CHAPTER II
VALUE ADDED TAX
AND
CENTRAL SALES TAX

2.1 Tax Administration

The Commercial Taxes Department is under the purview of Principal Secretary to Revenue Department. The Department is mainly responsible for collection of taxes and administration of Telangana Value Added Tax Act (VAT Act)[5], Central Sales Tax Act (CST Act), Telangana Luxury Tax Act, AP Entertainment Tax Act[6] and rules framed thereunder. Commissioner of Commercial Taxes (CCT) is the Head of the Department entrusted with overall supervision and is assisted by Additional Commissioners (ACCT), Joint Commissioners (JC), Deputy Commissioners (DC), Appellate Deputy Commissioners (ADC) and Assistant Commissioners (AC). AC (Large Tax payer Units (LTU) at Division level and Commercial Tax Officers (CTOs) at circle level are primarily responsible for tax administration and collection. Registration of all dealers is made by CTOs. The DCs are controlling authorities with overall supervision of the circles and LTUs under their jurisdiction. There are 12 LTUs and 92 Circles in the State functioning under the administrative control of DCs. Further, there is an Inter State Wing (IST) headed by a Joint Commissioner within Enforcement wing, which assists CCT in cross verification of interstate transactions with different States.

2.2 Internal Audit

The Department did not have a dedicated Internal Audit Wing that would plan and conduct audit in accordance with a scheduled audit plan. Internal audit is organised at Divisional level under the supervision of AC. Each LTU/circle is audited by audit teams consisting of five members headed by either CTOs or Deputy CTOs. Internal audit report is submitted within 15 days from the date of audit to DC (CT) concerned, who would supervise rectification work, giving effect to findings in such report of internal audit.

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[5] The nomenclature of AP VAT Act was changed as Telangana VAT Act as per G.O.Ms. No. 32 dated 15 October 2014.

[6] AP Entertainment Tax Act and Rules have not been formally adopted by Government of Telangana. However, by virtue of Sections 100 and 101 of the Andhra Pradesh Reorganisation Act 2014, these are applicable in the State of Telangana.

2.3 Results of Audit

In 2015-16, test check of the assessment files, refund records and other connected documents of the Commercial Taxes Department showed under-assessment of Sales Tax / VAT and other irregularities involving ₹ 345.17 crore in 1,068 cases which fell under the following categories as given in **Table 2.1.**

Table 2.1: Results of Audit

(₹ in crore)

Sl. No.	Categories	No. of cases	Amount
1.	Short levy of tax on works contracts	55	15.10
2.	Non-levy / short levy of interest and penalty	197	87.47
3.	Excess claim / allowance of Input Tax Credit	154	25.89
4.	Non-levy / short levy of tax under VAT Act	275	69.53
5.	Non-levy / short levy of tax under CST Act	216	51.18
6.	Other irregularities	171	96.00
	Total	**1,068**	**345.17**

During the year, the Department accepted under-assessments and other deficiencies in 189 cases involving ₹ 15.35 crore. An amount of ₹ 3.30 crore in 41 cases was realised during the year 2015-16.

A few illustrative cases involving ₹ 94.49 crore are discussed in the succeeding paragraphs.

Audit Observations

During scrutiny of records of the Offices of the Commercial Taxes Department relating to assessment and revenue collection of VAT and CST, Audit observed *several cases of non-observance of provisions of Acts / Rules, resulting in non-levy / short levy of tax / penalty and other cases as discussed in the succeeding paragraphs in this Chapter. These cases are illustrative and are based on a test check carried out by Audit. Such omissions are pointed out in audit every year, but not only do the irregularities persist; these also remain undetected until an audit is conducted again. There is a need for improvement of internal controls so that repetitions of such omissions can be avoided or detected and rectified.*

2.4 Input Tax Credit

2.4.1 Incorrect allowance of Input Tax Credit

As per Sections 13(1) and 13(3)(a) of the VAT Act, Input Tax Credit (ITC) shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods, used in the business if he is in possession of tax invoices. As per the provisions of Rule 20(2)(a) of TS VAT Rules, no ITC is allowed on purchase of automobiles unless the dealer is in the business of dealing in these goods. However, Rule 20(3)(a) of TS VAT Rules allows the dealer to claim notional ITC on the purchase price actually paid, at the time of sale of those used vehicles, if such claim is supported by documentary evidence of payment of tax at the time of purchase.

Audit observed (between May 2015 and February 2016) during the test check of VAT records of two circles[7] and four DC offices[8] for the assessment period from 2010-11 to 2013-14 that in seven cases, ITC was allowed to dealers on purchases of used vehicles from other than VAT dealers without proper tax invoices. Since no tax invoices were available and no tax was paid on such purchases, notional ITC was not admissible. Total incorrect allowance of ITC in all the seven cases was ₹ 9.83 crore.

