss of revenue of ₹ 1.05 crore was noticed due to non-submission of purchasing invoices and filing of 'Nil' returns by selling dealers.

(Paragraph 2.9.10.1)

In three LVOs the tax declared by 11 sellers in their returns was lesser than that shown in the invoices resulting in loss of revenue of ₹ 53.92 lakh. The selling dealers were also liable to pay penalty of ₹ 5.39 lakh and interest of ₹ 17.08 lakh.

(Paragraph 2.9.10.3)

15 purchasing dealers in 10 LVOs claimed ITC of ₹ 1.03 crore in their returns though no returns were filed by selling dealers. This resulted incorrect grant of ITC to that extent.

(Paragraph 2.9.10.4)

ITC claims of ₹ 15.58 lakh were incorrectly allowed as the purchases were made either from de-registered dealers or selling dealer had declared turnover less than the ITC claimed/filed 'nil' returns/ had not filed returns for the corresponding tax period.

(Paragraph 2.9.11)

In 260 cases though the dealers had under-declared their tax liability by ₹ 5.19 crore, their annual statements were approved by the LVOs.

(Paragraph 2.9.12.1)

In 24 cases the dealers had neither repaid the excess ITC claimed in the returns nor adjusted it in any of the subsequent returns filed by them. The excess claim of ITC in these cases amounted to ₹ 81.20 lakh.

(Paragraph 2.9.13)

Incorrect grant of refunds aggregating to ₹ 21.52 lakh in 23 cases and excess grant of refund of ₹ 49.41 lakh in one case were noticed during 2010-12.

(Paragraph 2.9.14)

2.9.1 Introduction

The KVAT Act 2003 and KVAT Rules govern the levy and collection of value added tax (VAT) in Karnataka at every point of sale. The tax payable by a dealer under the Act on sale is called output tax while the tax paid by the dealer on purchases is called Input tax. The process of setting off input tax credit (ITC) from the output tax is called input rebating. A dealer is liable to pay the net tax⁹ after such adjustment.

The Act provides that ITC can be claimed only on purchases made locally i.e. within the State and both the purchasing and the selling dealers should be registered under the KVAT Act. Section 35 of the KVAT Act provides for submission of monthly/quarterly returns for claiming ITC. The Department introduced electronic mode for submission of returns called e-Filing System (EFS) from 1 April 2010 for every dealer. Further every dealer shall be deemed to have been assessed to tax based on the return filed by him under section 38 of the KVAT Act.

Section 31(4) of KVAT Act, provides that every dealer whose total turnover in a year exceeds rupees one crore shall submit a copy of an audited statement of accounts certified by a chartered accountant in Form VAT 240 to the jurisdictional LVO within nine months after the end of the relevant year. The dealers upload the scanned copies of the VAT 240 into the EFS. ITC cannot be claimed on purchases made from 'COT',¹⁰ dealers.

Why we chose this topic: The VAT system provides for acceptance of returns filed by the dealers on self-assessment basis. Only a few returns are selected for scrutiny of books of accounts in selected cases. There is an inherent risk in the input tax rebate system. We had in the earlier Audit Reports pointed out cases of incorrect claims of ITC, incorrect carry forward of ITC, etc. amounting to ₹ 7.51 crore.

The Secretary to the Government of Karnataka, Finance Department, in a meeting with the Principal Accountant General in June 2012 also stressed the need for conducting a Performance Audit of ITC claims. As such we thought it was appropriate to conduct a PA on this topic.

2.9.2 Organisational Set up

Levy and collection of VAT is administered by the CTD, which is headed by the Commissioner of Commercial Taxes (CCT) and is under the administrative control of Finance Department. In the State, there are 13 DVOs, each headed by a Joint Commissioner of Commercial Taxes (JCCT). At the

⁹ (Output tax – Input tax)

¹⁰ 'COT', i.e. composition scheme - Those opting for composition scheme need not maintain books of accounts and shall pay a specified percentage of tax on the total turnover and should not collect tax on sales made by them. Dealers under 'COT' registration can neither issue tax invoices nor claim ITC. However, 'Works Contractors' registered under 'COT' registration can collect tax and issue tax invoices.

field level, the dealers are under the jurisdiction of a specified Local VAT Office (LVO)/VAT Sub-Office (VSO). Under KVAT Act, every dealer shall be deemed to have been assessed to tax based on the returns filed by him. The LVO/VSO monitors the tax payments due based on the returns (deemed assessments) filed. Re-assessment under section 39 of KVAT Act can be entrusted by the CCT to any Audit Office.

2.9.3 Audit objectives

The main objective of the audit was to assess whether:

- a system control existed for ascertaining that ITC claims were in accordance with the provisions of the Act;
- reversal of ITC was made on change over from VAT to COT registration;
- the system provides for collection of necessary data for verification of ITC claims in the returns filed;
- a system for processing of refunds provides for ensuring that ITC claims are correct and refund is made out of the revenue already realised to Government account; and
- control and monitoring devised for VAT re-assessment and/or enforcement activities to prevent loss or leakage of revenue in the form of ITC was effective and efficient.

2.9.4 Scope and Methodology of Audit

There are 13 Divisional VAT offices in the state, of these; four¹¹DVOs were selected for the period covered by e-filing i.e. years 2010-11 and 2011-12¹².The DVOs were selected on the basis¹³ of the total amount of ITC claimed by the dealers in their returns and geographical location of the units. There are 34 LVOs falling under the jurisdiction of these four DVOs, out of these 13 LVOs were selected on random sampling basis.

We also analysed the data of purchases and sales available in EFS for the entire State to check its utilisation in grant/availing of ITC claims. In addition

¹¹ Nos. 1 and 4, Bangalore, Davanagere and Mangalore

¹² e Filing System was introduced from 1 April 2010. Prior to this, VATSoft was used by CTD to digitise and maintain the self assessment returns filed manually by the dealers. The VATSoft was found to have numerous data entry errors which have been commented upon in the Performance Audit 'IT Audit of VATSoft in CTD' included in the Audit Report 2009-10. The CTD replaced VATSoft by EFS with effect from 1 April 2010. Therefore the period selected for audit was 2010-11 to 2011-12. In short, the data reliability during the period prior to April 2010 was poor and hence was not considered for audit.

¹³ There are seven divisions in Bangalore district and the remaining six divisions are spread throughout the State. These were arranged in the descending order of the quantum of ITC claims during 2010-11 and 2011-12. Two DVOs from Bangalore district and two DVOs from the rest of the State were selected. Of the two DVOs selected, one each was selected from highest and middle level ITC claiming divisions.

to above, we selected 847 dealers¹⁴ for production of sale and purchase accounts etc; under section 52(1-A)¹⁵ of the Act. Response was received from 321 dealers who had claimed ITC of ₹ 883.76 crore during 2010-12. These were cross verified with the returns filed by the selling dealers.

An entry conference was held with the Additional Chief Secretary Finance Department and Commissioner of Commercial Taxes Department in May 2012, in which the objectives of the PA, Scope and methodology to be adopted were explained to them. The draft PA Report was forwarded to the Government in August 2013 and was discussed in the Exit Conference held with the Principal Secretary, Finance Department and Commissioner of Commercial Taxes in October 2013. The replies received during the Exit Conference and at other point of time have been appropriately commented in the respective paragraphs.

2.9.5 Audit Criteria

The audit criteria for the Performance Audit were derived from the provisions/rules of the following Act/Rules etc:

- The Karnataka Value Added Tax (KVAT) Act, 2003
- The KVAT Rules, 2005
- Notifications issued under the KVAT Act, 2003

2.9.6 Acknowledgement

We acknowledge the co-operation of the Finance Department, Government of Karnataka and CTD in providing necessary information and records for audit. We also acknowledge the services of Institute of Social and Economic Changes (ISEC) in statistically analysing and projecting the findings of our sample to the entire population.

¹⁴ Selected on stratified random sampling based on amount of ITC claimed by the dealers.

¹⁵ This section was inserted into the KVAT Act, 2003 from 1 April 2009. It authorises the audit party of Accountant General to direct any dealer to produce books of accounts relating to his business activity.

Audit Observations

System Deficiencies

2.9.7 Lack of Monitoring for uploading purchase invoices in the data base

Under the KVAT Rules the dealers were required to furnish details of their sales and purchases to the jurisdictional Local VAT Office (LVO) who monitored the payment of tax based on the return filed by the dealer. Up to 31 March 2012 tax invoice, debit note, credit note were the basis for claiming ITC. However, with effect from 1 April 2012 tax invoice alone shall be the basis for ITC claims.

Thus for ascertaining the correctness of the ITC payable, a complete data base of the purchase invoices is essential. However, we found a number of dealers had either not uploaded their purchase/sale invoices or had uploaded it partially/incorrectly and in some cases where the data of invoices was available, it was not utilised in allowing in the ITC.

The CTD had not assigned the responsibility of cross-verifying the data of sales and purchases uploaded with the returns filed by the selling dealers, nor was the system designed to do the same itself. Besides, no monitoring system was put in place to monitor the uploading the details of all purchase/sales made by the dealers to build a complete database that was necessary for verification of ITC claims as mentioned in the following paragraphs.

