

## Chapter-II Taxes/VAT on sales, Trade etc.

### 2.1 Tax Administration

Sales Tax/Value Added Tax (VAT) laws and Rules framed thereunder are administered at the Government level by the Additional Chief Secretary, Finance Department. The Commissioner of Commercial Taxes (CCT) is the head of the Commercial Taxes Department (CTD) who is assisted by 14 Additional Commissioners. There are 13 Divisional VAT Offices (DVO), 13 Appeal offices, 13 Enforcement/Vigilance offices and one Minor Acts Division in the State managed by 42 Joint Commissioners (JCCTs). There are 123 Deputy Commissioners (DCCT), 321 Assistant Commissioners (ACCT) and 526 Commercial Tax Officers (CTO) in the State. At the field level, VAT is being administered through 118 Local VAT Offices (LVOs) headed by ACCTs, VAT Sub Offices (VSOs), Professions Tax Offices (PTOs) and Entertainments Tax Offices (ETOs) headed by CTOs. The DCCTs, ACCTs and CTOs head 266 Audit Offices of the Department where assessments/re-assessments are finalised by the Department.

### 2.2 Internal audit

The Department has an Internal Audit Cell under the charge of the JCCT (Internal Audit and Inspection). This cell is required to conduct test check of cases of assessment as per the approved action plan and in accordance with the criteria decided by the Steering Committee to ensure adherence to the provisions of the Act and Rules as well as Departmental instructions issued from time to time.

As per the information furnished by the Department, the Internal Audit Cell is functioning from the year 2011-12. During the year 2015-16, 17 offices were covered by Internal Audit Cell and the total number of offices to be audited was not furnished. 307 objections involving ₹ 35.44 crore were raised during 2015-16. As at the end of 31 March 2016 there were 1,141 objections pending, involving ₹ 168.80 crore.

### 2.3 Results of Audit

In 2015-16, test check of records in 152 offices of CTD relating to VAT, Entry Tax, Professions Tax and Agricultural Income Tax revealed under assessment of tax and other irregularities amounting to ₹ 320.15 crore raised through 763 paragraphs. The observations broadly fall under the following categories as given in **Table 2.1**.

**Table 2.1**  
**Results of Audit**

Sl No	Category	(₹ in crore)	
		No. of paragraphs	Amount
	<b>Value Added Tax</b>		
1.	Non/short payment of tax	82	8.93
2.	Non/short levy of penalty	269	27.05
3.	Non/short levy of interest	149	6.62
4.	Non/short levy of output tax	73	7.50

Sl No	Category	No. of paragraphs	Amount
	<b>Value Added Tax</b>		
5.	Incorrect / excess carry forward of credit	51	2.43
6.	Incorrect / excess allowance of input tax credit	35	1.89
7.	Unacknowledged returns	23	6.40
8.	Incorrect allowance of Tax Deducted at Source	5	4.42
9.	Other irregularities	43	3.51
	<b>Total</b>	<b>730</b>	<b>68.75</b>
	<b>Tax on Entry of Goods</b>		
10.	Non/short levy of tax under entry tax	21	0.94
11.	Other irregularities	2	0.02
	<b>Total</b>	<b>23</b>	<b>0.96</b>
	<b>Tax on Professions</b>		
12.	Performance Audit on 'Administration of Minor Taxes in Commercial Taxes Department'	1	250.36
13.	Non/short payment of tax	1	0.01
	<b>Total</b>	<b>2</b>	<b>250.37</b>
	<b>Agricultural Income Tax</b>		
14.	Non/short levy of interest	8	0.07
	<b>Grand Total</b>	<b>763</b>	<b>320.15</b>

During the course of the year, the Department accepted under assessments and other deficiencies of ₹ 3.33 crore in 42 paragraphs which were pointed out in audit during 2015-16 and recovered ₹ 0.04 crore in cases pointed out through six paragraphs. An amount of ₹ 24.83 crore was also recovered in cases pointed out in 499 paragraphs, pertaining to earlier years.

A Performance Audit on 'Administration of Minor Taxes in Commercial Taxes Department' involving ₹ 250.36 crore and a few illustrative cases involving ₹ 31.23 crore are discussed in the following paragraphs.

## 2.4 Performance Audit on “Administration of Minor Taxes in Commercial Taxes Department”

### Highlights

Transport vehicles owners to the extent of 2.75 lakh persons liable to Professions Tax (PT) in the State were not enrolled with Commercial Taxes Department. PT of ₹ 137.11 crore was due from them between April 2011 to March 2016.

(Paragraph 2.4.9.1)

Non-enrolment of 6,943 Private and Public Limited Companies, 12,316 Partnership firms and 60,480 individuals engaged in various professions under Service sector resulted in non-realisation of PT of ₹ 99.67 crore from these persons (entities) between 2011-12 and 2015-16.

(Paragraph 2.4.9.2)

Enrolment of only 76 persons out of the estimated 1,600 taxable persons who worked in the 667 films produced during the period of 2011-16 indicates inadequacy in the enforcement of the KTPTCE Act, 1976, in this Sector.

(Paragraph 2.4.9.4)

Failure to capture PAN details of 1.13 lakh persons enrolled under the KTPTCE Act, 1976, rendered CTD not being able to ascertain the correct amount of PT due in cases where liability under PT was dependent on whether the person was an Income Tax payee or not.

(Paragraph 2.4.10)

Misclassification and consequent application of incorrect rate of tax by the assesseees and deficiencies in PELSoft to detect the errors relating to payment of PT resulted in non/short payment of PT ₹ 82.57 crore by 2.81 lakh proprietors, 47,940 partnership firms and 17,867 Companies during the years 2011-12 to 2015-16.

(Paragraphs 2.4.12 to 2.4.14)

Cross-verification by Audit with Service Tax Department revealed that 10,935 dealers who had practised professions under Service sector did not pay PT of ₹ 4.59 crore.

(Paragraph 2.4.17)

## **2.4.1 Introduction**

Minor taxes administered by the Commercial Taxes Department (CTD) comprise of Professions Tax (PT), Entertainments Tax (ET) and Luxuries Tax (LT). The Karnataka Tax on Professions, Trades, Callings and Employment (KTPTCE) Act, 1976, the Karnataka Entertainments Tax (KET) Act, 1958, and the Karnataka Tax on Luxuries (KTL) Act, 1979, and the Rules made thereunder govern the levy and collection of said taxes in Karnataka.

The PT is payable by every person who exercises any profession or calling or is engaged in any trade or holds any appointment, public or private, or is employed in any manner in the State at the rate specified in the schedule to the Act subject to a maximum of ₹ 2,500 per annum<sup>1</sup>.

The ET is a levy on cinematograph shows including video shows, horse races, cable television, any amusement recreation or any entertainment performance or pageant or a game or sport, whether held indoor or outdoor, to which persons are admitted on payment. The rate of tax on payment for admission is prescribed from time to time.

Luxuries under the KTL Act means services ministering to enjoyment, comfort or pleasure extraordinary to necessities of life. Luxuries provided in a hotel, health club, marriage hall, club or in a hospital are levied with LT at the specified rates.