After Audit pointed out the cases, in one case, CTO Madhapur replied (January 2016) that the file was submitted to DC for revision. In five cases the Assessing Authorities (AAs)[9] contended (between June 2015 and April 2016) that ITC was allowed based on the documentary evidence produced by the dealer and as per Rule 20(3)(a) of VAT Rules notional ITC was allowable to dealers dealing in used vehicles, if they furnish the documents showing purchase value and registration details of the vehicles irrespective of the provisions stipulated under Section 13(1) and 13(3)(a) of the VAT Act. The reply was not acceptable as VAT rules cannot override the provisions of VAT Act since VAT Rules are framed under the VAT Act itself. ITC was allowed without tax invoices which was mandatory as per Section 13(3) of the VAT Act and the rules do not empower the AA to act against the provisions of

[7] CTOs - Jubilee Hills and Madhapur.
[8] DCs - Abids, Charminar, Hyderabad (Rural) and Punjagutta.
[9] DCs - Abids, Charminar, Hyderabad (Rural) and Punjagutta.

Section 13 of VAT Act. In the remaining case, CTO Jubilee Hills stated (June 2015) that the matter would be examined and reply sent in due course.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.4.2 Excess claim of Input Tax Credit due to incorrect method of restriction

As per Section 13(5) of the VAT Act, no ITC shall be allowed to any VAT dealer on sale of exempted goods (except in the course of export) and exempt sales, and to the works contractors who opt to pay tax under composition[10]. As per Section 13(6), ITC for transfer of taxable goods outside the State otherwise than by way of sale (exempt transactions) shall be allowed for the amount of tax in excess of four / five *per cent*. Further as per sub rules (7) (8) and (9) of Rule 20 of VAT Rules, a VAT dealer making taxable sales, exempted sales and exempt transactions of taxable goods shall restrict his ITC as per the prescribed formula A X B / C, where A is the ITC for common inputs for each tax rate, B is the taxable turnover and C is the total turnover.

Audit observed (between August 2015 and March 2016) during the test check of VAT records of DC Warangal office and 12 circles[11] for the assessment period from 2009-10 to 2013-14 that ITC was incorrectly restricted in respect of 18 dealers who had effected exempt sales and exempt transactions, which resulted in excess claim of ITC of ₹ 2.50 crore.

After Audit pointed out the cases, in two cases, AAs[12] stated (between March and June 2016) that the files were submitted to DC for revision. CTO, Punjagutta in one case contended (February 2016) that interstate sales made to Special Economic Zones (SEZ) are nothing but exempt transactions and partial restriction of ITC was sufficient. The reply was not tenable, as per Section 7A of the VAT Act, SEZ sales were exempt sales and ITC was not allowed. In another case, CTO contended that the amount shown under exempt sales represent inter-unit transfers within the State and therefore, ITC should be allowed. However, the AA did not produce any documentary evidence in support of his contention. In the remaining 14 cases, the AAs[13] stated (between June 2015 and March 2016) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in June-July 2016 and to the Government in October 2016; replies have not been received (December 2016).

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[10] 'Composition' is an option available to works contractors to pay tax at a fixed rate on the total value of the work done irrespective of tax rates applicable to the goods used in work.

[11] CTOs - Agapura, Basheerbagh, Begumpet, Kamareddy, Madhapur, M.G.Road, Mahankali Street, Narayanguda, Nizamabad-I, Punjagutta, Ranigunj and Vidyanagar.

[12] CTOs - Agapura and Nizamabad-I.

[13] DC Warangal; CTOs - Basheerbagh, Begumpet, Kamareddy, Madhapur, M.G.Road, Mahankali Street, Narayanguda, Ranigunj and Vidyanagar.

2.4.3 Excess allowance of Input Tax Credit due to incorrect determination of Purchase Turnover

As per Section 13(1) of the VAT Act, ITC shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods made by the dealer during the tax period, if such goods are for use in his business. Para 5.12 of VAT Audit Manual prescribes mandatory basic checks for conducting VAT audit, which include cross checking of figures reported by VAT dealers in their monthly VAT returns filed with those recorded in certified annual accounts, so as to detect under-declaration of tax, if any.

Audit observed (between May 2015 and March 2016) during the test check of VAT assessment records of 11 circles[14] for the assessment period from 2010-11 to 2013-14 that in 15 cases, the AAs had adopted excess purchase turnovers for allowing ITC, than those shown in Profit and Loss Accounts. This resulted in excess allowance of ITC of ₹ 83.55 lakh.

After Audit pointed out the cases, CTO Rajendranagar in two cases, stated (February 2016) that files would be submitted to DC for revision. In the remaining cases, AAs replied (between June 2015 and March 2016) that the matter would be examined.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.4.4 Excess claim of Input Tax Credit on ineligible items

As per Section 13(3) of the VAT Act, ITC shall be allowed to a VAT dealer on purchase of taxable goods if he is in possession of tax invoice obtained from any other VAT dealer. However, as per Section 13(4) of the VAT Act, read with Rule 20(2) (a), (c), (h), (i), (k) of VAT Rules, a VAT dealer is not entitled for ITC on the purchases of coal and other fuels used in manufacture or processing units, automobiles, air conditioners, generators and parts thereof, unless the dealer is in the business of dealing in these goods. Further, under Section 13(5)(h) of the Act read with Section 4(9)(d) thereof, the dealers running any restaurants or eating establishments etc., with annual total turnover of less than ₹ 1.50 crore are not entitled to claim ITC.