Deficiencies noticed in deemed assessed cases

2.9.7.1 Lack of monitoring in submission of purchase invoices/details

Rule 38 of the KVAT Rules stipulated that every dealer shall submit a return enclosing therewith the details of his purchases in respect of ITC.

We noticed that the Department had assigned individual accounts to all the dealers for use of EFS (software) for uploading the sale and purchase invoices along with their details but it had not put in place a mechanism for watching

the submission of the all purchase invoices by the dealers. As per the database of VAT 100¹⁶ available in the software, ITC of ₹ 33,624.66 crore was claimed by dealers in the years 2010-11 and 2011-12. But only 1.32 crore purchase invoice in support of ITC claims of only ₹ 8,420 crore were uploaded by 22,915 purchasing dealers. Thus purchase details of only 25 *per cent*¹⁷ of the ITC claimed in the returns was available in the EFS database. Absence of 75 *per cent* of data of purchase details indicated laxity on the part of the Department in submission of purchase details necessary for monitoring the grant of ITC.

¹⁶ Monthly tax returns filed by dealers

¹⁷ ₹ 8,420 crore/₹ 33,624.66 crore

2.9.7.2 Mistakes noticed in the scrutiny of purchase invoices

As per section 9 of KVAT Act, registering authority shall assign a registration number or Taxpayers Identification Number (TIN) to the dealer. TIN of registered dealers in Karnataka is a 11 digit number. A dealer has to furnish seller TIN, seller trade name, invoice number, invoice date, net value charged and tax charged while uploading purchase details into EFS.

The purchase details furnished by 22,915 purchasing dealers in support of ITC of ₹ 8,450 crore claimed by them related to the sales made by 1.09 lakh selling dealers. Our analysis of these purchase invoices and selling dealer's database available in the system revealed the

following:

TINs in respect of 705 selling dealers were wrongly mentioned in the purchase invoices uploaded by purchasing dealers who claimed ITC. It contained only 1 to 10 digits, i.e. less than 11 digits. Thus this information was of no use to the Department.

TINs of 6,673 selling dealers mentioned in the purchasing invoices were not traced in the dealer master database. These purchasing dealers had uploaded purchase invoices involving tax of ₹ 29.16 crore in respect of these selling dealers and claimed ITC to that extent.

Mistakes/errors like amount of tax charged in the invoice being shown equal to or more than the sale value of the goods in the invoice were noticed in 37,160 purchase invoice involving tax of ₹ 580.79 crore uploaded by 711 purchasing dealers for 2010-12. Thus, the data available in the system was not correct and reliable for verifying the correctness of the ITC claims.

2.9.7.3 Non-existence of TIN of dealers whose details were collected by audit under section 52(1-A)

ITC can be claimed only if the selling dealer and the purchasing dealer is registered under the KVAT Act 2003. Every registered dealer is allotted a TIN through the system.

The purchase details collected from 13 dealers by audit in 10 LVOs¹⁸ who had claimed ITC of ₹ 3.04 lakh on submission of 128 tax invoices issued by 30 selling dealers were cross verified with the database available in the system. The TINs of selling dealers quoted in these tax invoices did not exist in the dealer master

database indicating that these selling dealers were not registered with CTD. The purchasing dealers were thus not eligible for the ITC of ₹ 3.04 lakh claimed in their returns. This resulted in grant of ineligible ITC of ₹ 3.04 lakh.

¹⁸ LVOs 10, 20, 25A, 30, 40, 45A, 75, 100, 110A Bangalore, 465 Davanagere

The Department had at no time made an effort to check the correctness of the information furnished by physical verification of the invoices at least in a sample number of cases.

After this being pointed out the CCT accepted the audit observations and stated that though the provision for uploading the purchase/sale details was mandatory, there were gaps in the eco system of the business community and that the Department will have to put a mechanism to match the invoice on common platform of the entire data.

We recommend that:

- **the CTD may put in place a system by way of periodical inspections for ensuring uploading of all purchase/sales details by the dealers so as to build a complete database that is necessary for verification of ITC claims.**
- **an automated mechanism of verifying the tax paid in the purchase details uploaded with the ITC claim in the relevant tax return of the dealer be instituted and that ITC claim in the return be limited to the tax in the purchase details provided.**

2.9.8 ITC claims for purchases from de-registered dealers not disallowed

ITC can be claimed on purchases made by a registered dealer from another registered dealer within the State of Karnataka. Dealers that have been deregistered by the Department or have opted for deregistration are not entitled to issue tax invoices. A note of deregistration is made in the system.

Our analysis of the purchase invoice details uploaded in the EFS for 2010-12 with reference to dealer master database revealed that 3,747 purchasing dealers in 114 LVOs had claimed ITC of ₹ 21.54 crore based on 80,693 invoices issued by

3,814 selling dealers who were noted as deregistered in the system. These invoices were issued by the selling dealers after the date on which they were deregistered. Hence, the purchasing dealers were not eligible to the ITC¹⁹ claimed. No action was taken by the CTD to verify the correctness of these invoices and locate the dealers whose registrations were cancelled. The Department had not developed any mechanism to ensure that EFS did not accept the ITC claim in respect of purchases made from the de-registered dealers as would be evident from the following paragraph.

Audit collected purchase details from 978 deregistered dealers in 11 LVOs under section 52(1-A) to ascertain the correctness of the ITC claimed by them. Our verification of the invoices revealed the following:

¹⁹ Judgement of Hon'ble High Court of Karnataka in the case of M/s Packwell Industries V/s State of Karnataka held that purchases from deregistered dealers was similar to purchases from unregistered dealers. Hence, the purchasing dealer had to pay the tax due on such purchases and then claim ITC.

- 344 selling dealers were deregistered by the CTD but they had obtained new registration number from the CTD and issued invoices on the new registration number. However, the purchasers uploaded purchase invoice details involving ITC claims of ₹ 2.71 crore from these 344 selling dealers with their old TINs.
- 252 purchasing dealers had purchased goods from 336 selling dealers who were deregistered and had claimed ITC of ₹ 1.48 crore on the basis of invoices issued by the deregistered selling dealers. Though these ITC claims were not eligible, the mistakes remained unnoticed due to non-verification. This resulted in loss of Government revenue to that extent.
- In cases of a dealer, even though VAT reassessment had been concluded, the fact of purchase from deregistered dealer involving ineligible claim of ITC of ₹ 69,862 was not detected by the Department.

Audit verification was limited to the data of 45,098 purchase invoices collected by us. There is every apprehension that these deregistered selling dealers might have issued more invoices in respect of other sales made by them. Therefore matter needs to be investigated by the Department.

2.9.9 Suppression of sales by selling dealers whose purchase details were available in the data base (EFS)

We compiled and cross verified the purchase details uploaded in EFS for the years 2010-11 and 2011-12 with the returns filed by the selling dealers for the same period and found that the selling dealers had declared either less sales in their returns or had filed nil returns as mentioned in the following paragraphs.

2.9.9.1 Suppression of sales turnover where details were available for the entire year

We found that 3041 dealers had uploaded purchase invoice details with purchase turnover of ₹ 2139.77 crore and tax effect of ₹ 146.80 crore as purchases made from 1,865 selling dealers for the period between 1 April 2010 to 31 March 2012. However, these 1,865 selling dealers had declared tax of only ₹ 80.54 crore on the sales valued at ₹ 1,337.01 crore made by them in their tax returns for the period between 1 April 2010 to 31 March 2012. Thus, there was suppression of sales turnover of ₹ 802.76 crore and output tax of ₹ 66.26 crore by the selling dealers. Year-wise details of cases of short declaration of sales turnover were as follows:-

Table 2.8: Suppression of sales turnover

(₹ in crore)

Year	Details of the Purchases Uploaded in the EFS			Details of the sales as per the returns			Tax less declared
	No. of dealers	Purchase value of the goods	claimed as ITC	No. of selling dealers	sales turnover declared	Amount of tax declared	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2010-11	1,853	1,004.95	58.73	866	532.76	29.50	29.23
2011-12	1,188	1,134.82	88.07	999	804.25	51.04	37.03
Total	3,041	2,139.77	146.80	1,865	1,337.01	80.54	66.26

In addition to the above, 1,490 dealers declared 'Nil' local turnover against purchase turnover of ₹ 376.26 crore involving tax of ₹ 20.62 crore uploaded by the purchasers. Year-wise details of cases of short declaration of tax are given separately in the tables below:

Table 2.9: Nil returns filed by the selling dealers

(₹ in crore)

Year	No. of selling dealers who have filed 'nil' returns	Purchase value of goods	Amount of tax involved in purchase invoices uploaded
(1)	(2)	(3)	(4)
2010-11	806	241.07	11.85
2011-12	684	135.19	8.77
Total	1,490	376.26	20.62

2.9.9.2 Suppression of sales turnover where details of purchase invoices were partly available in the system

In addition to suppression for the entire year as discussed above, we also found suppression of the sales turnover by the selling dealers in a few tax periods (i.e., for relevant months) as compared to the corresponding purchase details available in the EFS as discussed in the following paragraph.