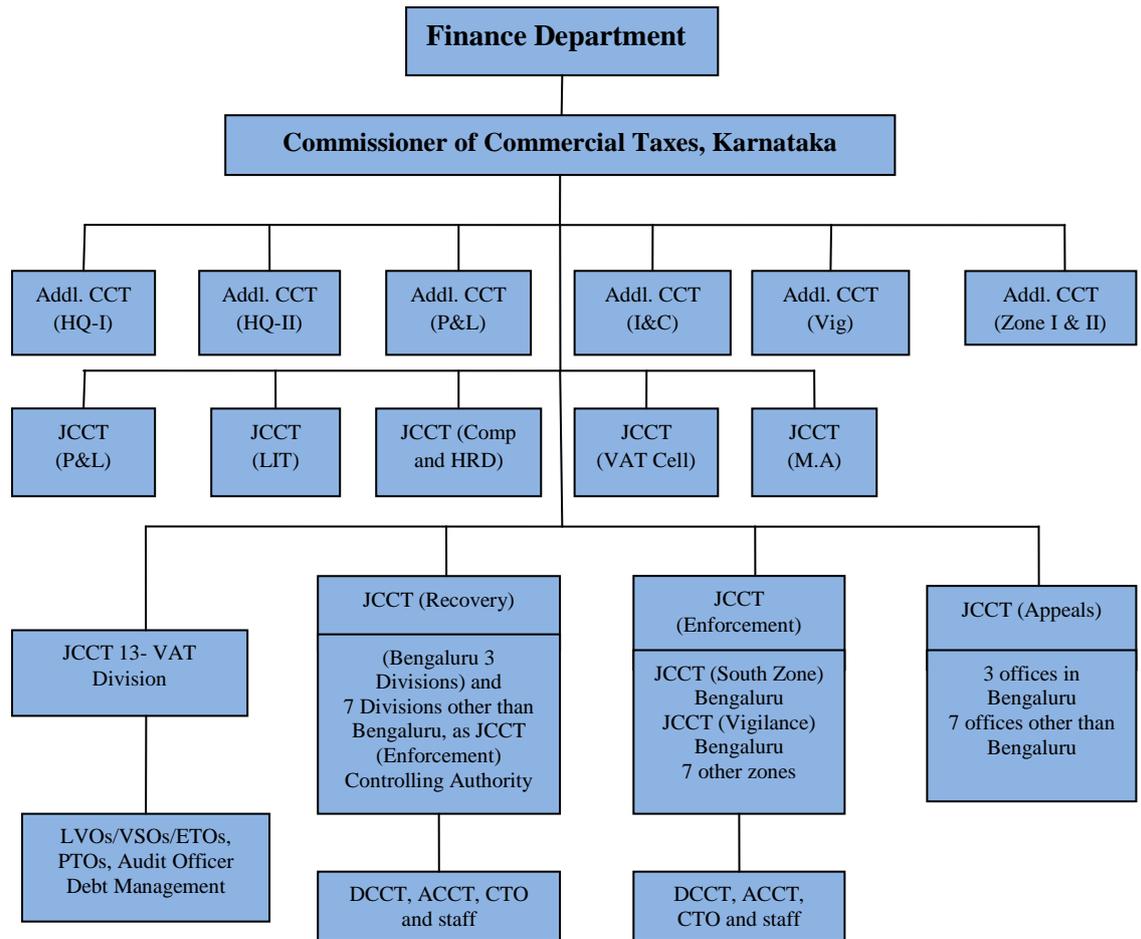
Online filing of returns and online payment of tax due on returns under the Professions Tax, Entertainments Tax and Luxury Tax are provided through the application software called PELSoft.

PELSOft generates list of defaulters who have either not filed the return due or delayed its filing, or failed to make payment of tax or delayed the same.

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<sup>1</sup> Clause (2) of Article 276 of the Constitution of India.

## 2.4.2 Organisational set up



## 2.4.3 Audit Objectives

The objectives of the Performance Audit (PA) were to ensure whether:

- The systems and procedures in place are adequate to ensure registration/enrolment of all the persons liable to Professions, Entertainment and Luxury Taxes and that filing of returns and payment of taxes by the persons registered/enrolled are effectively monitored?
- There has been follow-up/compliance with recommendations in the last two Performance Audits on this topic in the printed reports for the year 2006-07 and 2007-08?

## 2.4.4 Scope of Audit

Registration/enrolment, filing of returns, payment of taxes, re-assessments concluded and enforcement activities conducted between 1 April 2011 and 31 March 2016 under the PT, KET and KTL Acts were test-checked. The effectiveness of computerisation of tax administration in this regard was also reviewed. In Bengaluru, one exclusive Division is established for Minor Acts and two offices of this Division were taken up for pilot study. In addition,

four<sup>2</sup> out of 11 Divisions<sup>3</sup> were selected in such a way that adequate representation is given to all the regions in the State geographically. Records maintained in 20<sup>4</sup> field offices selected at random were test checked. Besides, database of both PELSoft and Electronic Filing System (*eFS*)<sup>5</sup> for the entire State was analysed using front-end and back-end accesses to database provided by the CTD.

#### 2.4.5 Methodology of audit

Information collected from other Departments/Agencies on Companies, Firms and other persons engaged in any business/profession was cross-verified with the records maintained in CTD to ascertain whether those persons were enrolled/registered with CTD and discharging their tax liabilities. In addition, test check was carried out on the re-assessments concluded by the department in the offices selected for audit. Database of *eFS* was cross-verified with the database of PELSoft to check whether defaults or underpayments of taxes due, if any, from dealers registered under Karnataka Value Added Tax (KVAT) Act, 2003, are detected and followed up with appropriate measures as provided under the respective Acts or Rules made thereunder. Enforcement activities of the Department with regard to the PT, KET and KTL Acts in the selected Divisions were also reviewed.

#### 2.4.6 Acknowledgements

Entry Conference was held (March 2016) with Additional Chief Secretary to Government of Karnataka, Finance Department and the CCT. In the Entry Conference, the Additional Chief Secretary suggested that Luxury Tax and Entertainments Tax would get subsumed in the upcoming Goods and Services Tax (GST) Act due to which only such issues that would be relevant even after implementation of GST may be looked into in respect of LT and ET. Mid-term meeting was also held with Additional Chief Secretary, Finance Department and CCT in May 2016 to discuss the observations noticed in Audit till then. Audit acknowledges the inputs/suggestions offered by the Additional Chief Secretary, CCT and the co-operation extended by the CTD in furnishing records and providing access to the database. The Audit findings and recommendations were discussed with the Additional Chief Secretary to Government of Karnataka, Finance Department and the CCT in the Exit Conference held in October 2016.

#### 2.4.7 Trend of revenue from Minor Taxes

**2.4.7.1** The revenue realised by Government of Karnataka under the PT, ET and LT during the last five years from 2011-12 to 2015-16 are detailed in **Table 2.2**.

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<sup>2</sup> Davangere, Dharwad, Kalaburgi and Mysore Divisions.

<sup>3</sup> Out of 13 VAT Divisions shown in Organisational Chart two Divisions do not deal with Minor Taxes. Hence four Divisions were selected out of remaining 11 Divisions.

<sup>4</sup> LVO-205, VSO-193, LVO-300, VSO-191, LVO-540, LVO-525, VSO-521, LVO-375, LVO-373, LVO-340, PTO-48, LVO-495, LVO-481, LVO-515, LVO-465, LT-4, PTO-1, 7 & 8 and ETO-4.

<sup>5</sup> *eFS* - The software established for the administration of VAT under CTD.

**Table:2.2**  
**Trend of revenue from Minor Taxes**

(₹ in crore)				
Year	Professions Tax	Entertainments Tax	Luxury Tax	Total from Minor Taxes
2011-12	600.20	480.15	139.99	1,220.34
2012-13	692.89	136.03	264.77	1,093.69
2013-14	792.98	146.22	299.06	1,238.26
2014-15	868.63	197.61	345.68	1,411.92
2015-16*	840.51	237.01	386.88	1,464.40

\* Revenue figures from Finance Accounts for the year 2015-16.

As may be seen from the above table the annual revenue realised by Government increased by ₹ 244.06 crore during last five years (₹ 1,464.40 crore in 2015-16 minus ₹ 1,220.34 crore in 2011-12). The average increase in revenue was ₹ 48.81 crore per annum.

#### 2.4.7.2 Cost of collection

The collection charges in respect of PT and ET only are shown distinctively in the Finance Accounts. The collection charges for LT were not shown separately but are included in the collection charges under the Head of Account 2040 – Taxes on sales, trade, etc. The details of cost of collection of PT and ET for last five years period are detailed in **Table 2.3**.

**Table: 2.3**  
**Cost of collection**

(₹ in crore)						
Year	Professions Tax			Entertainments Tax		
	Revenue realised	Collection charges	Cost of collection (percentage)	Revenue realised	Collection charges	Cost of collection (percentage)
2011-12	600.20	4.13	0.69	480.15	0.86	0.18
2012-13	692.89	4.71	0.68	136.03	0.96	0.71
2013-14	792.98	4.84	0.61	146.22	1.01	0.69
2014-15	868.63	5.18	0.60	197.61	1.08	0.55
2015-16*	840.51	5.37	0.64	237.01	1.13	0.48

\* Revenue figures from Finance Accounts for the year 2015-16.

It may be seen from the above that the cost of collection of PT ranged between sixty paise and sixty nine paise per one hundred Rupees and that of ET ranged between eighteen paise and seventy one paise per one hundred Rupees during last five years period.

#### Audit Findings

#### 2.4.8 Enrolment of potential tax payers currently outside the tax net

It is important for every tax administration to identify all the potential tax payers to meet the revenue targets and to reduce the tax burden on the existing tax payers. Understanding the revenue potential and taking measures to bridge the gap can be valuable in augmenting revenues, designing tax reforms, simplifying tax structures, reducing compliance costs and improving the efficiency of tax administration.

Audit made an attempt to analyse the revenue potential under PT in Karnataka by selecting at random certain professions, separately under organised sector and unorganised sector. The details of the persons engaged in such professions were collected from the authorities/sources concerned and their enrolment cross-verified under PT administration. The results of such analyses are as follows:

#### **2.4.9 Organised Sector**

Identification of potential tax payers in organised sectors and gathering information on them through well-organised sources is strategically a low cost, low risk, effective and highly rewarding approach in tax base expansion.

Section 15 of the KTPTCE Act, 1976, provides that the State Government may, at its discretion, appoint any Government Department, or a Municipal Corporation, Municipality or Taluk Board (called 'Collection Agents') as its agent responsible for collection of tax under this Act from such persons or class of persons as may be prescribed.