Audit observed (between May 2015 and March 2016) during the test check of VAT records of nine circles[15] for the assessment period from 2009-10 to 2014-15 that in five cases, ITC was incorrectly allowed on purchase of automobiles, air conditioners, generators, coal and on purchases made from other than VAT dealers. In six other cases ITC was claimed by hotel dealers though their annual total turnover was less than ₹ 1.50 crore. Thus, the total excess claim of ITC in all the 11 cases amounted to ₹ 40.37 lakh.

[14] CTOs - Agapura, Afzalgunj, Balanagar, Jeedimetla, Khairatabad, Market Street, Miryalaguda, Nizamabad-III, Rajendranagar, RP Road and Tarnaka.

[15] CTOs - Hyderguda, Kamareddy, Market Street, Medak, Mehdipatnam, M.J. Market, Nampally, Nizamabad-II and Tarnaka.

After Audit pointed out the cases, AAs stated (between May 2015 and March 2016) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.5 Under-declaration of tax due to adoption of incorrect rate of tax

Under Section 4(3) of the VAT Act, every VAT dealer shall pay tax on sale of taxable goods at the rates specified in the Schedules to the Act. Commodities which fall under Schedule VI to the Act attract special rate of tax. Commodities not specified in any of the schedules fall under Schedule V and tax is to be levied at the rate of 14.5 *per cent*[16]. Further, as per Section 4(9)(c) of the Act, every dealer whose annual total turnover is ₹ 1.50 crore and above shall pay tax at the rate of 14.5 *per cent* on the taxable turnover representing sale or supply of food served in restaurants, sweet-stalls etc.

Audit observed (between March 2015 and March 2016), during the test check of VAT records in Saroornagar Division and 16 circles[17] for the assessment period from 2009-10 to 2014-15 that 20 dealers incorrectly declared tax at the rate of four *per cent* / five *per cent* on sale of commodities such as air conditioners, confectionery, electronic weighing scales, empty gas cylinders, fabricated steel structures, LED lights, mosquito repellents etc., though they were liable to pay tax at the rate of 12.5 / 14.5 *per cent*. In five cases, dealers running bars and restaurants declared annual total turnover below ₹ 1.50 crore and paid VAT at five *per cent* on sale of food excluding liquor sales. As each dealer's turnover exceeded ₹ 1.50 crore by including liquor sales, they were liable to pay tax at 12.5 / 14.5 *per cent*. In one case, a dealer dealing in a sale of *pan masala* which was taxable at the rate of 20 *per cent* under Schedule VI to the Act, incorrectly declared tax at the rate of 14.5 *per cent*. The AAs also did not identify the incorrect payment of tax during their audit. The application of incorrect rates of tax resulted in under-declaration / short levy of tax of ₹ 23.79 crore.

After Audit pointed out the cases, in one case, CTO Bhongir stated (August 2015) that the assessment file would be submitted to DC for revision. In another case, the DC Saroornagar contended (June 2015) that fruit pulp was nothing but fruit juice and therefore, taxable at four *per cent*. The reply of the DC was not acceptable as the commodity was inserted in Schedule IV to VAT Act from 29 January 2013 only and not classified earlier. Hence, it was liable to tax at the rate of 14.5 *per cent*. In the remaining 24 cases, AAs stated (between March 2015 and March 2016) that the matter would be examined.

[16] Rate was revised from 12.5 *per cent* to 14.5 *per cent* from 15 January 2010.

[17] CTOs - Begumpet, Bhongir, Gowliguda, Hyderguda, Jubilee Hills, Madhapur, Mahabubnagar, Malkajgiri, Miryalguda, M.J.Market, Nampally, Rajendranagar, Ranigunj, Saroornagar, Somajiguda and Taranaka.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.6 Non-declaration of VAT on Taxable Turnover

Under Section 4(3) of the VAT Act, every VAT dealer shall pay tax on sale of taxable goods at the rates specified in the Schedules to the Act. As per the Government Order[18] dated 8 July 2011, the commodity 'textiles and fabrics' was added to Schedule-IV and made taxable at five *per cent*[19]. However, as per Ordinance No. 9 of 2012 dated 05 November 2012, the dealers of 'textiles and fabrics' may opt to pay tax at the rate of one *per cent* under composition. Later, the Government, by another order[20], included this commodity in Schedule-I from 7 June 2013 and made these sales exempted. Hence, the commodity was liable to tax at the rate of five *per cent* between 8 July 2011 and 6 June 2013, if the dealers had not opted for composition.

As per Section 20(3)(a) of the Act, every monthly return submitted by a dealer shall be subjected to scrutiny to verify the correctness of calculation, application of correct rate of tax, input tax credit claimed therein and full payment of tax payable for such tax period.