We found from the EFS that 5,662 dealers in 117 LVOs had declared tax of ₹ 401.32 crore on local sales during the period from April 2010 to March 2012 for different tax periods in the monthly returns filed. Cross-verification of these sales with the purchase invoices uploaded by the purchasing dealers in the EFS revealed that the selling dealers had sold goods with tax of ₹ 539.28 crore. Thus there was suppression of tax by the selling dealers amounting to ₹ 137.96 crore in 13,184 returns.

Since ITC of ₹ 539.28 crore was already availed by the purchasing dealers who had uploaded the purchase invoice details, these cases of suppression need further investigation by the CTD. A few illustrative cases are as follows:

Table 2.10: Suppression of sales in specific tax periods

(₹ in crore)

Sl. No.	TIN/LVO of dealer	Tax period/	Output tax declared by selling dealer	ITC claimed by purchasing dealer	Tax Difference
		No. of purchase invoices uploaded in EFS			
1	29270450283/ LVO 500	March 2011	0.34	2.42	2.08
		5			
2	29980793903/ LVO 75 Bangalore	December 2010 August 2011 October 2011 November 2011 February 2012 March 2012	0.62	1.81	1.19
		94			
3	29360065095/ LVO 110	June 2011	0.16	0.80	0.64
		11			
4	29700033189/ LVO 500 Hospet	May 2010	1.05	1.61	0.56
		6			
5	29590453211	October 2010	0.01	0.10	0.09
		1			

We cross-verified the purchase invoice details with tax effect of ₹ 50.23 crore uploaded by 3,265 purchasing dealers in the EFS with the returns of the selling dealer and found that 3,693 selling dealers had filed 'nil' 11,486 monthly returns for the corresponding tax periods. However, the purchasing dealer had availed the ITC based on these purchase invoice details. A few illustrative cases are given below:-

Table 2.11: Nil returns filed by selling dealers for specific tax periods

(₹ in lakh)

Sl. No.	TIN/LVO of selling dealer	Tax period	ITC claimed	No. of purchase details uploaded in EFS
1	29380899381/ LVO 150 A Bangalore	July 2011	16.19	1 invoice/ 290900519606/ LVO 510 Koppal
2	29530793132/ LVO 10, Bangalore	June 2010	15.89	1 invoice
3	29640771974/ LVO	September 2010	13.25	1 invoice/ 29220080013
4	29980864519/ LVO 70 A, Bangalore	April 2010, May 2010 and June 2010	11.67	25 invoices
5	29500765940/ LVO 20, Bangalore	May 2011, August 2011, November 2011 and December 2011	5.69	6 invoices

The Department may investigate the transactions and the claims made by the dealers by checking their books of accounts, ascertain the stage at which lapse has occurred and rectify the system to prevent such occurrence in future and realise the Government dues.

2.9.10 Suppression of sales by dealers whose purchase details were not available in the EFS but were collected by Audit

We collected purchase details from 321 dealers under section 52(1-A) and cross verified the purchase invoice details with the returns filed by selling dealers. It revealed suppression of sales by selling dealers as discussed below:-

2.9.10.1 Loss of revenue due to non-submission of purchase invoices and filing of 'Nil' returns by selling dealers

Under section 72(2) of the KVAT Act a dealer is liable to pay penalty at the rate of 10 per cent of his understated tax liability if it was more than 5 per cent of his actual liability to tax. Interest under section 36 (2) simple interest is levied for delayed payment of tax.

34 purchasing dealers in 14 LVOs²⁰ had claimed ITC of ₹ 1.05 crore based on invoices issued by 75 selling dealers in 38 LVOs²¹. We cross verified the purchases made by these dealers with the returns filed by the selling dealers and found that the selling dealers had filed 'nil' returns for that tax periods indicating tax collected by them was not remitted to Government on these sales. This

resulted in loss of Government revenue of ₹ 1.05 crore. A few illustrative cases are mentioned below:

Table 2.12: Nil returns filed by selling dealers in the sample

(₹ in lakh)

Sl. No.	Purchasing dealer LVO	Selling dealer LVO	Amount of tax claimed as ITC by the purchasing dealer	Tax period for which 'nil' return filed by the selling dealer
1	LVO 040	LVO 120	27.96	March 2011, April 2011 and September 2011
2	LVO 040	LVO 50A	20.35	May 2010, June 2010, March 2011, April 2011, May 2011
3	LVO 15A	LVO 15	6.64	September 2010 and December 2010
4	LVO 30	LVO 35A	3.93	June 2011, July 2011, November 2011 and January 2012
5	LVO 15A	LVO 25A	3.01	July 2010, September 2010 and October 2010

²⁰ LVOs 15A, 20, 25, 25A, 30,35A, 40, 45A, 50, 50A, 110, 130, 270, 495

²¹ LVOS 15, 15A, 20, 25, 25A, 35, 35A, 40, 45, 45A, 50, 50A, 55, 55A, 60, 60A, 65, 65A, 70, 70A, 75, 80, 90, 100, 110, 120, 130, 150, 155, 184, 190, 192, 221, 240, 250, 260, 365, 495, 530

The selling dealers were also liable to pay penalty of ₹ 10.49 lakh and interest of ₹ 38.97 lakh as per the provisions of the KVAT Act.

2.9.10.2 Under reporting of output tax by selling dealers

Input tax claimed by a purchasing dealer should be less or at least equal to output tax declared by a selling dealer in the returns for the corresponding tax periods.

16 dealers in 11 LVOs²² had claimed ITC of ₹ 91.93 lakh in 95 returns based on the tax invoices issued by 40 selling dealers in 22 LVOs²³. Hence, these 40 selling dealers should have declared minimum output tax of ₹ 91.93 lakh in their returns for the corresponding tax periods. Cross-verification with the returns filed by the 40 selling dealers for the relevant tax period revealed that the selling dealers had reported output tax of ₹ 40.11 lakh only in their VAT returns. This resulted in less realisation of revenue of ₹ 51.83 lakh. The selling dealers were also liable to pay penalty of ₹ 5.20 lakh and interest of ₹ 20.85 lakh.

After this was pointed out the CCT informed that an intra-Departmental Committee Report regarding the monitoring of input tax credit claims was formed to look into these cases and that a phased action was being contemplated.

A few illustrative cases are given below:

Table 2.13: Suppression of sales detected in the sample

(₹ in lakh)

Sl. No.	LVO of		Amount of tax		
	Purchasing dealer	Selling dealer	claimed as ITC by purchasing dealer	declared by selling dealer	declared less
1	LVO 130	LVO 152	15.80	2.13	13.67
Suppression was noticed in tax periods May 2010, June 2010, August 2010, September 2010, February 2011 to April 2011, June 2011 and July 2011.					
2	LVO 130	LVO 130	13.99	5.95	8.04
Suppression was noticed in tax periods July 2011, August 2011, September 2011, October 2011, December 2011, January 2012 and February 2012.					
3	LVO 495	LVO 495	18.09	13.13	4.96
Suppression was noticed in tax periods May 2010, June 2010, August 2010, September 2010, February 2011 to April 2011, June 2011 and July 2011.					
4	LVO 25	LVO 25A	2.80	nil	2.80
Suppression noticed in tax period April 2010, October 2010 and December 2010.					

²² LVOs 15A, 20, 25A, 30, 35 A, 40, 50A, 65A, 130, 270, 495

²³ LVOs 15, 15A, 25, 25A, 35, 35A, 40, 45A, 55, 55A, 60, 80, 120, 130, 150, 152, 181, 192, 261, 262, 370, 495

2.9.10.3 Non-inclusion of amounts of sale invoices in the sales turnover

Information furnished in six cases in three LVOs²⁴ revealed that the tax declared by 11 selling dealers in their returns was less than the tax shown in the invoices collected by audit from the purchasers. In all these cases, the selling dealers have not included these invoices in the turnover declared in the returns indicating that the entire sales on account of these invoices were suppressed. The loss of revenue in these cases works out to ₹ 53.92 lakh.

The selling dealers were also liable to pay penalty of ₹ 5.39 lakh and interest of ₹ 17.08 lakh. A few illustrations are given below:

Table 2.14: Omission to account invoices by selling dealers

(₹ in lakh)

Sl. No.	LVO of Purchasing dealer	LVO of Selling dealer	Amount of tax claimed as ITC by purchasing dealer	Amount of tax declared by selling dealer in return	Tax less declared
1	LVO 130	LVO 460	30.64	1.15	29.86
Suppression of sales turnover noticed in the invoices issued in the periods May 2011, June 2011, August 2011, September 2011, November 2011, January 2012 and February 2012 was ₹ 29.86 crore.					
2	LVO 130	LVO 191	18.38	11.68	7.73
Suppression of sales turnover noticed in tax period May 2010, June 2010, August 2010 to January 2011, March 2011, April 2011 and June 2011 was ₹ 6.70 lakh.					
3	LVO 130	LVO 152	5.95	1.15	5.71
Suppression was noticed for the tax periods October 2010, November 2010, January 2011, May 2011, September 2011, October 2011, November 2011 and November 2012.					
4	LVO 130	LVO 15	3.71	1.77	3.71
The suppression was noticed in the tax periods of February 2012. The tax declared by the dealer was for goods taxable at five <i>per cent</i> . Invoices obtained by us were for sale of goods taxable at 14 <i>per cent</i> . Hence total ITC in the invoices is taken as suppressed.					
	Total				47.01

After we reported these cases to the CTD between April and May 2013, CTD reported recovery of ₹ 42.58 lakh in one case including penalty of ₹ 2.99 lakh and interest of ₹ 9.73 lakh.