Audit analysis of the tax potential under professions like owners of transport vehicles, companies registered under Companies Act, partners involved in partnership firms and individuals who are Service Tax assesseees revealed that CTD has not adequately tapped such information sources to improve the tax collection. The instances are described below:

##### **2.4.9.1 PT on owners of transport vehicles**

Entry No.20 of the Schedule to the KTPTCE Act, 1976, prescribes tax on owners of transport vehicles (other than autorickshaws) at ₹ 1,000 per annum for owners of one vehicle and ₹ 2,500 per annum for vehicles for owners of more than one vehicle.

From the database of the CTD, it was noticed that only 4,294 persons were enrolled as owners of transport vehicles of which only 320 persons owned more than one transport vehicle and collection of PT from this sector was ₹ 6.55 lakh only during last five years.

Audit analysis of the information obtained in respect of this profession from Transport Department revealed that there were 2,42,186 persons<sup>6</sup> owning single transport vehicle and 32,590 owning two to 160 transport vehicles in the State which were not enrolled with CTD for PT. Tax due from these persons worked out to ₹ 137.11 crore between April 2011 to March 2016.

CTD did not make any efforts to obtain information of the owners of transport vehicles which was easily accessible, as the source of such data was another State Government Department.

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<sup>6</sup> The number of transport vehicle owners considered by audit was on a conservative basis and was from the total population of over 17 lakh transport vehicles registered in the State. Transport vehicles which are paying quarterly tax to the Transport Department were only considered. Certain classes of transport vehicles on which Life Time Tax (LTT) is collected by Transport Department are not considered. Similarly, other States vehicles operating in the State for more than 120 days a year either through All India Permit or through Inter-State permits issued or vehicles covered by reciprocal agreements entered into by the State Transport Authority are also liable for PT. If these vehicles are considered, PT revenue of ₹ 50 crore per annum could be expected under this entry.

Besides, PT is also due from the owners of transport vehicles registered in other States but entering the State of Karnataka on the basis of permits obtained for more than 120 days in a year.

Ensuring enrolment of all the persons who are owners of transport vehicles and collection of PT at applicable rate can fetch revenue not less than ₹ 32 crore<sup>7</sup> per annum and expected to grow at nine *per cent* per annum.

After these cases were pointed out in May 2016, the CTD replied in October 2016 that efforts were made to obtain information from Transport Department. Also physical surveys were conducted. So far 161 persons had been enrolled and tax and interest of ₹ 5.54 lakh collected while 33,941 cases are being pursued by issuing notices. The Audit Observations had been forwarded to all the Divisional VAT Offices (DVO) for necessary action at their end.

In the exit conference, the CTD expressed difficulties faced by them in locating the persons at the addresses at which the transport vehicles were registered with Transport Department. In this regard, Audit suggested to the Government/CTD that the Transport Department be made the collection agents for PT as the owners of transport vehicles would be frequently visiting that Department for various services such as permits, fitness certificate renewal, payment of quarterly tax, etc. The Additional Chief Secretary and the CCT agreed that entrusting the PT collection to Transport Department could be a workable solution and assured to look into the modalities.

***Recommendation 1: Government may designate the Transport Department as the Collection Agent for PT due from owners of transport vehicles operating in the State.***

#### **2.4.9.2 Persons/entities engaged in various professions in Service Sector**

All persons/entities offering services for consideration and whose annual turnover exceeds ₹ 10 lakh, were liable for registration with Service Tax Department and to pay Service Tax. As these persons/entities were engaged in provision of services which are classified as professions like event management, cinematograph film processing, transport contract, clearing agencies, property development, providing internet services, operating e-commerce business, stock broking through Stock Exchange Boards, educational institutions, film distribution, nursing homes, banking and financial institutions, etc. they were liable for registration/enrolment under PT at the rate of ₹ 2,500 per annum.

Audit obtained details of registrations from Service Tax Department and cross-verified the same with CTD to check the registration of such service providers under PT. This revealed that 6,943 Private and Public Limited Companies and 12,316 Partnership firms were not registered/enrolled with CTD. This had deprived Government of revenue of ₹ 24.07 crore during 2011-12 to 2015-16. Besides, there were 60,480 individuals engaged in the

<sup>7</sup> Of the revenue due of ₹ 137.11 crore mentioned in the paragraph, the amount due during the year 2015-16 was about ₹ 32 crore. The growth in transport vehicles in the State is approximately nine *per cent* per annum.

professions mentioned above, where there was PT potential of ₹ 75.60 crore which remained unexplored by the CTD during the same period.

Potential non-realisation of revenue from these entities between April 2011 and March 2016 worked out to ₹ 99.67 crore. Ensuring enrolment of these entities would fetch additional revenue of ₹ 19.93 crore per annum.

After these cases were pointed out in August 2016, the CTD stated in October 2016 that the cases noticed by Audit have been forwarded to all the DVOs concerned for necessary action at their end.

***Recommendation 2: Department may establish a system of collection and updation of information available with other Government Departments to capture the details such as the name of assessee, address, age in case of individuals, the turnover or income from the profession, etc. that affect the chargeability to PT. Also, the licensing authorities in respect of certain professions such as 'Financiers', 'Stock Brokers', 'Clearing Agencies', etc. be made collection agents for PT to ensure tax collection from all the potential tax payers under their control.***

#### **2.4.9.3 Unorganised sector**

Audit acknowledges the difficulty in identification of potential tax payers in the professions under unorganised sector compared to those under the organised sector. However, no visible plans/efforts were found to be undertaken by the Department in devising any strategy to deal with this sector.

In order to assess the tax potential under this sector and to show the existence of the tax gap, audit analysed the following professions with the results stated against each profession.

#### **2.4.9.4 Persons engaged in different professions in Film/Television industry**

(a) Under entry No.12 of the Schedule to the KTPTCE, Act, 1976, self-employed persons in the motion picture industries viz. Directors, Actors, Actresses (excluding junior artists), playback singers, recordists and Editors are liable to PT of ₹ 2,500 per annum if they are Income Tax payers otherwise PT of ₹ 1,500 per annum is payable. Cameramen and Still Photographers covered under the same entry are liable to PT at ₹ 900 per annum.

Audit noticed that only 76 persons were enrolled with the Department under this category. Considering the volume of motion pictures produced in recent times and the number of regional channels telecasting several daily serials and shows, the number of registered persons under this category appeared low.

Considering 667<sup>8</sup> films that were produced during the last five years period, Audit estimated that at least 1,600<sup>9</sup> taxable persons existed under three categories of activities (Actors/Actresses, Directors and Music Directors). Accordingly, the tax potential of this entry could be between ₹ 1.2 crore to ₹ 2 crore<sup>10</sup>.

This indicates that the enforcement of the levy of PT on this Sector also had not received due attention of the Department which could have been tackled through interaction with the associations of persons relating to that industry such as Film Chamber of Commerce, Actors Association, etc.

After the issue was pointed out to the CTD in April 2016, the CTD in their reply furnished in October 2016 stated that they had sought information from various sources and conducted physical survey through which 419 persons liable to PT have been identified. After this, notices were issued by the Department to various television channels to furnish the details of persons working under different serials telecast by them.

(b) Under entry 12 of the Schedule, specific persons employed in motion picture industries, like Actors/Actresses, Playback Singers, Recordists and Editors are liable to pay PT at ₹ 2,500 per annum, if they are Income Tax payers and at ₹ 1,500 per annum in case they are not Income Tax payers. Prescription of only ₹ 900 per annum as PT for Cameramen and Still Photographers under the same entry irrespective of their Income Tax liability is sans logic and appears arbitrary.

#### 2.4.9.5 Cable TV Operators

Under entry 39 of the KTPTCE Act, 1976, PT at specified rates has to be paid by persons providing entertainment using Dish Antennae and Cable TV.

Entertainments Tax at ₹ 15/- per connection per month is payable by the cable operators under Section 4-C of the KET Act. The cable operators were also eligible to opt for composition<sup>11</sup> of tax under Section 4-D of the KET Act. Further, no ET shall be payable by the cable operators who are receiving signals from Multi-System Operators (MSOs) who have paid tax under Section 4-G of the Act. The cable operators obtain licence from local Head Post Offices (HPOs) to transmit signals through cables.

Details regarding the number of cable operators licensed by jurisdictional HPOs and number of cable operators functioning under local MSOs in six places were collected and cross verification with CTD revealed that 641 out

<sup>8</sup> The number of films produced each year during 2011-12 to 2015-16 was 134, 106, 151, 116 and 160 respectively.

<sup>9</sup> The list of Kannada feature films released in last five years was prepared. The Actors/Actresses who played major roles and the name of the Director and Music Director were noted against each of the film. This list was analysed to extract list of persons who featured in at least one movie in a year.