Audit observed (between August 2015 and March 2016), during the test check of VAT records of Abids DC Office and 11 circles[21] for the period from 2008-09 to 2013-14 that in 27 cases, the dealers incorrectly reported turnovers amounting to ₹ 263.76 crore showing the sales of 'textiles and fabrics' as exempt, instead of paying tax at the rate of five *per cent* as none of them opted for composition. The AAs, while finalising the assessment, did not levy tax on the sale turnover of textiles. This resulted in non-levy of tax of ₹ 13.19 crore at five *per cent* on the turnover of ₹ 263.76 crore.

After Audit pointed out the cases, in two cases CTO Srinagar colony stated (July 2016) that the assessment file was submitted to DC. In the remaining cases the AAs stated (between August 2015 and March 2016) that the matter would be examined and report submitted in due course.

The matter was referred to the Department between May and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.7 Interstate Sales

2.7.1 Short levy / Non-levy of tax on Interstate Sales

As per Sections 8 of CST Act read with Rule 12 of CST (Registration and Turnover) Rules 1957 (R&T Rules), every dealer shall file a separate 'C' form

[18] G.O.Ms.No.932, Revenue (CT-II) Department, dated 08 July 2011.
[19] Four *per cent* up to 13 September 2011.
[20] G.O.Ms.No.308, Revenue (CT-II) Department, dated 07 June 2013.
[21] CTOs - Abids, Charminar, Begum Bazar, Kamareddy, Lord Bazar, Malkajgiri, Mancherial, Punjagutta, Srinagar Colony, Sultan Bazar and Warangal.

to cover all interstate sales, which take place in a quarter of a financial year between the same two dealers to claim concessional rate of two *per cent* tax. As per Section 8(2) of the Act, in case the dealer fails to file the statutory forms, the transactions are treated as interstate sales not covered by proper declaration forms and tax levied at the rates applicable to the goods inside the appropriate State.

Audit observed (between May 2015 and March 2016) during the test check of CST assessment files in the office of the DC Saroornagar and 14 circles[22] that in 22 cases the AAs, while finalising the assessments between June 2013 and March 2016 for the years 2009-10 to 2012-13 had levied tax at lower than the applicable rates on interstate sales of goods not covered by "C" forms. In another case[23], though the dealer reported CST collections for the year 2011-12 at 14.5 *per cent* on interstate sales of navigation devices, the AA levied tax (March 2015) at five *per cent* only. This resulted in short levy of tax of ₹ 3.63 crore on the total turnover of ₹ 38.02 crore.

After Audit pointed out the cases, in one case, CTO IDA-Gandhinagar stated (July 2016) that the assessment file was submitted to DC concerned for revision. In two cases, CTOs, Basheerbagh and Ramannapet stated (July 2016) that revision show cause notices were issued to the dealers. In one case, CTO Musheerabad stated (June 2016) that the assessment was revised and effectual orders were issued. However, no documentary evidence in proof of demands raised / collections made were furnished. The DC Saroornagar (June 2015) in one case, contested that fruit pulp was nothing but fruit juice and therefore taxable at four *per cent*. The reply of the department is not acceptable as the commodity was inserted in Schedule IV to VAT Act from 29 January 2013 whereas the turnover pertained to earlier period and hence, was liable to tax at the rate of 14.5 *per cent*. CTO Jubilee Hills, in one case, stated (June 2015) that the item 'elastic rail clip' was produced from iron and steel and therefore, fell under Schedule IV to VAT Act and was eligible to tax at four *per cent*. The reply was not tenable as the commodity was not enlisted in the Schedule IV to the VAT Act. In the remaining 17 cases, the AAs[24] stated (between May 2015 and March 2016) that the matter would be examined and detailed report submitted in due course.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.7.2 Non-levy of penalty for misuse of 'C' Form in Interstate Purchases

As per Section 8(4) of CST Act, the concessional tax rate of two *per cent* on interstate sale of taxable goods is applicable if such transactions are supported by valid 'C' forms obtained from CST dealer of other State. As per Section

[22] CTOs - Basheerbagh, Bodhan, Gandhinagar, IDA-Gandhinagar, Jeedimetla, Jubilee Hills, Malkajgiri, MJ Market, Musheerabad, Ramannapet, Nacharam, Rajendranagar, Sanathnagar and Siddipet.

[23] CTO – Basheerbagh.

[24] CTOs - Bodhan, Gandhinagar, Jeedimetla, Malkajgiri, MJ Market, Nacharam, Rajendranagar, Sanathnagar and Siddipet.

8(3)(b) of CST Act, a dealer registered under the CST Act shall mention the goods he intends to purchase from outside the State and these shall be mentioned in his registration certificate. These goods so purchased, are to be intended only for (i) resale; (ii) manufacture or processing of goods for sale; (iii) mining; (iv) generation or distribution of electricity or any other form of power; and (v) packing of goods for sale/resale.

Under Section 10A of CST Act, penalty not exceeding 1.5 times the tax, which would have been levied in the absence of statutory declaration forms, is to be imposed if the dealer violates the provisions of Section 8(3)(b) of CST Act.