²⁴ LVOs 15A, 130, 30

2.9.10.4 ITC allowed though no returns were filed by selling dealers

15 dealers in 10 LVOs²⁵ claimed ITC of ₹ 1.03 crore in their returns based on invoices issued by 15 selling dealers in 12 LVOs²⁶. Cross verification of these details so collected with the EFS revealed that these 15 selling dealers had neither filed tax returns nor any record of having tax paid by them was available in the EFS. This resulted in loss of Government revenue of ₹ 1.03 crore. The selling dealers were also liable to pay penalty of ₹ 10.34 lakh and interest of ₹ 43.72 lakh. A few illustrative cases are given below:

Table 2.15: Non-filing of returns by selling dealers

(₹ in lakh)

Sl. No.	LVO of Purchasing dealer	LVO of Selling dealer	Amount of tax claimed as ITC	Tax period for which 'nil' return filed
1	LVO 270, 260	LVO 260	70.01	April 2010 to June 2010
2	LVO 495	LVO 495	21.48	June 2011 to January 2012
	Total		91.49	

The Department had made no effort for cross linking of purchase details with the sales details furnished by the corresponding selling dealers.

We recommend that an automated mechanism for cross-linking purchase details with selling dealers' returns may be implemented to detect and prevent loss of revenue.

Deficiencies noticed in reassessment concluded

2.9.11 Non-Detection of incorrect ITC claims in re-assessments concluded under KVAT ACT

As per section 39 of KVAT Act, cases are selected for re-assessment and detailed scrutiny is conducted.

We scrutinised 1,207 cases of re-assessments concluded in 21 audit offices²⁷ in Divisions I and IV of Bangalore, Mangalore and Davangere divisions and found that during re-assessment the Department had not used the data available with them for ascertaining the correctness of the refunds made by them. The ITC claims were allowed though purchases were made from de-registered dealers, selling dealer had declared turnover less than the ITC claimed, selling dealers having filed 'nil' returns for the corresponding tax period, selling dealers had not filing returns etc. A few cases are as follows: -

²⁵ LVOs 10, 20, 15A, 25, 35A, 45A, 260, 270, 465, 495

²⁶ LVOs 15A, 25, 25A, 35, 50A, 90, 100, 170, 260, 350, 460, 495

²⁷ Bangalore: DCCTs (Audit-1.7 & 4.7), ACCTs(Audit-1.7 & 4.1), CTOs(Audit-1.2, 1.3, 4.2, 4.3 & 4.4), ACCTs(Audit and Recovery-4.8 & 4.9)

Mangalore: ACCT(Audit and Recovery-8), CTOs(Audit-3, 6, 7 & 8)

CTO(Audit), Kundapura, DCCT(Audit and Recovery), Bellary, ACCTs(Audit-2 & 3), Davangere, ACCT (Audit and Recovery), Chitradurga.

2.9.11.1 11 audit officers concluded re-assessments of 18 purchasing dealers between February 2012 and January 2013. As per the purchase details filed by these 18 dealers along with the returns, ITC claim of ₹ 13.02 lakh was on account of purchases made from 21 dealers during 2010-11 and 2011-12. The ITC claims of the purchasing dealers were allowed in the re-assessment orders. However, our cross verification of the returns filed by the selling dealers in the EFS revealed that these 21 selling dealers had filed nil returns for these tax periods. This had resulted in grant of ITC to purchasing dealers against which output tax from the selling dealers was not realised to Government. This was not detected at the time of re-assessments resulting in incorrect grant of ITC of ₹ 13.02 lakh. Interest of ₹ 6.54 lakh was also leviable.

2.9.11.2 Three audit officers concluded re-assessments of three purchasing dealers between May 2012 and March 2013. As per the purchase list filed by the purchasing dealers in support of ITC claimed by them, they had claimed ITC of ₹ 1.81 lakh for purchases made from four dealers. The ITC claims of the purchasing dealers were allowed in the re-assessment orders. However, our cross verification with EFS revealed that the selling dealers were de-registered and had not filed any return or paid the tax collected. This had resulted in grant of ineligible ITC of ₹ 1.81 lakh. The mistake was not detected by the audit officers at the time of re-assessment and ITC claims of ₹ 1.81 lakh was allowed. Interest of ₹ 0.91 lakh was also leviable.

2.9.11.3 Four audit officers concluded re-assessments of five purchasing dealers between April and December 2012. As per the purchase list filed by the purchasing dealers ITC claims of ₹ 1.07 lakh was on account of purchases from six selling dealers. The same were allowed by the audit officers in the re-assessment orders. Our cross verification with returns filed by the selling dealers in EFS revealed that the selling dealers had reported output tax liability of ₹ 0.32 lakh only. This had resulted in grant of ITC of ₹ 0.75 lakh in excess of corresponding output tax realised to Government. The same was recoverable together with interest of ₹ 0.39 lakh. However, the mistake was not detected at the time of re-assessment resulting in non-raising of demands to that extent at the time of re-assessments.

We recommend that CCT may issue directions for cross-linking purchase details with selling dealers' returns at the time of finalisation the reassessments to detect and prevent loss of revenue.

2.9.12 Discrepancies noticed in "e-annual statement"

"e-annual statement" is a electronic compilation of all e-returns filed by the dealer in the EFS. Once the statement is compiled in LVO, it is approved by the LVO and a copy of the same sent to the dealer for his confirmation and signature. The dealer is required to send back the signed copy of the annual statement to the concerned LVO. A report indicating the total purchases on the basis of the purchase invoices made by a dealer can be generated by a module called 'MIS Reports – Analysis – Purchase Invoices' available in the EFS.

CTD had in October 2012 had issued directions for approving “e-annual statements” for active registered dealers. The LVOs were required to ascertain the filing of returns for all tax periods, payment of tax as per returns and verify the credits carried forward etc; before approving annual statements for active registered dealers. In respect of deregistered dealers, the LVOs were required to consider any material evidence of sale/purchase available for assessment of the dealers.

2.9.12.1 We noticed that though a report of all claims of purchase from a dealer was being generated by the module ‘MIS Reports – Analysis – Purchase Invoices’, the same was not cross-linked to the sales turnover reported in the returns by a dealer. We compared MIS Reports – Analysis – Purchase Invoices’ with the respective ‘e’ statements and found in 260 cases though the dealers had under-declared their tax liability by ₹ 5.19 crore, their “e-annual statements” had been

approved by the LVOs.

No action was initiated to probe the undeclared tax liability and recover Government revenue due.

2.9.12.2 Excess claim of ITC:- In addition to above we noticed mistakes in the returns filed by dealers. These could have been rectified at the time of approval of "e-annual statement" by the LVO and sent to the dealer for his confirmation and signature. However, no mechanism was put in place by way of sample selection to verify their correctness as mentioned in the following paragraph.

We noticed that nine dealers had claimed ITC of ₹ 19.68 lakh as against tax of ₹ 17.68 lakh paid as per purchase details furnished. This had resulted in excess claim of ₹ 2 lakh as given below:

Table 2.16: Deficiencies noticed in e-annual statements

(₹ in lakh)					
Sl. No.	Nature of observation	No. of dealers	ITC amount claimed	ITC amount as per purchase details	Excess claim
1	ITC claimed in excess of tax charged in invoice	2	0.58	0.40	0.18
2	ITC claim not supported by purchase details	3	16.54	16.00	0.54
After we pointed out the cases, LVO 10 reported recovery of ₹ 0.34 lakh in one case.					
3	ITC claimed twice on the same invoice	4	2.56	1.28	1.28

We recommend that a control mechanism be introduced at the time of approval of “e-annual statement” to cross-link details of purchases uploaded to tax declared by the sellers.

2.9.13 Non-monitoring of reduction in ITC on filing of Form VAT 240

As per Form VAT 240 prescribed under the KVAT Rules, the auditor has to furnish a certificate of his observations and summary of the additional tax liability or additional refund due to the dealer as the case may be. Dealer was permitted to file a revised return at any time within a period of 6 months from the end of the relevant tax period, without having to obtain any permission.

Scrutiny of the database and VAT 240 (scanned copies) submitted by 63 dealers revealed that ITC in respect of these dealers was reduced by ₹ 7.23 crore. We cross checked the data entered by the dealers in the system with the scanned copies of the Form VAT 240 uploaded and noticed the following mistakes/errors:

Data entry mistakes:- Dealers are required to enter the details of the Form VAT 240 in the system. This ensures the tax payable and ITC available to the dealers. We noticed that seven dealers incorrectly entered the details of Form VAT 240 in the system. Though no amount was payable by these dealers as per Form VAT 240, the system showed an amount of ₹ 1.40 crore payable by these dealers indicating lack of monitoring.