<sup>10</sup> Tax at the rate of ₹ 1,500 per annum as applicable in case of persons who are not Income Tax payers, for 1,600 persons for 5 years worked out to ₹ 1.2 crore. If the persons were Income tax payers then tax at ₹ 2,500 per annum for five years works out to ₹ 2.00 crore.

<sup>11</sup> Under this provision the cable operators would be required to pay fixed amount each month irrespective of the number of connections held by them.

of 698 cable operators were not enrolled / registered with CTD. The details are given in the **Table 2.4**.

**Table :2.4**  
**Cable TV Operators**

Sl. No.	Place (City Municipal Corporation (CMC) or Taluk Municipal Corporation (TMC))	No. of Cable Operators (as per HPO or MSO)	No. of Cable Operators registered with CTD
1.	Ballari (CMC)	178	1
2.	Honnavar (TMC)	30	0
3.	Kumta (TMC)	11	2
4.	Yadgir (CMC)	148	2
5.	Bidar (CMC)	78	9
6.	Kalaburgi (CMC)	253	43
	<b>Total</b>	<b>698</b>	<b>57</b>

The above table shows that only 8.17 per cent of the cable operators were registered with CTD in six test-checked places. Thus, there is ample scope to expand the tax base in this sector through systematic collection and updation of details from the connected sources. CTD needs to ensure that all the cable operators are registered so that ET and PT due to Government could be collected either from them or through the MSOs.

In the exit conference, CTD stated that action has been initiated to enroll all the cable operators.

**Recommendation 3: Department may collect information from all possible sources like Recognised Associations, Nodal Agencies, etc. to bring in more persons liable to tax under the tax ambit in respect of unorganised sectors.**

#### **2.4.10 Enrolment/demand of tax from persons who are paying Income Tax**

Under the residual entry 73 of the Schedule to the KTPTCE Act, 1976, persons other than those mentioned in any of the preceding entries who are engaged in any profession, trade, calling or employment and who are paying tax under the Income Tax Act, 1961, are prescribed to pay PT at the rate of ₹ 2,500 per annum. Besides, for the persons paying tax under the entries 9 and 12, higher amount of PT at the rate of ₹ 2,500 per annum has been prescribed for Income Tax payers while those who are not Income Tax payers are liable to pay lower amount of PT at the rate of ₹ 1,500 or ₹ 1,000 per annum, as the case may be.

Though the payment of Income Tax was one of the criteria under the entries aforesaid, no action plan was available with the Department to ascertain liability under Income Tax in order to identify, demand and collect tax from such persons liable to tax. Liability under the Income Tax Act varies from year to year and hence, CTD is required to collect the details of payment of Income Tax in order to assess the correctness of tax paid or to check the liability to tax for a person. As an initial step towards this goal, the Department needs to ensure capturing of PAN of all the existing registered assesseees.

Audit noticed that in respect of 1.13 lakh out of 2.52 lakh enrolled persons, the Department had not ascertained PAN. In the database of PELSoft, the field meant to record PAN was either left blank or filled with invalid data, i.e. data which is not in the valid PAN format. In the absence of PAN, the Department was not able to ascertain the liability of Income Tax with the Income tax Department and hence could not ascertain the correctness of tax paid under PT or to raise demands wherever PT was due and recover the same.

After these cases were pointed out in August 2016, the CTD in their reply furnished in October 2016 stated that information from Income Tax Department was obtained and 85,776 persons liable to PT were identified. Of these 29,970 persons were enrolled and PT together with interest amounting to ₹ 6.71 crore was collected from them.

***Recommendation 4: CTD may capture details of PAN in respect of all the existing tax payers and establish cross-verification with Income Tax Department to ascertain the actual liability under the KTPTCE Act.***

#### **2.4.11 Administration of the existing tax base enrolled with the Department**

Maintenance of relevant information of the tax payers is essential to detect and bring into the tax net any person/s who are evading or not paying tax and to ensure that persons enrolled are properly classified and are paying tax as applicable under the relevant entry or their claim for exemption from tax.

Audit analysis of the database of PELSoft and *eFS* revealed that CTD is not ascertaining and maintaining verifiable information about its tax payers under the KTPTCE Act. Certain deficiencies noticed in gathering information about the tax payers are as mentioned below:

- Though tax is collected from employees through the employer, actual details of the tax payer (employee) are not available;
- In respect of partnership firms, the details of each partner are not obtained and updated from time to time;
- In respect of Companies, details of branches are not being updated from time to time;
- Unique Identity of persons (PAN/Aadhaar Card) enrolled with CTD were not gathered and maintained.

In the absence of unique identity of each tax payer, whenever CTD identifies any person, it will not be able to ascertain whether that person is already a tax payer or not. Therefore, lack of information about its existing tax base poses major challenges to the CTD in its endeavour to widen the tax base either by reaching out to professionals by issue of notices or by co-ordination with agencies or associations or organisations with which such professionals are engaged.

Detailed observations in respect of the deficiencies mentioned in the PT above are as follows:

## **2.4.12 Inadequate monitoring of PT dues from persons/entities registered/enrolled with CTD**

Audit analysed the data of the assesseees registered under KVAT Act, 2003, with the CTD to check the utilisation of its own data by the Department to ascertain the level of compliance of the assesseees under the control of the Department itself. Findings in this respect are detailed in the following paragraphs:

### **2.4.12.1 Non/short realisation of PT from persons registered as dealers/contractors under the KVAT Act**

Under Entries 10 and 13 of the KTPTCE Act, 1976, individuals registered as contractors or dealers under the KVAT Act or Karnataka Sales Tax (KST) Act are liable to pay PT at the rate of ₹ 1,000, ₹ 1,500 or ₹ 2,500 per annum depending on the turnover achieved by them during that financial year.

The annual turnover of dealers was available in the *eFS* database. PT was to be paid online by each dealer through PELSoft. During the period from April 2011 to March 2016 there were 4,65,117 proprietorship firms who were liable to file 14,15,155 annual PT returns for one to five years period and were liable to pay PT due on the returns. Audit analyses revealed the following deficiencies under this sector:

- There were 2,10,847 dealers (45.33 *per cent*) who defaulted in filing one to five annual returns and consequently defaulted in the payment of PT due. The annual turnovers achieved by these dealers were in the range of ₹ 0.02 crore to ₹ 523.44 crore. The PT due from the defaulting dealers worked out to ₹ 48.78 crore. Of these, 19,699 dealers who had defaulted in payment of PT of ₹ 2.85 crore have got their TIN de-registered subsequently.
- PT of ₹ 10.69 crore was paid by 69,654 dealers in 89,473 annual PT returns for the years 2011-12 to 2015-16. However, based on the turnover achieved by these dealers, the total tax due for the said period works out to ₹ 18.26 crore. Consequent short realisation of revenue was ₹ 7.57 crore.

Since there was no linkage between PELSoft and *eFS*, PELSoft could not pull data about defaulting and short-paying VAT dealers from *eFS*, even though both databases were under the control of CTD. Suitable controls in PELSoft to access the annual turnover from *eFS* database and to watch for PT due for the particular slab could have ensured proper revenue realisation to Government.

In the exit conference the CTD stated that the LVOs concerned have been instructed to take necessary action to demand PT from the dealers under their jurisdiction.

***Recommendation 5: CTD may establish link between PELSoft and eFS so as to automate the levy and demand of PT after ascertaining the turnover declared under eFS and suitable modifications may be made in PELSoft to detect and alert both dealer and the assessing authority in case of default in payment of PT.***

### 2.4.12.2 Collection of PT not due from proprietors registered under VAT

Under the proviso (1) below Section 3 of the KTPTCE Act, 1976, no tax shall be payable by persons who have attained sixty (sixty-five up to 31 March 2015) years of age.

However, it was noticed that PT of ₹ 3.30 crore had been paid by 10,115 proprietors registered under VAT between April 2011 and March 2016 who were not liable to pay PT due to their age, under the above mentioned provision of the Act. Such collection made was not due and hence refundable to the persons concerned.

Though the information on age of individual dealers was available in the database of *eFS*, PELSoft was not designed to access the same to ensure that no payments are received from the persons exempted under the KTPTCE Act, 1976.

After these cases were pointed out in August 2016, CTD in their reply furnished in October 2016 stated that a Committee to revamp the KTPTCE Act has been constituted and the issue has been referred to the committee for examination in the light of the Audit observations.

***Recommendation 6: Necessary controls may be established in PELSoft to prevent online tax payment from persons who are exempt on the basis of their age computed from date of birth entered in the registration table<sup>12</sup> of the eFS.***

### 2.4.13 Non/short demand of PT from Companies registered under KVAT

Under entry No.25 of the Schedule to the KTPTCE Act, 1976, Companies registered under the Companies Act, 1956 and engaged in any profession, trade or calling was liable to PT of ₹ 2,500/- per annum.