Audit observed (February 2016) during the test check of VAT assessment records and CST records of Abids DC office for the period from June 2012 to March 2014 that in one case the dealer had made interstate purchase of iron and steel and hardware items against 'C' forms and used for self-consumption. As the purchase of goods by the dealer were not for the purpose as mentioned under Section 8(3)(b) of the CST Act, the dealer clearly misused 'C' forms by violating the provisions of the Act, inviting penalty under Section 10A of the Act. Penalty of ₹ 2.62 crore was not levied on the turnover of ₹ 35 crore, for misuse of 'C' forms.

After Audit pointed out the case, the AA stated (February 2016) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.7.3 Incorrect Exemption on Interstate Transactions not covered by Documentary Evidence

As per Section 5(1) and 5(3) of CST Act, export of goods and goods sold for export are not liable to tax. Further, under Section 5(4) of the Act read with Rule 12(10) of the CST (Registration and Turnover) Rules 1957, the dealer selling the goods shall furnish documentary evidence such as bill of lading, purchase order, 'H' form duly filled and signed by the exporter in support of the transaction. Under section 6(2) of CST Act, goods sold during interstate transit are exempt from tax on production of E1 / E2 and 'C' forms. As per Section 5(2) of CST Act, high sea sales are exempt from tax if they are supported by bill of lading, bill of entry and high sea sale agreement. Failure to file documents entails the transactions to be treated as interstate sale not covered by 'C' form and tax levied under Section 8(2) of the Act at the rates applicable to such goods inside the State.

During the test check of the CST assessment files in eight circles[25], Audit observed (between August 2015 and January 2016) that the AAs while finalising the assessments (between March 2011 and March 2015) in 13 cases

[25] CTOs - Agapura, Balanagar, Bhongir, Jedcherla, Nacharam, Saroornagar, Somajiguda and Suryapet.

had incorrectly allowed exemption on the total turnover of ₹ 13.95 crore representing export sales, transit sales and high sea sales though not supported by documentary evidence. The incorrect exemption resulted in non-levy of tax of ₹ 1.59 crore.

After Audit pointed out the cases, in one case, CTO Jedcherla stated (September 2015) that the assessment would be revised. In two cases, CTOs Balanagar and Bhongir stated (between August 2015 and July 2016) that show-cause notices were issued to the dealer. In the remaining 10 cases, the AAs[26] stated (between August 2015 and January 2016) that the matter would be examined.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.7.4 Short levy of tax due to incorrect computation of taxable turnover under CST Act

As per Section 8(2) of the CST Act read with Rule 12 of the R&T Rules, every dealer, who in the course of interstate trade or commerce sells goods to a registered dealer located in another State, shall be liable to pay tax under the CST Act at the rate of two *per cent*, provided the sale is supported by a declaration in form 'C', otherwise tax shall be leviable at the rate applicable to goods within the State.

During the course of audit of six circles[27] (conducted between October 2015 and March 2016) it was observed from VAT and CST assessment files of seven dealers for the years 2009-10 to 2011-12 that the turnovers adopted or arrived at while finalising VAT assessments in respect of CST sales, were more than the turnovers actually assessed under CST. In another case, the assesse had collected an amount of ₹ 7.79 lakh towards tax. However, the AA, while finalising the assessment, incorrectly allowed exemption of ₹ 63.98 lakh towards tax collections. The incorrect determination of taxable turnover resulted in short levy of tax of ₹ 1.52 crore on a turnover of ₹ 28.63 crore in all eight cases.

After Audit pointed out the cases, the AAs stated (between October 2015 and March 2016) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

[26] CTOs - Agapura, Nacharam, Saroornagar, Somajiguda and Suryapet.
[27] CTOs - Keesara, Rajendranagar, Medak, Nacharam, Saroornagar and Vanasthalipuram.

2.7.5 Short levy of tax due to excess adjustment of input tax credit against CST payments

As per Rule 35(7) of VAT Rules, a VAT dealer making interstate sale of goods may adjust any excess credit available under the VAT Act against any tax payable under the CST Act, for the same tax period.

Audit observed (between May 2015 and March 2016) during the test check of CST assessment records of DC Secunderabad and CTO-I Nizamabad that AAs while finalising the CST assessments of two cases for the years 2010-11 and 2011-12 adjusted ₹ 1.95 crore excess credit available under VAT Act against tax payable under CST Act. However, cross verification of VAT records of the dealers showed that the actual adjustment made by them from the excess input tax credit available with them towards their CST liability was ₹ 1.81 crore only. This resulted in short levy of tax of ₹ 14.37 lakh.

After Audit pointed out the cases, the AAs stated (between May 2015 and March 2016) that the matter would be examined with reference to books of accounts and report submitted in due course.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.7.6 Incorrect Grant of Concessional Rate of Tax due to acceptance of invalid Statutory Forms

As per Section 8(4) of the CST Act, read with Rule 12(1) of R&T Rules, every dealer shall file a single declaration in form 'C' covering all interstate sales, which took place in a quarter of a financial year between the same two dealers, to claim concessional tax rate of two *per cent*. As per Rule 14-A(1)(b)(i) of CST(AP) Rules 1957, original 'C' forms received from the dealer to whom goods were sold shall be filed. As per Section 8(2) of the CST Act, interstate sale turnover, not covered by proper declarations, shall be taxed at the rates applicable to goods in the respective States.