Non-revision of the Returns:- 17 dealers had carried forward the reduced ITC of ₹ 65.05 lakh in their April 2012 return and subsequent to filing of Form VAT 240 but did not file the revised returns.

Refunds not processed:- Six dealers claimed refunds of ITC of ₹ 1.42 crore but the refunds were not processed/allowed.

Non-demand of the amount payable:- 28 dealers who had to pay additional tax of ₹ 1.50 crore due to reduction of ITC of ₹ 3.77 crore in the Form VAT 240 filed; only four dealers had discharged the payments of ₹ 68.80 lakh. The remaining amount ₹ 81.20 lakh was not demanded by the Department.

A few illustrative cases are given below:

- A dealer registered with LVO 155, Ramanagar for the year 2011-12 showed output tax liability of ₹ 2.36 crore in his returns. The dealer claimed ITC of ₹ 2.15 crore and brought forward credit of ₹ 8.38 lakh from 2010-11 and paid VAT of ₹ 42.28 lakh. Consequently, there was excess credit of ₹ 28.77²⁸ lakh and the same was carried forward to the year 2012-13.

²⁸ ₹ (214.55 lakh+8.38 lakh+42.28 lakh =265.21-236.44 lakh=28.77 lakh)

The CA who certified the audited accounts of the dealer for the year 2011-12 in December 2012 determined the output tax liability as ₹ 2.36 crore and brought forward credit of ₹ 8.38 lakh which were same as reported by the dealer in his returns. However, the CA determined the correct amount of ITC as ₹ 1.18 crore instead of ₹ 2.15 crore claimed by the dealer in his returns. Thus ₹ 68.19 lakh were payable by the dealer. Besides excess credit of ₹ 28.77 lakh carried forward to the year 2012-13 was required to be recovered.

Accordingly the CA advised the dealer to pay tax of ₹ 96.96 lakh and interest and penalty of ₹ 28.92 lakh. But the dealer paid tax of ₹ 48.98 lakh and interest and penalty of ₹ 14.59 lakh in two installments in December 2012 and February 2013. CTD had not taken action to recover tax of ₹ 47.98 lakh and interest of ₹ 14.33 lakh.

We also noticed that in the EFS that the dealer had uploaded additional tax liability determined by CA in Form VAT 240 as nil. Consequently, the EFS depicted the status of Form VAT 240 as 'deemed acknowledged'.

- We noticed in case of a dealer registered with LVO 525, as per the returns filed for the year 2011-12 output tax payable was ₹ 12.34 lakh with ITC claim of ₹ 1.28 crore. Since ITC was more than the output tax liability, no payments were made by the dealer during 2011-12 and he carried forward the excess credit available to the year 2012-13. The CA who certified the audited accounts of the dealer for the year 2011-12 in December 2012 determined the output tax payable at ₹ 12.34 lakh but the entire ITC of ₹ 1.28 crore claimed by the dealer was determined as ineligible. Therefore, the dealer was liable to pay tax of ₹ 12.34 lakh. However, the same was not paid by the dealer.

The above mistakes went unnoticed because the Department did not have a system in the EFS to reduce or enhance the ITC as per the certificate issued by CA.

We recommend that the Department may introduce an inbuilt system in EFS that automatically reduces/enhances the ITC available to be carried forward when Form VAT 240 are filed by the dealer.

2.9.14 Incorrect/excess Grant of Refunds

Incorrect Grant of Refunds:- Test check of the refunds processed in 148 cases during 2010-12 revealed grant of incorrect refund of ₹ 21.52 lakh in 23 cases as given below:

As per circular issued by CCT in June 2011, the LVO should invariably satisfy himself that the dealer from whom the ITC refund claimant dealer purchased goods has, in fact, paid the tax in respect of which ITC refund is being claimed by the refund claimant dealer. Only upon confirming or satisfying himself that the selling dealer or the earliest of the successive dealers has paid the tax, the refund order should be issued.

2.9.14.1 ITC amount of ₹ 13.58 lakh was refunded to seven purchasing dealers by four LVOs even though the purchases were made from 11 deregistered selling dealers and no tax was realised from the dealers. The grant of

refunds was in contravention to the provisions of the circular instructions.

2.9.14.2 In eight cases, ITC refunds of ₹ 7.18 lakh were granted to 10 purchasing dealers by five LVOs. The purchases for which ITC refund was claimed were purchased from 19 selling dealers. Cross-verification of the refunds made with returns filed by the selling dealers revealed that either the selling dealers had not filed their returns or had paid tax less than the tax claimed or had filed NIL returns. The refunds were, thus, allowed without ensuring the payment of tax into the Government.

2.9.14.3 ITC of ₹ 0.75 lakh claimed was refunded to three dealers by three LVOs. The TIN of the corresponding three selling dealers furnished by the purchasing dealers were not found in database. LVOs had not checked the database before granting the refunds to ascertain whether the revenue refunded was not previously paid to Government.

2.9.14.4 We found arithmetical error in computation of the refund amount in one case and in the other three cases, purchase details furnished by the dealers were incomplete; however the refunds were granted. This resulted in grant of refund of ₹ 0.41 lakh by two LVOs to four dealers.

2.9.14.5 Excess grant of refunds:- We noticed that a dealer registered with LVO 500 had been granted six refunds of ₹ 1.65 crore²⁹ for the tax period 2008-09 and 2009-10. These refunds were subject to the finalisation of the actual refunds due to the dealers by the appellate authority. The appellate authority decided the case in January 2013 and ordered for a refund of ₹ 1.16 crore against the dealer instead of ₹ 1.65 crore paid to the dealer. The refunds were accordingly recalculated but while doing so the LVO omitted to consider fourth refund of ₹ 49.41 lakh granted to the dealer. Thus there was excess refund of ₹ 49.41 lakh.

After we pointed out the case, LVO 500 accepted the audit observation and reported that the dealer had deposited the excess refund amount of ₹ 49.41 lakh through five post dated cheques realisable between September 2013 and January 2014.

2.9.15 Reversal of ITC on change of registration type from 'VAT' to 'COT'

As per Section 19(3) of the KVAT Act, where any dealer registered under 'VAT' opts for 'COT', ITC claimed on the goods held in stock on the date on which the dealer exercises such option, shall be repayable in the month following such change of registration.

In 10³⁰ LVOs, 48 dealers had opted for payment of tax under composition instead of VAT between April 2010 and September 2012. We noticed that in these cases the LVOs had not obtained details of

²⁹ ₹ 9.69 lakh, ₹ 70.53 lakh, ₹ 22.77 lakh and ₹ 49.41 lakh, ₹ 12.62 lakh totaling to ₹ 1.65 crore

³⁰ LVOs- 10, 15A, 25A, 40, 260, 265, 465, 495, 500, 510.

closing stock from the dealers and reversed the input tax on the closing stock before issuing the 'COT' registration certificate except in two cases. Due to the absence of the details of the closing stock details as on the date of switch over we could not ascertain the correctness of the ITC reversed.

Scrutiny of the two cases revealed that ITC of ₹ 0.85 lakh on the closing stock of the COT dealers was required to be reversed. However, this was not done and the re-payment of ITC was not demanded before issue of 'COT' certificate.

2.9.16 Non-reversal of ITC on purchases made from dealers identified as bogus dealers by intelligence wing of the CTD

Enforcement Wing, South Zone, Bangalore had identified 92 dealers as 'bogus'³¹ dealers'. The CTD had issued a letter in September 2012 to all field offices notifying these bogus dealers and directed that action to disallow ITC on account of purchases from these bogus dealers was to be taken as per law while concluding re-assessments.

We found that two purchasing dealers had claimed ITC amounting to ₹ 11.35 lakh on account of purchases from these identified bogus dealers. However, these dealers were neither issued any re-assessment notice nor any action was taken to reverse ITC indicating therein that the Department was not following its own instructions.

The measures taken to disallow ITC on purchases from these bogus dealers though called for (May 2013), the Department has not furnished any information (December 2013).

2.9.17 ITC claims on purchases from COT dealers

As per Section 15 of KVAT Act, dealers under 'COT' registration should not collect taxes on their sales. Only 'Works Contractors' under 'COT' were authorised to collect taxes and issue tax invoices. As per section 10 of KVAT Act, ITC cannot be claimed for purchases from 'COT' dealers.

We noticed that six purchasing dealers in four³² LVOs had claimed ITC of ₹ 3.12 lakh for purchases from eight COT dealers. The ITC claim was ineligible and was required to be

disallowed. No reply was furnished by the Government/Department for its recovery.

³¹ These were termed as bogus by the Department.

³² LVOs 15A, 25A, 50A, 270

2.9.18 Incorrect grant of ITC on stock transfer

Sections 14 and 17 of the KVAT Act prescribe special rebating scheme and partial rebating scheme for ITC claims in respect of purchases for goods dispatched outside the State other than as a direct result of a sale or when the inputs are used in sale of both taxable and exempted goods.

We noticed that three dealers of LVOs 260, Mangalore and Davanagere 465 had ITC of ₹ 14.44 crore during 2010-11. However, they transferred goods outside the state or used the goods in the manufacture of exempted goods.