Also, as per Explanation VI below the Schedule to the Act, 'every branch of any self-employed assessee enumerated in any item of the Schedule shall be deemed to be a separate assessee for the purpose of levy of PT specified in the Schedule'. Hence, under the Act, the Companies and its branches are deemed as separate assessees and tax has to be collected from each of the functioning branches.

**2.4.13.1** There were 29,981 Companies (both Public Limited and Private Limited Companies) registered under VAT as on 31 March 2016. Audit analysis of these Companies revealed that between April 2011 to March 2016, there were 13,963 Companies which had defaulted in annual payments of PT for one to five years and 3,904 Companies had short paid the PT dues in their 7,247 annual returns. The total non-realisation of PT was ₹ 8.92 crore. This was due to non-payment of PT on their branches or incorrect self assessment of PT by the Companies concerned at the rates applicable to proprietorship firms instead of at the rates prescribed for them

<sup>12</sup> Dealers are required to apply for registration under Karnataka VAT Act, 2003, in Form VAT-1 furnishing all the particulars sought therein. The information such as name of the applicant, address, date of birth, nature of business, etc. are filled in that form by the applicants. These details are entered in the registration table of the *eFS*.

under entry 25. This also showed that PELSoft was not designed to detect such errors and prompt both assesseees and the LVOs concerned for necessary corrective actions.

**2.4.13.2** In respect of 693 Companies enrolled under KTPTCE Act, 1976, and having at least one additional place of business it was noticed that PT due from them in their 1,039 returns for the years 2011-12 to 2015-16 was paid short by ₹ 93.18 lakh. This was due to omissions, incorrect self-assessments without considering the PT due on their branches or payment of tax at incorrect rates.

It was further noticed that the information on number of branches held by the enrolled Companies in the State were not being updated by CTD in their registration records. As a result, the CTD could only watch, if at all, for PT due on the number of branches held by the Companies at the time of their initial enrolment. Audit found that as against five branches declared by four Companies (details given in *Annexure 'A'*) at the time of their enrolment, there were 78 branches working in the State. Failure to put in place a system for updating information on new branches opened from time to time by the Companies enrolled/registered with CTD had resulted in foregoing of PT revenue due from branches every year.

***Recommendation 7: PELSoft may be suitably modified to automate demand of PT based on the type of assessee and to incorporate vital information such as number of branches held by the assessee (already stored in the registration table of eFS) for the purpose of assessment and demand of tax.***

#### **2.4.14 Non/short demand of PT from Partnership firms registered under KVAT**

Partnership firms fall under different professions and hence are governed by the entries 10 (Contractors executing works contract), 13 (Dealers registered or liable to be registered under VAT) and 26 (Partners of firms) of the Schedule to the KTPTCE Act, 1976, read with Explanations IV and V below the Schedule<sup>13</sup>.

On the basis of these multiple entries along with the explanations, it becomes evident that whenever the turnover of a partnership firm is less than ₹ 25 lakh, it has to pay tax under entry 26 for each partner and under 10 or 13, as the case might be, if it exceeds ₹ 25 lakh.

There were 75,783 partnership firms registered under KVAT as on 31 March 2016. Audit analysis of the data with respect to these partnership firms revealed the following:

<sup>13</sup> Under the entries 10 and 13, tax has been fixed based on the ATO of the dealers as below:

- Less than ₹ 2 lakh - Nil
- ₹ 2 - ₹ 10 lakh - ₹ 1,000
- ₹ 10 - ₹ 25 lakh - ₹ 1,500 and
- Greater than ₹ 5 lakh - ₹ 2,500

Under the entry 26, each partner of firm engaged in any profession is liable to pay ₹ 1,000/- per annum.

Further Explanation IV read with V states that partners of the firms shall be taxed if the turnover is less than ₹ 25 lakh and firms shall be taxed if the turnover exceeds ₹ 25 lakh.

- There were 5,052 partnership firms with Annual Turnover (ATO) below ₹ 25 lakh, who in their 8,016 annual PT returns filed before 118 LVOs/VSOs for the years 2011-12 to 2015-16 had self assessed and paid PT under entry 10 or 13 instead of the actual tax due under entry 26 of the schedule. The total amount of tax due was ₹ 2.06 crore at the rate of ₹ 1,000 for each partner of a firm per annum. But the actual amount of tax liability reported through the self-assessed returns by those firms and paid was only ₹ 1.19 crore which resulted in short payment of tax of ₹ 0.87 crore.
- There were 13,601 partnership firms whose ATO exceeded ₹ 25 lakh, who were engaged in trade through 2 to 40 branches in the State. Total tax liability of these firms, including tax due on their branches as per Explanation VI<sup>14</sup> below the Schedule to KTPTCE Act, 1976, works out at ₹ 10.75 crore. However, it was found that the dealers concerned, in their 9,413 annual returns before the 118 LVOs/VSOs for the years between 2011-12 and 2015-16, paid PT of ₹ 6.43 crore only which resulted in short realisation of PT revenue amounting to ₹ 4.32 crore.
- There were 29,287 partnership firms (20,817 instances where ATO more than ₹ 25 lakh and 21,261 instances where ATO less than ₹ 25 lakh) under 118 LVOs/VSOs, who had neither filed any returns nor paid PT during the period from 1 April 2011 to 31 March 2016. The tax liability in these cases was calculated by Audit on the basis of number of partners where ATO was less than ₹ 25 lakh and at ₹ 2,500 where the ATO exceeded ₹ 25 lakh. Accordingly, tax due from these defaulting firms worked out to be ₹ 11.18 crore for the period mentioned.

These instances clearly showed that PELSoft was not able to ensure correctness of classification of the type of dealers and the PT due from them.

After these cases were pointed out in May/June 2016, CTD in their reply furnished in October 2016 stated that the audit observations have been forwarded to the JCCTs of the Divisions concerned for compliance.

#### **2.4.15 Excess collection of tax from partnership firms**

As per the provisions of the KTPTCE Act, 1976, no tax shall be demanded from partners but tax at the rate of ₹ 2,500 per annum has to be collected from the firms whose total turnover in a year was more than ₹ 25 lakh. It was, however, noticed that in respect of 8,403 firms, PT at ₹ 1,000 per partner for each branch of the firm was collected in 16,529 occasions where the ATO was greater than ₹ 25 lakh for the firms. This had resulted in excess collection of tax of ₹ 2.46 crore which is refundable to the firms concerned.

<sup>14</sup> Explanation VI under the Schedule states that every branch of any self-employed assessee enumerated in any item of the Schedule shall be deemed to be a separate assessee for the purpose of levy of PT specified in the Schedule.

#### **2.4.16 Need for rationalisation of levy of PT in case of Partnership Firms**

As explained in paragraph 2.4.14, the levy of PT on Partnership Firms is very complex with many parameters prescribed and needs simplification. Explanation IV read with V below the Schedule to the KTPTCE Act, 1976, states that for partnership firms whose ATO exceeds ₹ 25 lakh or who have employed more than 10 employees, etc. tax shall be levied only on the firm but not on individual partners (entry 26). Audit infers that the explanations aforesaid work against the interest of revenue in cases of partnership firms having many partners and with significant turnovers. Comparing the same with entry 10 or 13 of the Schedule where individuals registered under VAT are liable to pay PT of ₹ 2,500 if their total turnover exceeds ₹ 25 lakh brings out the lack of equality in treatment of assessee under the Act.

Audit analyses of 36,842 partnership firms registered under VAT during the period from 2011-12 to 2015-16 showed that if the ATO of the firms are apportioned to each partner of the firm and the liability of each partner is determined as if each partner is an independent professional, tax on each partner could have been levied between ₹ 1,000 to ₹ 2,500 per annum. Total number of persons (individuals) involved in these cases ranged between 52,367 and 63,314 and Government could have earned revenue ranging from ₹ 2.19 crore to ₹ 12.79 crore totalling to ₹ 49.62 crore for the years from 2011-12 to 2015-16 against which only ₹ 23.73 crore was realised. The potential revenue that could have been earned by Government over last five years was ₹ 26.76 crore. If suitable amendment in this direction is considered by Government/Department, it could fetch additional revenue of ₹ 5.22 crore per annum for future years.

In the exit conference, CTD stated that a Committee has been constituted to revamp the KTPTCE Act and all the issues raised by Audit would be referred to that Committee.

#### **2.4.17 Incorrect exemption to Dealers who reported Nil turnover in a year**

In addition to the above mentioned cases, it was seen that 1,61,698 dealers registered under KVAT Act had not paid PT for one or more years during the period from 2011-12 to 2015-16. During the years of non-payment of PT, the respective dealers had filed 'Nil' ATO under VAT/KST/Central Sales Tax and hence did not pay PT.