Audit observed (between May and November 2015) during the test check of the CST assessments of DCs Saroornagar and Secunderabad and CTO Nirmal that in five cases, while finalising the assessments for the years 2010-11 and 2011-12 between March 2014 and March 2015, the AAs had incorrectly allowed concessional rate of tax on the interstate sales turnover of 'dyes and chemicals, plastic goods, paints, cotton and cotton seed' amounting to ₹ 4.81 crore, supported by invalid 'C' forms. i.e., forms covering transactions of more than a quarter, fictitious and duplicate forms. This resulted in short levy of tax of ₹ 11.58 lakh.

After Audit pointed out the cases, the DC Saroornagar stated (June 2015) in one case that the date of receipt of goods by the purchaser was taken as criteria and 'C' forms were issued accordingly. Further, as per CCT circular, 'C' forms were acceptable even though the sale and purchases relate to different quarters. The reply was not acceptable as it was mandated under Rule 12(1) of

R&T Rules that separate 'C' forms were to be submitted for each quarter and the rules had not yet been amended as per the CCT's circular. In the remaining four cases, AAs[28] stated (between May and November 2015) that the matter would be examined.

The matter was referred to the Department in July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.8 Short Levy of Tax due to incorrect determination of Taxable Turnover

As per Section 21(4) of the VAT Act, the authority prescribed may, based on any information available or on any other basis, conduct a detailed scrutiny of the accounts of any VAT dealer and where any assessment, as a result of such scrutiny, becomes necessary, such assessment shall be made within a period of four years from the end of the period for which assessment is to be made. Rule 25(10) of the VAT Rules requires all the VAT dealers to furnish for every financial year to the prescribed authority, the statements of manufacturing / trading, Profit and Loss accounts, balance sheet and annual report duly certified by a Chartered Accountant on or before 31 December subsequent to the financial year to which the statements relate. As per para 5.12 of the VAT Audit Manual 2012, audit officer has to reconcile the figures given by the dealer on VAT returns with certified annual accounts.

Audit observed (between May 2015 and March 2016) during the test check of the VAT assessments and other records of Abids DC office and 27 circles[29] in 40 cases, where assessments were finalised between April 2013 and December 2015 for the period from 2009-10 to 2013-14, that the sales turnover determined by the AAs was ₹ 718.71 crore and the turnovers reported in Profit and Loss accounts was ₹ 864.18 crore. Variation in turnover of ₹ 145.47 crore resulted in short levy of tax of ₹ 7.36 crore.

After Audit pointed this out, in seven cases the AAs[30] stated (between August 2015 and July 2016) that the assessment files would be submitted to DCs for further necessary action. The CTO, Sangareddy stated that the assesse disclosed sales in profit and loss account which was inclusive of tax component and the sales shown in VAT was exclusive of VAT component. The reply was not acceptable as there was variation in sale turnover even after inclusion of VAT component. In the remaining cases, the AAs stated (between June 2015 and March 2016) that the matter would be examined and report submitted in due course.

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[28] DCs - Saroornagar, Secunderabad and CTO Nirmal.

[29] CTOs - Agapura, Basheerbagh, Begumpet, Bhongir, Gandhinagar, Gowliguda, Hydernagar, Jeedimetla, Kamareddy, Kothagudem, Keesara, Madhapur, Market Street, Marredpally, Miryalaguda, Musheerabad, Nacharam, NS Road, Ranigunj, Sangareddy, Siddipet, Srinagar Colony, Sultan Bazar, Tarnaka, Vengalaraonagar, Vidyanagar and Warangal.

[30] CTOs - Basheerbagh, Bhongir, Kothagudem, Gowliguda, Madhapur and Vengalaraonagar.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.9 VAT on Works Contract

2.9.1 Payment of VAT under non-composition method

2.9.1.1 Short Levy of Tax due to incorrect determination of Taxable Turnover under Works Contract

Under Section 4(7) (a) of the VAT Act, tax on works contract receipts is to be paid on the value of goods at the time of their incorporation in the work at the rates applicable to them. To determine the value of goods incorporated, deductions prescribed under Rule 17(1) (e) of VAT Rules, such as expenditure incurred towards labour charges, hire charges etc., are to be allowed from the total consideration and the remaining turnover is to be taxed at the rates applicable to them taking the same proportion at which the goods were purchased.

During the test check of VAT audit files of four circles,[31] Audit observed (in January and February 2016) that in five cases, AAs had incorrectly determined taxable turnover for the period from 2010-11 to 2013-14 as ₹ 46.35 crore, instead of ₹ 50.30 crore, due to allowing certain inadmissible and excess deductions from gross turnovers on account of profit relatable to labour charges on works awarded to sub-contractor, incorrect calculation of cost of establishment and profit relatable to labour etc. In another case[32], a dealer had received works contracts receipts of ₹ 8.91 crore during the year 2011-12 towards construction work as well as pure earth works. After deducting the turnover of ₹ 6.78 crore relating to pure earth works, on which no tax was payable, the assessable turnover should have been ₹ 2.13 crore, whereas the AA had determined a turnover of ₹ 1.91 crore, resulting in incorrect determination of taxable turnover of ₹ 21.49 lakh. Thus, the incorrect determination of turnovers in all these six cases led to short levy of tax of ₹ 35.77 lakh.