Accordingly the dealers were not entitled to the ITC in respect of goods that were transferred or used in the manufacture of exempted goods. Based on the special rebating scheme and partial rebating scheme for ITC claims ineligible ITC amounted to ₹ 5.97 crore instead of ₹ 2.37 crore allowed by the Department for which no base was made available to audit.

2.9.19 Statistical inference from our sample analysis

We verified ITC claims in respect of 321 dealers and the various observations noticed in the sample are already detailed in the report. The stratification of the results of our observations is as shown below:

Table 2.17: Statistical inference

(₹ in crore)

Category of purchasing dealers	Number of dealers whose books of accounts were verified	Amount of ITC claimed by them in 2010-12	Number of dealers whose ITC claims were not preceded by earlier revenue realisation to Government	Amount of ITC not eligible as per our observations
ITC claims of less than ₹ 25 lakh	125	11.30	18	0.18
ITC claims between ₹ 25 lakh and ₹ 100 lakh inclusive of the limits	120	58.65	15	0.26
ITC claims of more than ₹ 100 lakh	76	813.82	23	2.67
Total	321	883.77	56	3.11

With the above data, we can infer that ITC claims in respect of about 17 per cent of the population is susceptible to claims without earlier realisation of revenue in the VAT chain. On the basis of identification of a single purchaser in the sample vis-à-vis a seller who is suppressing the sales turnover, the most likely estimate of total loss on account of ineligible ITC claimed throughout the State of Karnataka across the strata

works out to be ₹ 353 crore. If more such purchasers were identified from the same selling defaulter, the loss would have been manifold.

2.9.20 Conclusion

The Performance Audit revealed a number of system and compliance deficiencies that require immediate attention of CTD. Though the KVAT Rules provided for mandatory submission/uploading of purchase details/invoices in the EFS database by the dealers, the CTD had not put in place to monitor the task. Purchase details of 74 *per cent* of ITC claimed were not available in the EFS database indicating that claims to that extent were allowed without verification of the purchase details, thus defeating the very purpose of the Rules.

We found the data available in the system was not put to use allowing ITC claims and refunds. Our cross-verification of the data with the returns filed by the selling dealers revealed allowing of ITC claim in respect of purchases that were made from de-registered dealers or for which no revenue had previously been realised. A number of dealers continued to issue tax invoices and collect taxes after the date of their de-registrations while several dealers had declared less sale in their returns or had filed nil returns.

Besides, the CTD had not put in place a system to monitor the correctness of the data uploaded by the dealers. A number of errors were made in the data uploaded which remained un-detected till these were pointed out by us. The CTD had not entrusted the responsibility of verifying the correctness of data uploaded. The data entry errors and the mistakes made in the invoices indicated that the Department needs to strengthen its inter controls for ensuring a reliable and complete data base.

2.9.21 Summary of the Recommendations

We recommend that the CTD may:

- put in place a system by way of periodical inspections for ensuring uploading of all purchase/sales details by the dealers so as to build a complete database that is necessary for verification of ITC claims.
- introduce an automated mechanism of verifying the tax paid in the purchase details uploaded with the ITC claim in the relevant tax return of the dealer and that ITC claim in the return be limited to the tax in the purchase details provided. This will ensure that ITC claims are on account of purchases from valid registered dealers in the State.
- introduce an automated mechanism for cross-linking purchase details with selling dealers' returns to detect and prevent loss of revenue.
- issue directions for cross-linking purchase details with selling dealers' returns at the time of finalisation the reassessments to detect and prevent loss of revenue.
- develop an inbuilt system in EFS that automatically reduces/enhances the ITC available to be carried forward when VAT 240 are filed by the dealer.

2.9.22 Response of the Department

In response to our report, the Department stated that the extent of granularity intended in VAT chain was at the macro level of data collection from dealers. The report, however, seems relevant for the granularity at micro level of individual transactions. The reply further stated that the extent of granularity intended for establishment and supervision of the value chain in the tax administration depends on the capability of the entire ecosystem which includes the CTD as well as the dealers.

2.10 Non-observance of provisions of the Acts/Rules

The KVAT Act provides as under:

Section 4 for levy of output tax at prescribed rates;

Section 10(2), 11, 14 and 17 for deduction of ITC subject to certain restrictions;

Section 10(3) for net tax liability which shall be the amount of output tax less the input tax deductible;

Section 10(5) for adjustment/refund of excess ITC for any other tax period;

Section 9-A for tax deduction at source in respect of works contractors;

Section 15 for composition of tax in lieu of net tax payable;

Sections 35 and 36 for levy of interest for omission to pay tax;

Section 35(4) for furnishing of revised returns within six months after the end of the relevant tax period; and

Section 72(2) for levy of penalty for understatement of output tax/overstatement of ITC.

Under the KVAT Act, every registered dealer is required to furnish returns in the prescribed form and pay the tax due on such return within 20 days after the end of the preceding month or any other tax period. Every dealer shall be deemed to have been assessed to tax based on such return filed by him. Where any prescribed authority has grounds to believe that any return furnished, which is deemed as assessed, understates the correct tax liability, it may re-assess such cases.

We noticed in test check of the records of 71 VAT offices that the above provisions were not fully followed by the concerned Assessing Authorities (AAs). The omissions and irregularities in 139 cases involve non/short realisation of Government revenue amounting to ₹ 8.43 crore. The Department has accepted audit observations in 54 cases involving ₹ 1.53 crore and intimated recovery of ₹ 1.38 crore in 50 cases. In respect of the remaining cases, final reply has not been received (December 2013).

2.10.1 Non-forfeiture of tax collected in excess

Four VAT offices in two³³ districts

Under Section 47 of the KVAT Act, when any amount is wrongly collected by way of tax or purporting to be way of tax from any person by any dealer, whether knowingly or not, such dealer shall pay the entire amount so collected, to the prescribed authority within 20 days after the close of the month in which such amount was collected. Any such amount which is not due as tax shall be forfeited to the Government and recovered from the dealer which will discharge him of the liability to refund the amount to the person from whom it was collected.

During the test check of records of five VAT offices (two Audit offices and three LVOs) in Bangalore and Mangalore districts conducted between April 2012 and January 2013. We noticed that seven dealers had collected tax of ₹ 2.53 crore in excess of the output

tax assessed. The details of the cases are as below:

Our scrutiny of annual accounts (Form 240) certified by the Chartered Accountant (CA) in respect of three works contract dealers, revealed that they have declared collection of tax of ₹ 11.33 crore where as the output tax declared by them was ₹ 9.26 crore. Thus the dealers had collected excess tax of ₹ 2.07 crore, which was not remitted to the Government Account. This was required to be forfeited by the Department for which no action was taken.

In another work contractor case, our scrutiny of the reassessment order passed by DCCT (Audit)-1.6, Bangalore, revealed that the dealer had collected tax of ₹ 2.02 crore and ₹ 95.25 lakh during the period 2007-08 and 2008-09 respectively. However, the output tax liability assessed by the Assessing Authority (AA) was only ₹ 1.90 crore and ₹ 94.86 lakh for the period. Thus the dealer had made excess collection of ₹ 12 lakh and ₹ 0.39 lakh, which had to be forfeited. The AA omitted to issue orders of forfeiture.

Our scrutiny of Form 240, in respect of two retail dealers for the year 2011-12 revealed that they had declared collection of ₹ 4.70 crore where as the output tax declared ₹ 4.66 crore. Thus, the dealer had collected ₹ four lakh in excess which was not remitted.

In respect of another retailer, we found from their monthly returns filed for the year 2011-12 that ₹ 1.78 crore was declared as tax collection where as the output tax liability was only ₹ 1.48 crore. Thus, the dealer had collected ₹ 30 lakh in excess, which was not remitted to the treasury. However, the Department did not pass orders for forfeiture.

³³ Bangalore and Mangalore.

These cases were pointed out to the Department between June 2012 and February 2013, the LVOs concerned stated to take action in five cases. In the remaining 2 cases compliance is still awaited (December 2013).

These cases were reported to the Government in July 2013. Their replies are awaited (December 2013).

2.10.2 Non-forfeiture of Central sales tax collected in excess

DCCT (Audit) 5.1, Bangalore

According to section 9(2) of the CST Act, 1956, the provisions of penalty under the general sales tax law of the state is applicable for enforcing the payment of tax under CST Act. Further, Under Section 47 of the KVAT Act, when any amount is wrongly collected by way of tax or purporting to be way of tax from any person by any dealer, whether knowingly or not, such dealer shall pay the entire amount so collected, to the prescribed authority within 20 days after the close of the month in which such amount was collected. Any such amount which is not due as tax shall be forfeited to the Government and recovered from the dealer which will discharge him of the liability to refund the amount to the person from whom it was collected.

We noticed in an assessment order passed under the CST Act that a manufacturer dealer had collected tax of ₹ 12.69 crore for the interstate sales made by him for the period from April 2006 to December 2006. The output tax liability determined by the AA under KVAT Act for the period was ₹ 12.43 crore. Thus collection of tax of ₹ 26 lakh which was in excess of the output tax assessed which was required to be forfeited under

section 47 of the KVAT Act, 2003 read with section 9(2) of the CST Act. The AA omitted to pass the orders of forfeiture, which resulted in non forfeiture of ₹ 26 lakh.