Audit analysed the CTD database in respect of these dealers and collected valid PAN in respect of 1,41,284 dealers. PAN number, being a unique identity, was utilised to cross-verify these dealers with the data of assessee under Service Tax Department to check the reporting of turnover by any of these dealers under Service Tax. This revealed that 10,935 of these dealers were performing business under service sectors and filing returns and paying taxes with the Service Tax Department. Hence, these dealers were liable to

pay PT and the PT due from these dealers at ₹ 2,500 per annum worked out to ₹ 4.59 crore<sup>15</sup> during 2011-12 to 2015-16.

In respect of remaining 20,414 dealers, PAN was not captured by the CTD and hence the same could not be cross-verified. Possibility of some of those dealers also being liable for PT could not be ruled out.

Ensuring recovery of PT due from dealers registered under VAT/KST may prevent non-realisation of revenue to the tune of ₹ 17.23 crore per annum.

In the exit conference, the CTD stated that the LVOs concerned have been instructed to take necessary action to demand PT from the dealers under their jurisdiction.

#### **2.4.18 LT and PT revenue due from owners of lodging houses**

Under entry 18 of the Schedule to the KTPTCE Act, 1976, owners of lodging houses with less than 20 rooms were liable to pay PT at ₹ 1,500 per annum and those with 20 rooms or more were liable to pay PT at ₹ 2,500/- per annum. Under the KTL Act, owners of lodging houses charging room rent of ₹ 750<sup>16</sup> or more per day were liable to get registered and pay LT under the Act with the jurisdictional LVO or Luxury Tax Circle.

It was noticed that PELSoft had no field to capture vital details such as number of rooms in a lodging house and the tariff per day required to assess PT and LT dues. During 2011-12 to 2015-16, PT was not paid by owners of 1,071 out of 3,072 lodging houses registered with CTD.

In 27 Districts<sup>17</sup>, 973 bills issued to their customers between April 2011 and March 2016 by 609 lodging houses<sup>18</sup> were collected at random and analysed by audit. The analysis revealed 242 lodging houses in 24 Districts<sup>19</sup> were not registered with the CTD. Of these, 119 lodging houses charged room rent at the rate which attracted levy of LT. Though these lodging houses had been running for three to five years without registration and were collecting taxable charges from the public, they were not detected and brought to the tax net by the CTD. Twelve other lodging houses registered with CTD were found to have defaulted in filing returns or suppressed the tax liability in their returns.

<sup>15</sup> Though the number of persons were 10,935, the instances of defaults were 18,374 (i.e. same dealer for more than one year in many cases) and hence the liability of ₹ 4.59 crore.

<sup>16</sup> ₹ 500 or more up to 31 March 2014.

<sup>17</sup> Bagalkote, Belagavi, Bengaluru, Bidar, Chamarajanagar, Chikkamagaluru, Dakshina Kannada, Davangere, Dharwad, Gadag, Hassan, Haveri, Kalaburgi, Kodagu, Kolar, Koppal, Madikeri, Mandya, Mysuru, Raichur, Ramanagara, Shivamogga, Tumakuru, Udupi, Uttar Kannada, Vijayapura and Yadgir.

<sup>18</sup> The lodging house bills obtained by officers/officials while on official tour inside the State were collected for last three years. The bills were then summarised hotel wise and month wise. The hotel bills having their LT registration number were cross-verified with the returns filed for the respective month to ensure that they have disclosed the turnover involved and tax collected as per the bills. In respect of hotel bills without LT registration number, 'dealer search' option in PELSoft was used to check the registration status of those hotels and non-registrations were detected and where registration numbers were found, cross-verification with returns were carried out as mentioned above.

<sup>19</sup> Bagalkote, Belagavi, Bidar, Chamarajanagar, Chikkamagaluru, Dakshina Kannada, Davangere, Dharwad, Gadag, Hassan, Haveri, Kalaburgi, Kolar, Koppal, Madikeri, Mandya, Mangaluru, Mysuru, Raichur, Ramanagara, Shivamogga, Uttar Kannada, Vijayapura and Yadgir.

In the absence of detailed accounts of the lodges, number of days of occupancy of the rooms, total charges collected by them, taxable charges, etc. Audit estimated the occupancy rate at 60 *per cent* of the days in a year (i.e. 240 days out of 365 days). Accordingly, the LT due to the Government from 62 non-registered lodging houses (out of 119 lodges, where tax was found collected in the bills issued) worked out to ₹ 2.45 crore. Besides, these lodging houses were liable to pay PT annually.

It may be seen from the above that a small sample of 973 bills of 609 lodging houses for five years period from April 2011 to March 2016 brought out 254 non-compliant cases which is 39.90 *per cent* of the lodging houses in the sample. This is quite alarming and the actual loss of revenue sustained by Government could be huge.

In the exit conference CTD agreed that the lodging houses that are charging LT from customers without registration have to be brought to the tax net and such exercises are also being carried out by them.

#### **2.4.19 Compliance with recommendations made in the Previous Performance Audits**

In the previous Performance Audits conducted on Minor Taxes (Audit Reports of 2006-07 and 2007-08), recommendations were made to Government / Department to put in place specific controls that could help the Department to expand its tax base, detect and follow-up on non-realisation of revenue due to dishonour of cheques or other instruments remitted to banks and to detect the cases of omission or commission leading to loss of revenue in a timely and effective manner so that corrective action could be taken up. The action taken by the Department in respect of these recommendations were verified during the course of this Performance Audit and results of that verification are mentioned below:

##### **2.4.19.1 Establishing a system of obtaining information from various Licensing/registering authorities**

In the Performance Audits mentioned above, Audit recommended to establish a system for obtaining periodical information from various authorities<sup>20</sup> permitting/licensing 'persons' to engage in business/profession which made them liable to tax under PT/KET/LT Acts and to follow-up on such information to bring all those persons under the tax net.

Departmental Notes furnished to the Public Accounts Committee by the Department in reply to audit recommendation stated that the data furnished by audit in respect of the non-registered persons engaged in various professions obtained from various authorities permitting / licensing several professions/businesses could not yield the revenue at the expected level. This was due to the fact that these persons were not traceable due to change of address, change of profession, not performing the profession for 120 days or more, etc.

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<sup>20</sup> Karnataka Bar Council, Chief Electrical Inspector, Medical Council of India (Karnataka Chapter), Registrar of Co-Operative Societies etc.

Audit acknowledges the difficulties stated by the CTD. However, the licenses or permits issued by the licensing authorities would be for the period specified under the respective Act or Rules. Thereafter, the licenses would become due for renewal and the persons who intend to pursue the profession would apply for periodical renewal of licenses. Hence, making the licensing authorities collection agents for PT would ensure proper tax collection. The benefits that could accrue from organised sectors / licensing authorities have already been explained in paragraph 2.4.9.

In addition, in four<sup>21</sup> districts, the lists of pawn brokers, chit funds, financiers licensed by the offices of the Registrar of Co-operative Societies were obtained and cross-verified with the LVOs/VSOs. They revealed that 2,504 persons had not enrolled/registered with CTD. Total amount of PT due from these persons during 2011-12 to 2015-16 amounted to ₹ 2.02 crore. The licenses issued were valid for five years only.

In the exit conference, the CTD agreed that making Registrar of Co-operative Societies as collection agent for PT from pawn brokers, chit fund and financiers would be a reasonable control to ensure collection of PT due from this sector.

#### **2.4.19.2 Non-reconciliation of cheques/cash deposited into banks**

It was recommended in our previous Performance Audit to fix a time limit for sending challans from banks to assessing authorities concerned to enable them to carryout timely reconciliation.

It was noticed that the Department has developed a module in PELSoft for reconciliation of cheques/cash deposited in banks with the monthly information obtained from banks/Treasury concerned, containing the realisation particulars of instruments deposited in the previous month in softcopy and uploaded to PELSoft. After matching the cheques/cash as per the CTD records with the details brought from banks, PELSoft generates 'Report on Reconciliation of Instruments sent to Bank with Bank statement' for each office.

During the course of audit, the Performance Audit team generated this Report once on 31 March 2016 and subsequently on 4 August 2016 in respect of 20 field offices<sup>22</sup>. The reconciliation report as on 31 March 2016 for these 20 offices showed 64,789 instruments involving revenue of ₹ 50.61 crore were pending for realisation particulars. This was communicated to all the 20 offices concerned in April 2016.

However, even after four months (as of 4 August 2016), 61,537 instruments involving ₹ 47.80 crore were pending for realisation in the same offices. This shows that though the Department has developed a computerised system of reconciliation and was able to generate report on instruments pending for reconciliation, it had failed to ensure timely reconciliation of all the instruments sent to banks for realisation. In the absence of timely

<sup>21</sup> Bidar, Kalaburgi, Haveri and Uttara Kannada.

<sup>22</sup> LVOs/VSOs-205, 193, 300, 191, 540, 525, 521, 375, 373, 340, 370, 495, 481, 515 and 465 ETO-4, PTOs-1, 7 & 8 and LT-4 offices.

reconciliation, the risk of dishonoured instruments, if any, escaping the attention of the Department cannot be ruled out.