After Audit pointed out the cases, in one case CTO Madhapur stated (January 2016) that the file would be submitted to DC Hyderabad (Rural) Division for revision. In three cases, AAs[33] stated (in January and February 2016) that the matter would be examined. In the remaining two cases, CTO Somajiguda stated (January 2016) that exemption allowed in the ratio of labour to material which gives the correct attributable cost of establishment. Reply was not acceptable as the accepted ratio for calculation of profit and other charges relatable labour charges is expenditure x total labour charges/total receipts, whereas the AA stated that it was sufficient to put the material value and labour charges in the denominator to arrive at the ratio instead of total receipts.

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[31] CTOs - Agapura, Madhapur, Somajiguda and Tarnaka.
[32] CTO - Madhapur.
[33] CTOs - Agapura, Madhapur and Tarnaka.

The matter was referred to the Department in June 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.9.1.2 Short Levy of Tax on Works Contractors who did not maintain detailed accounts

As per Section 4(7)(a) of the VAT Act, works contract receipts are taxable at the rates applicable to the goods on the value of goods at the time of incorporation. However, as per Rule 17(1)(g) of VAT Rules, if any works contractor has not maintained detailed accounts to determine the correct value of the goods at the time of their incorporation, tax shall be levied at the rate of 14.5 *per cent* on the total consideration received after allowing permissible deductions on percentage basis based on the category of work executed. Civil works and works which do not fall under any category are entitled to 30 *per cent* deductions. In such cases, the contractor / VAT dealer shall not be eligible to claim ITC.

During the test check of VAT audit files of CTO, Vanasthalipuram, Audit observed (October 2015) that in one case, for the period 2012-13 and 2013-14, the AA had arrived at the taxable turnover of a works contractor by adding a fixed percentage of profit on the purchase value of material which is not provided for in the Act. Rule 17(1)(e) of the VAT Rules clearly prescribes the procedure to arrive at the taxable turnover but the same was not followed by the AA. In view of this, it is considered that the dealer did not maintain detailed accounts to arrive at the value of material at the time of incorporation and therefore, the provisions of Rule 17(1)(g) have to be invoked to finalise the assessment. Failure to do so, resulted in short levy of tax of ₹ 1.46 crore.

After Audit pointed out the case, AA stated (October 2015) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in June 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.9.2 Payment of VAT under composition method

As per the provisions of Section 4(7) (b) of the VAT Act, any works contractor may opt to pay tax by way of composition at the rate of five *per cent*[34] on the total consideration received towards execution of works contract. Similarly, under Section 4(7)(d) of VAT Act, the rate of tax payable under composition by any dealer engaged in construction and selling of residential apartments, houses, etc., is 1.25 *per cent* of the consideration received or receivable or the market value of land and building fixed for the purpose of stamp duty, whichever is higher. In the method of composition, no deductions are allowable to arrive at taxable turnover except payments made to sub-contractors.

[34] Four *per cent* before 14 September 2011.

Audit observed (between June 2015 and January 2016) during the test check of VAT records of four circles[35] for the years 2010-11 to 2014-15 that in two cases the AAs[36], while finalising the assessments of works contractors who had opted to pay tax under composition under Section 4(7)(b), allowed deduction of an amount of ₹ 3.63 crore pertaining to service tax, sales tax collections etc., though not admissible. In another case, in CTO Musheerabad circle, a dealer who had executed works contract of construction work on the land owned by others without having selling rights of constructed flats paid tax at the reduced rate of 1.25 *per cent* on the consideration received, though not entitled to. In view of this, the assessee's option for composition should have been considered only for Section 4(7) (b) under which tax was payable at the rate of five *per cent* on the total consideration received for execution of construction work. The AA also did not levy the differential tax while finalizing the assessment (January 2014). In two other cases, the builders engaged in construction and sale of apartments who had opted to pay tax by way of composition at the rate of 1.25 *per cent* under Section 4(7)(d) of the Act, declared the output tax at the rate of one *per cent* only. Thus there was an under-declaration of tax of ₹ 33.57 lakh in all five cases.

After Audit pointed out the cases, in one case, CTO Madhapur stated (January 2016) that the file would be submitted to DC for further action. In four cases the AAs[37], stated (between June 2015 and January 2016) that the matter would be examined.

The matter was referred to the Department in July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.10 Non-forfeiture of excess collection of Tax

As per provisions of Section 57(2) of the VAT Act, no dealer shall collect any amount by way of tax at a rate exceeding the rate at which he is liable to pay tax. Under Section 57(4) of the VAT Act, if any dealer collects tax in excess of his actual tax liability, the excess tax so collected shall be forfeited to the Government.