The case was reported to the Department (October 2012) and Government (July 2013); their replies are awaited (December 2013).

2.10.3 Excess adjustment of credit amount

22 LVOs and five Audit Office in 12³⁴ districts

Any dealer in whose case, on the basis of return filed for any tax period, the input tax deductible exceeds the output tax payable by him, such dealer may adjust the excess amount towards the tax payable by him for any other tax period.

We scrutinised the monthly returns (VAT 100), Form 240 and reassessment orders of 46 dealers for the period from 2006-07 to 2011-12.

³⁴ Bangalore, Dharwad, Ramanagara, Bidar, Dakshina Kannada, Gulbarga, Hassan, Jamkhandi, Karwar, Koppal, Yadgir and Bellary Districts.

We found that the dealers had brought forward excess Input Tax Credit (ITC) of ₹ 6.16 crore in the succeeding months against the actual ITC of ₹ 4.33 crore available in the immediate preceding months. This has resulted in excess adjustment of credit amount of ₹ 1.83 crore. No action was taken by the LVOs/Audit Officers concerned to demand the tax due or advice the dealers to file revised returns.

A few illustrative cases are mentioned below:

Table 2.18: Excess credit availed

(₹ in lakh)						
Sl. No.	Name of LVO	Previous Tax period	Credit Carried forward	Subsequent Tax period	Credit brought forward	Excess credit availed
1	LVO-120, Bangalore, M/s X	March 2012	19.15	April 2012	25.32	6.17
2	LVO-60, Bangalore, M/s Y	March 2010	0.93	April 2010	8.61	7.68
		July 2010	6.74	August 2010	7.01	0.27
3	LVO-155, Ramanagara, M/s Z.	January 2009	Nil	February 2009	5.47	5.47
4	LVO-45, Bangalore, M/s P.	March 2010	Nil	April 2010	61.27	61.27
5	LVO-270, Mangalore, M/s Q	March 2012	23.83	April 2012	40.81	16.98

After we pointed out the cases, the Government/Department reported recovery of ₹ 37.29 lakh in respect of fifteen cases, three cases were referred for audit scrutiny and twenty six cases were stated to be under examination. In the remaining two cases replies are still awaited (December 2013).

2.10.4 Non/short realisation of tax due to application of incorrect rates/ arithmetical errors

Six LVOs and five Audit Offices office in three³⁵ districts

Under the KVAT Act, every registered dealer shall be liable to pay tax on his taxable turnover (output tax) at the rates specified in the relevant schedules to the Act. In respect of goods not specified in any of the schedules, tax is payable at the rate of 12.5 per cent up to 31.03.2010 and 13.5 per cent from 01.04.2010.

We noticed between August 2010 and December 2012 that in respect of 11 dealers for the period from March 2008 to March 2011, output tax liability was incorrectly arrived at due to arithmetical

³⁵ Bangalore, Hubli and Kolar.

errors and application of incorrect rate of tax. The details of the cases are as detailed below:

Mistakes in reassessment order:

In respect of six cases, we scrutinised the reassessment orders passed and found that tax of ₹ 85.19 lakh was levied on a taxable turnover of ₹ 17.44 crore, instead of ₹ 1.38 crore due to arithmetical mistakes. This resulted in short levy of tax of ₹ 53 lakh.

Mistakes noticed on verification form 240:

In another five cases, on scrutiny of the returns and form 240 filed by the dealers, we found that a tax of ₹ 1.7 crore was levied on a taxable turnover of ₹ 41.40 crore instead of ₹ 2.46 crore due to application of incorrect³⁶ rates of tax. This resulted in short realisation of tax of ₹ 76 lakh. The reasons for application of incorrect rate of tax were not furnished by the Department.

After these cases were pointed out between September 2010 and January 2013, the Department reported recovery of ₹ 6.15 lakh in two cases. Seven cases were stated to be under examination. In respect of the remaining two cases, reply is not yet received (December 2013).

These cases were reported to the Government in June 2013. Their replies are awaited (December 2013).

2.10.5 Non/short levy of interest

Four LVOs and 15 Audit Offices in seven³⁷ districts

Under the KVAT Act, every dealer is liable to pay simple interest at the rate of 1.25 per cent per month up to 31 March 2011 and 1.5 per cent per month thereafter.

We scrutinised the reassessment orders passed and monthly returns filed in respect of 22 assesses between April 2005 and March 2011. We found that additional tax demands were created in the reassessment orders and that tax paid in the returns were paid

belatedly. In all these cases interest though leviable was not levied. This resulted in non/short levy of interest of ₹ 52 lakh. The details of the cases are as below:

In 5 cases, we found that the tax liability of ₹ 4.96 crore was paid after a delay ranging from one month to nine months and the interest liability works out ₹ 8.35 lakh. This was not levied by the Department.

In 17 cases, we found that reassessment orders were passed and additional tax demand of ₹ 6.79 crore was created. The delay in these cases ranged

³⁶ Medical instruments, scrap and buckets were levied at 4 per cent instead of 5 per cent, cranes were levied at 4 per cent instead of 12.5 per cent and Calcium Ammonium Nitrate was levied at 5 per cent instead of 13.5 per cent.

³⁷ Bangalore, Dakshina Kannada, Gulbarga, Ramanagara, Mysore, Belgaum and Tumkur districts.

from 12 months to 72 months and the interest leviable works out to ₹ 4.18 crore against which the Department had levied only ₹ 3.75 crore. The non/short levy of interest amounted to ₹ 43.59 lakh.

After this was reported between June 2012 and December 2012, the Government/Department reported recovery of ₹ 11.12 lakh in eight cases and stated to examine the remaining 14 cases.

2.10.6 Short payment of tax

Four VAT offices in Bangalore and Shimoga districts

Under section 35 the KVAT Act, every registered dealer is required to file a monthly return indicating *inter alia* the tax payable/paid by him. The tax collected by the dealer during a month should be remitted into the Government Account within 20 days (regular dealers) and 15 days (composition dealers) after the expiry of the month. Further, under section 36(2) of the Act, the assessee is liable to pay interest on delayed payment of tax at 1.25 per cent per month till 31.03.2010 and 1.5 per cent per month thereafter, from the due date to the date of payment.

We noticed between August 2012 and January 2013 that three dealers had declared a tax of ₹ 1.86 crore in their monthly returns. But they had remitted only ₹ 1.46 crore which resulted in short remittance of ₹ 40 lakh. Besides, interest leviable on the short remittance works out to ₹ 12.72 lakh.

Further, our scrutiny of returns on April 2012 in respect of a composition dealer dealing in jelly, we found that the dealer had a crushing unit of size 20"X 12" for which the tax leviable was ₹ 16,500 per month. Hence, the tax liability for the period from June 2010 to March 2011 works out to ₹ 1.65 lakh. However, the dealer had declared and paid only ₹ 82,500. This has resulted in short remittance of tax of ₹ 82,500. Besides, the interest leviable works out to ₹ 20,419.

After these cases were pointed out, the Department reported a recovery of ₹ 1.81 lakh in two cases and stated that one case is under examination. In one case, it was replied that short payment was due to bounced cheques and an investigation has been taken up.

These cases were reported to the Government in July 2013. Their replies are not yet received (December 2013).

2.10.7 Non-raising of demand of the additional tax declared in Form 240

16 LVOs/VSOs and one Audit Office of eight³⁸ districts

Under KVAT, 2003 every dealer whose total turnover in a year exceeds ₹40 lakh till 31.03.2010, ₹ 60 lakh from 1.04.2010 to 31.03.2011 and ₹ 100 lakh thereafter, shall have his accounts audited by a Chartered Accountant or a Cost Accountant (CA) or a Tax Practitioner (Auditor) and shall submit to the prescribed authority a copy of the audited statement of accounts in Form VAT-240 and prescribed documents in the prescribed manner.

In case of any difference in tax from the tax paid in the monthly returns, the Auditor may advise the dealer either to pay the difference of tax together with the interest and penalty if any, or to claim refund due to him as the case may be.

We scrutinised the returns of 16 dealers between April 2012 and January 2013 that along with their audited accounts certified by the CA in Form VAT 240. We noticed that the CA had created an additional tax liability of ₹ 30.79 lakh compared to the tax paid in the monthly returns for the years 2007-08 to 2011-12. The additional demand created was to be paid by the concerned dealers together with mandatory interest of ₹ 5.34 lakh and penalty of ₹ 2.11 lakh. The concerned dealers neither paid the dues on their own, on filing the audited accounts nor the dues were demanded by the

LVOs/VSOs. This resulted in non-raising of demand of tax of ₹ 37.24 lakh along with interest and penalty.

After these cases were pointed out, the Department reported recovery in six cases involving tax effect of ₹ 17.20 lakh, and stated that eight cases are being examined. In respect of the remaining two cases replies are still awaited (December 2013).

These cases were reported to the Government in June 2013. Their replies are awaited (December 2013).