In the exit conference, CTD stated that the necessary information for reconciliation had been collected from banks but due to some technical problems, the same was not being able to be uploaded to PELSoft.

### **2.4.19.3 Setting up of an Internal Audit Wing (IAW) in the Department**

CTD was recommended for setting up of an IAW to ensure timely detection and correction of errors in assessments, levy and collection of taxes.

Audit acknowledges that the Department has established an IAW with effect from June 2011 as recommended by Audit. The IAW is catering to the needs of all the Acts/Rules administered by the Department. The focus is mainly on major taxes such as Value Added Tax, Karnataka Sales Tax and Central Sales Tax revenues.

### **2.4.20 Conclusion**

As mentioned in paragraph 2.4.7, the annual revenue growth of PT, ET and LT was ₹ 48.81 crore over the period from 2011-12 to 2015-16. If the Government/Department considers preventive controls to plug the leakage of revenue from dealers registered under VAT and persons enrolled under PT and the rationalisation measures to bring equity among the tax payers as explained in the previous paragraphs, Government may get annual additional revenue of not less than ₹ 75.51 crore.

Department lacked strategies to capture potential tax payers who are presently outside the tax net. The Department had failed to tap even well-organised and well-regulated sources like owners of transport vehicles, service tax assesseees, etc. where large scale non-compliance was noticed in Audit. Though identification of potential tax payers is difficult under the unorganised sector, no strategy was developed to optimise the revenue due from this sector. Monitoring of existing assesseees was deficient which resulted in non-filing of returns and non/short payment of taxes. The Department did not capture basic details like PAN which poses challenges in ascertaining the correctness of tax liability and in efforts to widen the tax base.

The application software (PELSoft) being used for the administration of the Minor Taxes was inadequate as it was unable to detect non/short payments based on the turnovers reported in VAT and to check the status of the dealer, whether individual, firm, Company, etc.

At the same time, CTD failed to provide fair treatment to all tax payers and collected revenue from persons who were exempted from tax under the KTPTCE Act, 1976.

In the exit conference with the Additional Chief Secretary (Finance) to the Government, it was replied that action would be taken to make other State Government Departments/licensing Authorities collection Agents of PT, wherever possible. Further, CTD in their reply stated that a Committee to revamp the Professions Tax Act has been constituted and the issues raised in Audit have been referred to the Committee for examination.

## 2.5 Non-discharge of tax liability declared in the returns

Under Section 35(1) of the KVAT Act 2003, every registered dealer shall furnish a return in the prescribed form and shall pay the tax due on such return within 20 days (or 15 days in the case of dealers assessed under composition of tax) after the end of the tax period.

Test check of returns between January 2015 and June 2016 in 38 LVOs in eight<sup>23</sup> Districts revealed that for 947 returns pertaining to tax periods between April 2010 and March 2015 filed by 413 assesseees, the respective tax liabilities amounting to ₹ 5.51 crore were not discharged. Penalty and interest as applicable worked out to ₹ 0.55 crore and ₹ 2.78 crore respectively. Total amount due worked out to ₹ 8.84 crore.

Even though the 'e-VARADI' system for online filing of returns clearly indicates a status of 'not acknowledged' against all returns where the tax liability is not discharged in full, the officers concerned failed to follow up on these cases and ensure timely recovery. The persistence of the irregularity despite the same being pointed out in the previous reports also indicates that the Department is yet to take proactive measures to address the issue at the systems level. It is recommended, therefore, that a system of escalation of a pendency report for resolution at higher levels be built into the computerised system and controlling officers be made responsible to review and ensure clearance of outstanding liabilities in a timely manner.

When Audit brought these cases to the notice of the Commissioner of Commercial Taxes and to Government between January and August 2016, Government replied that ₹ 19.19 lakh had already been collected from nine dealers. In respect of two dealers, Government replied that the observation may be dropped as tax was paid to the Department. The reply is not acceptable as the payment details furnished by the Department for having paid the tax was not traceable in eFS. Reply in respect of the remaining dealers is still awaited (December 2016).

## 2.6 Non-levy of penalty under Section 72(1) of the KVAT Act

According to Section 35 (1) of the KVAT Act, 2003, every registered dealer shall furnish a return and shall pay tax due on such return within twenty days after the end of the preceding month or any other tax period as may be prescribed.

Further, as per Section 72(1) of KVAT Act, a dealer who fails to furnish a return or who fails to pay the tax due on any return furnished as required under the Act shall be liable to pay together with any tax or interest due, a penalty equal to:

- five *per cent* of the amount of tax due or ₹ 50 whichever is higher, if the default is not for more than 10 days, and
- ten *per cent* of the tax due, if the default is for more than 10 days.

<sup>23</sup> Bengaluru, Bagalkote, Ballari, Dakshina Kannada, Dharwad, Mysuru, Ramanagara and Tumakuru.

Further, as per Section 72(6) of KVAT Act, 2003, the power to levy above penalty shall be vested with the prescribed authority to which returns are required to be furnished or the prescribed authority making an assessment or re-assessment.

During test check of records of 67 (56 LVOs, four VSOs and seven Audit Offices) in twenty-one<sup>24</sup> districts between December 2014 and February 2016, Audit noticed that

(a) There was belated payment of tax (i.e. beyond 20 days after the expiry of the applicable tax period) of ₹ 185.94 crore in the returns for the years 2011-12 to 2013-14 by 290 assesseees. Though all these cases attracted penalty under Section 72(1) of the Act, it was neither paid by the assesseees nor were any efforts made by the officers concerned to impose the same. This had resulted in non-levy of penalty of ₹ 12.55 crore.

(b) On similar grounds, 10 assesseees had filed returns for the years 2008-09, 2010-11, 2011-12 and 2013-14 and paid tax of ₹ 6.03 crore belatedly. It was noticed that though re-assessments orders for the aforesaid periods were passed by the assessing officers during the years 2012-13 to 2014-15, penalty for belated payment of tax was not levied. This had resulted in non-levy of penalty of ₹ 0.38 crore.

It is pertinent to note here that basic checks on the returns filed by the dealers are not undertaken by the department and hence the belated payments go unnoticed, escaping levy of penalty.

Despite the Hon'ble Supreme Court of India upholding the imposition of penalty under this section in December 2014, the department has not yet incorporated this provision into the computerised system. It is recommended, therefore, that the same may be effected expeditiously to ensure that dealers file returns and pay taxes in time and any delay in realising Government revenue is duly compensated through the levy of this penalty following extant procedures.

When Audit brought these cases to the notice of the Commissioner of Commercial Taxes and to Government between January and July 2016, Government replied that ₹ 1.86 crore had already been collected from 87 dealers, notices were issued by the Department in respect of 31 dealers for recovery of penalty and orders levying penalty was issued in respect of eight dealers.

In another case, Government replied that the observation may be dropped based on the assessee's reply that sales were made to Indian Railways and payment were received belatedly. Due to this, the dealer did not pay tax within the due date prescribed. It was also stated that according to the judgement<sup>25</sup> passed by the Hon'ble High Court of Delhi, no penalty was

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<sup>24</sup> Ballari, Belagavi, Bengaluru, Bidar, Chikkaballapura, Chikkamagaluru, Dakshina Kannada, Davanagere, Dharwad, Kalaburgi, Kodagu, Kolar, Koppal, Mandya, Mysuru, Ramanagara, Shivamogga, Tumakuru, Udupi, Uttara Kannada and Vijayapura.

<sup>25</sup> Judgement of Hon'ble High Court of Delhi in the case (121STC600) of M/s.Calcom Electronics Limited vs Sales Tax Officer.

leviable when there is genuine reasons for delay in submission of return and payment of tax.

Reply is not acceptable since Section 7 of the KVAT Act, 2003, states that sale is deemed to have taken place at the time of issue of invoice and hence has to be included in the taxable sales of goods during the period of issue of the tax invoice. Therefore, a registered dealer shall declare such turnover in monthly returns for which tax invoices was issued.

Reply in respect of the remaining dealers is still awaited (December 2016).

## **2.7 Non/short payment of differential tax liability declared in audited statement of accounts**

According to Section 31(4) of the KVAT Act 2003, every dealer whose total turnover in a year exceeds a prescribed amount<sup>26</sup> shall have the accounts audited by a Chartered Accountant or a Cost Accountant 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 other documents as prescribed in the Act.

Form VAT-240 provides for the auditor to file a comparative statement of dealer's liability to tax and his entitlements for input tax/refund as declared in the tax returns, and the corresponding correct amount determined in audit. In case of a difference between them, the auditor is to advise the dealer either to pay the differential tax together with the penalty and interest, if any, or to claim refund due to him, as the case may be.

During test check of records in 24 LVOs and two VSOs in ten<sup>27</sup> districts between January 2015 and February 2016, Audit noticed that 34 dealers in their audited accounts in Form VAT 240 had declared additional tax liability of ₹ 4.08 crore compared to the tax liability declared in the monthly returns for the years 2011-12 to 2013-14. As per the Act, this additional liability declared was to be paid by the dealers along with penalty (at 10 *per cent*) and interest (at 1.5 *per cent* per month). The dealers concerned, however, neither paid the dues on their own while filing the audited accounts, nor were the dues demanded by the LVOs / VSOs concerned. This had resulted in non/short payment of tax of ₹ 4.08 crore. Further, penalty and interest leviable under Sections 72(2) and 36 of KVAT Act, 2003, amounted to ₹ 0.40 crore and ₹ 1.06 crore respectively. The Department has not put into place a practice to examine whether the tax declared by the dealer in Form VAT 240 was in excess of the amount paid in the monthly returns. Hence, inaction on the part of the Department to raise timely demands resulted in amounts declared payable by the dealers themselves to be shown as pending realisation to the Government.

<sup>26</sup> ₹ 40 lakh till 31 March 2010, ₹ 60 lakh from 1 April 2010 to 31 March 2011 and ₹ 100 lakh thereafter.

<sup>27</sup> Bagalkote, Ballari, Belagavi, Bengaluru, Chikkamagaluru, Kalaburgi, Kodagu, Ramanagara, Udipi and Vijayapura.

It is pertinent to note here that Audit had repeatedly recommended<sup>28</sup> the establishment of an online ledger account for dealers that would compile liabilities of dealers from all the various sources of demand (Returns, Audited Statement of Accounts, Re-assessment orders etc.). The same observation was also reported in the previous report<sup>29</sup> which indicates that a practice of non-clearance of liabilities declared in VAT 240 is fairly prevalent among dealers. It is recommended, therefore, that the Department take pro-active steps to address this issue, specifically, by introducing a control by which such liabilities along with penalty due are adjusted against the Input Tax Credit claims made by the dealers in their subsequent VAT Returns.

When Audit brought these cases to the notice of the Commissioner of Commercial Taxes and to Government between January and August 2016, Government replied that ₹ 0.66 crore had already been collected from nine dealers, order levying tax was issued in one case and notices were issued by the Department in respect of four cases. Reply in respect of the remaining dealers is still awaited (December 2016).

## **2.8 Non/short levy of interest**

Under Section 36(2) of the KVAT Act, 2003, every dealer who fails to pay any amount of tax or additional tax declared in the returns or furnishes a revised return more than three months after the tax becomes payable, shall be liable to pay simple interest. The rate of interest was 1.25 *per cent* per month up to 31 March 2011 and 1.5 *per cent* per month with effect from 01 April 2011 under Section 37(1) of the above Act, leviable from the date on which any amount payable under this Act was due.

During test check of VAT-100<sup>30</sup> returns, annual audited accounts filed in VAT-240<sup>31</sup> and re-assessment orders in 43 Offices (31 LVOs and 12 Audit Offices) in thirteen<sup>32</sup> districts between January 2015 and January 2016, Audit noticed that there was a delay in payment of tax amounting to ₹ 62.25 crore for the tax period from 2006-07 to 2013-14 by 75 dealers. The tax due was either against original returns or against additional tax liabilities arising from re-assessments / revised returns / annual audited accounts filed in VAT-240. Though the belated payment of tax in all these cases attracted payment of interest under Section 36(2) of the Act, it was either not levied or levied short. The total non/short levy of interest for the tax periods between April 2006 to March 2014 worked out to ₹ 2.62 crore. Though there is a provision in monthly returns, i.e. VAT-100, for payment of interest for delay in payment

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<sup>28</sup> Recommendation No.5 under Paragraph No.2.12.11 of Report No.3 for the year ended 31 March 2010 and Recommendation No.1 under Paragraph No.2.8.18 of Report No.1 of 2014.

<sup>29</sup> Paragraph No.2.4 of Report No.3 of 2015.

<sup>30</sup> VAT-100 is a form used for filing monthly returns in which sales and purchases made by the dealers for a particular month are depicted.

<sup>31</sup> VAT-240 is a form used for filing Annual Audited Statement prepared by Chartered Accountant or a Sales Tax Practitioner. VAT-240 is a comparative statement of dealer's liability to tax and his entitlements for input tax/refund as declared in the monthly returns (VAT-100), and the corresponding correct amount determined on audit.

<sup>32</sup> Bagalkote, Ballari, Bengaluru, Dakshina Kannada, Davanagere, Dharwad, Kalaburgi, Kolar, Madikeri, Mysuru, Shivamogga, Vijayapura and Uttara Kannada.

of tax, the department failed to monitor compliance to this provision which resulted in the non/short levy of interest.

It is noteworthy to mention here that Audit had recommended the establishment of facility for automatic computation of interest on belated payment of taxes in the published report of Performance Audit<sup>33</sup> on “Online System in the Commercial Taxes Department”. Further, similar paragraphs were continuously published in the various Audit Reports on Revenue Sector which indicates the prevalence of non-compliance with payment of interest among the dealers. Hence, it is recommended that automation of levy of interest on belated payment may be established on a priority basis not only to plug the revenue loss but also to encourage the dealers on making timely payments.

When these cases were brought to the notice of the Commissioner of Commercial Taxes and to Government during February and August 2016, Government replied that an amount of ₹ 28.57 lakh was collected in respect of 19 dealers, orders have been passed for levy of interest in respect of nine dealers and notices have been issued in respect of four dealers. Reply in respect of remaining dealers is awaited (December 2016).

## **2.9 Excess adjustment of credit amount**

According to Section 10 of the KVAT Act, 2003, 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’. A dealer is liable to pay the net tax<sup>34</sup> after setting off input tax paid against output tax payable.

The said provision of the KVAT Act, 2003, also stipulates that “where the input tax deductible by a dealer exceeds the output tax payable by him, the excess amount shall be adjusted or refunded together with interest, as may be prescribed”. As per Rule 127 of the Karnataka Value Added Tax Rules, 2005, any dealer, whose input tax deductible exceeds the output tax payable by him as specified under sub-section (5) of Section 10 on the basis of the return submitted for any month or quarter during a year or where any dealer, in whose case the input tax deductible exceeds the output tax payable by him on the basis of any final return submitted under sub-section (4) of Section 27, such dealer may, adjust such amount towards the tax payable by him under this Act or the Central Sales Tax Act, 1956.

Test check of VAT-100 returns, annual audited accounts filed in VAT-240 and re-assessment orders in 14 Offices (10 LVOs, two VSOs and two Audit Offices) in six<sup>35</sup> districts were conducted between January 2015 and December 2015. Audit cross verified the credit amounts brought forward and adjusted against the output tax liability by the dealers in their returns with respect to returns / revised returns filed by them for previous tax periods, advices given by auditors in Form VAT-240 and re-assessments concluded by the prescribed authorities. The cross verification revealed that 22 dealers for the tax periods from 2010-11 to 2013-14 were eligible for input tax credit

<sup>33</sup> Recommendation No.11 under Paragraph No. 2.8.18 of Report No.1 of 2014.

<sup>34</sup> Net Tax = Output Tax – Input Tax.

<sup>35</sup> Bengaluru, Bagalkote, Davanagere, Dharwad, Madikeri and Tumakuru.

amounting to ₹ 3.15 crore, however, these dealers had adjusted input tax credit of ₹ 4.45 crore, resulting in excess adjustment of credit amount of ₹ 1.30 crore. Audit noticed that the excess adjustment was primarily due to the mismatch of credits claimed by dealers in different returns/orders like monthly returns, revised returns, VAT 240, reassessment orders, etc. There is no mechanism in the Department for cross verification of details filed by dealers in different returns and reassessment orders to ensure correctness of input tax credit claimed by the dealers.

It is noteworthy to mention that Audit had repeatedly recommended<sup>36</sup> the establishment of an online ledger account for dealers that would compile liabilities of dealers from all the various sources of demand (Returns, Audited Statement of Accounts, Re-assessment orders, etc.) which would have reconciled the credits claimed differently in various sources. Similar observation was included in the previous report<sup>37</sup> which also indicates that practice of excess adjustment of credit is fairly prevalent among dealers. It is recommended, therefore, that modifications may be made to electronic filing system to enable the system for cross verification of details filed by the dealers in monthly returns, revised returns, audited statement, re-assessment orders, etc. to prevent loss of revenue.

When these cases were brought to the notice of the Commissioner of Commercial Taxes and to the Government during July and August 2016, Government replied that an amount of ₹ 2.04 lakh was recovered from two dealers and notice was issued in respect of one dealer. Reply in respect of remaining dealers is awaited (December 2016).

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<sup>36</sup> Recommendation No.5 under Paragraph No.2.12.11 of Report No.3 for the year ended 31 March 2010 and Recommendation No.1 under Paragraph No.2.8.18 of Report No.1 of 2014.

<sup>37</sup> Paragraph No.2.7 of Report No.3 of 2015.