2.10.8 Incorrect refund

Two VAT offices in two³⁹ districts

Under the KVAT Act, any dealer in whose case, on the basis of return filed for any tax period, the input tax deductible exceeds the output tax payable by him such dealer may adjust the excess amount towards the tax payable by him for any other tax period.

We noticed in December 2012 that a dealer was allowed a refund of ₹ 35.56 lakh for the month of August 2006. Our

³⁸ Bangalore (Urban), Bangalore (Rural), Belgaum, Dharwad, Dakshina Kannada, Karwar Koppal and Mandya Districts.

³⁹ Belgaum and Bellary.

scrutiny of the refund proceedings by the DCCT (Audit)-6.1, Bangalore revealed that excess ITC refundable for the month of August 2006 was ₹ 10.20 lakh as shown below:

Table 2.19: Excess refund

(₹ in lakh)	
Particulars	Amount
Tax liability arrived as per refund proceedings	12.68
Excess ITC brought forward from July 2006	22.88
Hence excess ITC for August 2006	10.20

However, the excess ITC was arrived as ₹ 35.56 lakh⁴⁰ in the refund proceedings due to arithmetical mistake and the same was refunded. This resulted in excess refund of ₹ 25.36 lakh.

In another case, our scrutiny of Form 240 for the year 2009-10 along with the returns filed for the months of April 2010 and May 2010 revealed that the tax refundable to the dealer at the end of May 2010 works out to ₹ 24.77 lakh against ₹ 27.02 lakh allowed by the Department as shown below:

Table 2.20: Incorrect refund

(₹ in lakh)	
Particulars	Amount
Excess ITC at the end of the year 2009-10	27.18
Excess ITC brought forward from July 2006 (inclusive of excess ITC of ₹ 44,105 brought forward from 2008-09)	2.41
Hence eligible refund at the end of May 2010	24.77

However, the refund issued to the dealer for the period was ₹ 27.02 lakh due to non-verification of Form 240. This has resulted in excess refund of ₹ 2.24 lakh.

After the cases were pointed out between October 2012 and January 2013, the Department reported a recovery of ₹ 25.36 lakh in one case. The final reply in respect of the second case is still awaited (December 2013).

These cases were reported to the Government in June 2013. Their replies are awaited (December 2013).

⁴⁰ instead of subtracting, the officer concerned had added the tax liability and excess ITC.

2.10.9 Incorrect grant of exemption

One LVO in Bangalore

Under section 15(1) of the KVAT Act, 2003, a registered dealer who is executing works contract may elect in lieu of the net amount of tax payable by him under this Act by way of composition. The rate of tax payable by a dealer under composition was four *per cent* on the total consideration for the works contract executed during the financial year. The Act does not provide deduction of any amount from the total consideration except amounts paid to the sub-contractors as consideration for execution of works contract.

We noticed in May 2012 that two works contract dealers executing civil works contracts had opted for payment of tax by way of composition. Our scrutiny of the Form 240 for the period 2010-11 revealed that they had claimed deduction of ₹ 4.43

crore from the total turnover of ₹ 17.14 crore as labour charges. Since the dealer had opted for composition of tax, as such deduction of labour charges was not admissible under the Act. The ineligible deduction resulted in short levy of tax of ₹ 17.73 lakh.

The cases were reported to Department in June 2012 and to Government in July 2013. Their reply has not been received (December 2013).

2.10.10 Non/short levy of penalty

VAT Offices (LVOs) and two Audit Offices in four⁴¹ districts

Under section 35(4) of the KVAT Act, 2003 a dealer can submit a revised return in case he finds any omission or incorrect statement in the original return filed. However, this is subject to the payment of penalty under section 72(2).

Section 72(2) of the Act stipulates that a dealer who for any prescribed month furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five *per cent* of his actual liability to tax or his actual tax credit, as the case may be, shall after being given the opportunity of showing cause in writing against the imposition of a penalty, be liable to a penalty equal to ten *per cent* of the amount of such tax under or overstated.

We noticed between May 2012 and December 2012 that two dealers had declared tax of ₹ 2.72 crore in their original returns for the months January 2007 and March 2012. The dealers had revised their returns for the months increasing the tax liability to ₹ 3.03 crore. As the additional tax liability declared of

⁴¹ Bangalore, Dharwad, Gulbarga and Dakshina Kannada districts.

₹ 30.93 lakh was more than five *per cent* of the tax originally declared in each case, levy of penalty at 10 *per cent* on additional tax liability was mandatory after issue of notices to the dealer. This was not done by the Department. Thus non-levy of penalty works out to ₹ 3.09 lakh.

In one case, we noticed that an additional tax of ₹ 22.84 lakh was declared by the dealer in Form 240 compared to the tax of ₹ 12.43 lakh paid in the monthly returns. Since the additional tax liability was more than five *per cent* of the tax paid in the original returns, the levy of penalty under section 72(2) was mandatory which was not levied by the Department. The non levy of penalty works out to ₹ 2.28 lakh.

In one works contractor case, our scrutiny of the reassessment order revealed that the AA had created an additional tax liability of ₹ 4.14 lakh and ₹ 2.28 lakh for the years 2008-09 and 2009-10. Though this was more than five *per cent* of the tax paid in the original return, penalty was not levied by the AA. This resulted in non levy of penalty of ₹ 0.64 lakh for both the years.

After these cases were pointed out to the LVOs and the Audit Offices concerned and to the Department between July 2012 and February 2013, the Department reported recovery of ₹ 8.78 lakh in three cases and stated to examine the two remaining cases.

The cases were reported to Government in July 2013. Their reply has not been received (December 2013).

2.10.11 Short levy of CST

Under the CST Act 1956 every registered dealer who sells goods to another registered in the course of inter-State trade or commerce was liable to pay tax at the rate of three *per cent* of his turnover subject to production of declaration in Form 'C'. The rate of tax was reduced to two *per cent* with effect from 1 June 2008. Further, if the turnover is not covered by C-forms, the tax on inter-State sale of goods shall be at the rate applicable to the sale or purchase of goods inside the State.

Two Audit Offices and one Local VAT Office in two⁴² districts

We noticed, between June 2012 and July 2012, short levy of CST of ₹ 12.23 lakh in respect of three dealers. The details of the cases

are as mentioned below:

⁴² Bangalore and Bidar districts

Table 2.21: Short levy of CST

(₹ in lakh)

Sl. No.	Assessing Authority and name of the assessee	Tax period and Date of Assessment/ Date of Filing	Tax payable	Tax paid	Balance payable
1	DCCT(Audit)- 1.5, Bangalore, M/s Prakash Acrylics	April 2007/ 03.05.2010	1.39	0.44	0.95
Nature of objection :- As per the assessment order, the interstate sales valued at ₹ 11.10 lakh was not covered by 'C' forms, but the AA incorrectly levied CST @ four <i>per cent</i> instead of 12.5 <i>per cent</i> .					
2	DCCT(Audit)- 5.1, M/s L&T Komatsu Ltd.	April 2008 to June 2008/ 28.12.2010	1025.45	1021.17	4.27
		October 2008 to December 2008	428.99	423.26	5.73
Nature of objection :- Tax on the interstate turnover of ₹ 33,371 lakh and ₹ 15,487.16 lakh for the periods mentioned was levied incorrectly due to arithmetical mistakes.					
3	ACCT (LVO)- 40, Bidar, M/s Gampa Alcoats Ltd.	April 2008	1.88	1.25	0.63
		May 2008	1.95	1.30	0.65
CST rate of tax was reduced from three per cent to two per cent from June 2008. However, a dealer had declared tax at two <i>per cent</i> on the turnover of ₹ 62.52 lakh and ₹ 65.11 lakh for the months of April 2008 and May 2008 respectively.					

After this was reported between July 2012 and October 2012, the Government/Department reported recovery of ₹ 11.29 lakh in 02 cases. It was stated to take action in the remaining case.

Taxes on entry of goods

2.11 Non/short levy of interest on belated payment of advance tax

Fourteen Audit Offices in four⁴³ districts

Under the Karnataka Tax on Entry of Goods (KTEG) Act 1979, every dealer is required to pay the full amount of tax payable on the basis of turnover computed by him for the preceding month within 20 days after the end of that month. In case of default beyond 10 days after that period, the assessee is liable to pay interest at the rate of 2 *per cent* per month of the tax payable for every month or part thereof during which such default is continued.

We noticed between May 2010 and January 2013 that 19 dealers had brought goods valued at ₹ 48.45 crore into the local area. They were liable to pay advance tax of

₹ 1.30 crore. However, the assessees filed incorrect returns and had paid only advance tax of ₹ 31.85 lakh. The mistake was detected by the Department while concluding the assessments but interest though leviable was either not levied or levied at 1.25 *per cent*. This resulted in non/short levy of interest of ₹ 38.11 lakh.

After the cases were pointed out between June 2010 and February 2013, the Government/Department reported recovery of ₹ 19.83 lakh in 11 cases, issued notice in one case, and stated that the remaining six cases will be examined.

⁴³ Bangalore, Davangere, Belgaum and Dakshina Kannada districts.