Audit observed (between January and March 2016) during the audit of four circles[38] for the period from 2009-10 to 2012-13 that in four cases tax of ₹ 14.06 lakh was collected in excess of tax liability. However, the AAs did not forfeit the same.

After audit pointed out, in four cases, the AAs[39] stated (between January and March 2016) that the matter would be examined and result intimated to audit in due course.

[35] CTOs - Gandhinagar, Madhapur, Musheerabad and Somajiguda.
[36] CTOs - Madhapur and Somajiguda.
[37] CTOs - Gandhinagar, Musheerabad and Somajiguda.
[38] CTOs - Jeedimetla, Nizamabad-II, Siddipet and Sultan Bazar.
[39] CTOs - Jeedimetla, Nizamabad-II, Siddipet and Sultan Bazar.

The matter was referred to the Department in July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.11 Non-levy / Short levy of VAT on transfer of right to use goods

As per Section 4(8) of VAT Act, every VAT dealer who leases out or licenses others to use taxable goods, for cash or consideration, in the course of his business shall pay tax at the rates on the consideration as are applicable to the goods involved.

Audit observed (between May 2015 and January 2016) during the test check of VAT records of Karimnagar DC office and three circles[40] that in four cases for the years from 2009-10 to 2013-14, the AAs did not levy or short levied taxes on total turnovers of ₹ 1.12 crore representing lease rentals for concrete mixers, vehicles, transit mixers and construction equipment. In one more case pertaining to Karimnagar DC office, the dealer did not declare tax on a turnover of ₹ 12 lakh received towards machinery hire charges during 2012-13. This resulted in non-levy / short levy of VAT of ₹ 17.73 lakh in all the five cases.

After audit pointed out the cases, in one case, CTO Narayanguda stated (January 2016) that the assessment file would be submitted to DC Abids for revision; in one case, CTO Mancherial stated (July 2016) that revised show cause notice was issued to the dealer; in two cases the AAs stated (between May and November 2015) that the matter would be examined. In the remaining case, the DC Karimnagar contended that proclainers were given for rent on hourly basis and there was no transfer of right to use and hence no tax was payable under section 4(8) of the VAT Act. The reply was not acceptable as the AA had not furnished any documentary evidence to substantiate his reply.

The matter was referred to the Department in May and June 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.12 Short realisation of tax for failure to register as VAT dealers

As per Section 17(3) of the VAT Act, every dealer whose taxable turnover exceeds ₹ 50 lakh in the 12 preceding months shall be liable to be registered as a VAT dealer. As per Section 17(5)(h) of the Act, every dealer engaged in sale of food items including sweets etc., whose annual total turnover is more than ₹ 7.5 lakh is liable for VAT registration and has to pay tax at the rate of five *per cent* under the provisions of Section 4(9)(d) of the Act. As per Rule 11(1) of the VAT Rules, the prescribed authority may *suo motu*, register a dealer, who is liable to apply for registration as VAT dealer but has failed to do so.

[40] CTOs - Mancherial, Narayanguda and Nirmal.

During the test check of Turnover Tax (TOT) records of five circles[41] Audit observed (between October 2014 and December 2015) in eight cases that the taxable turnover of the dealers during the period from 2011-12 to 2014-15 had crossed the threshold limit, making them liable for VAT registration. These TOT dealers had neither applied for VAT registration nor registered by the respective AAs. The total turnover that exceeded the threshold limits in these cases amounted to ₹ 3.31 crore on which VAT of ₹ 17.52 lakh was to be levied had they been registered as VAT dealers. Failure to get them registered as VAT dealers resulted in short realisation of tax of ₹ 16.02 lakh.

After Audit pointed out the cases, in one case, CTO Gowliguda stated (July 2016) that revision show-cause notice was issued to the dealer. In the remaining cases, the AAs[42] stated (between October 2014 and December 2015) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in July 2015 and June 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.13 Levy of Penalty and Interest under VAT

2.13.1 Short Levy of Penalty for using false Tax Invoice

As per Section 55(2) of VAT Act, any dealer who issues false tax invoice or receives and uses a tax invoice knowing it to be false, shall be liable to pay a penalty of 200 *per cent* of tax shown on the false invoice.

Audit observed (January 2016) during the test check of VAT assessments in CTO Somajiguda circle that in one case, AA had disallowed input tax credit of ₹ 12.29 crore, based on false tax invoices for the years 2011-12 and 2012-13. The dealer was therefore liable for a penalty of ₹ 24.57 crore at the rate of 200 *per cent* of the input tax credit claimed by the dealer on the basis of false invoices. However, the AA levied a penalty of ₹ 12.29 crore only resulting in short levy of penalty of ₹ 12.28 crore.

After Audit pointed out the case, AA stated (January 2016) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.13.2 Non-Levy of Penalty and Interest on belated payment of Tax

As per Rule 24 (1) of VAT Rules, in case of a VAT dealer, the tax declared to be due in Form VAT 200 shall be paid not later than 20 days after the end of the tax period. As per Section 22 (2) of the VAT Act, if any dealer fails to pay the tax due on the basis of return submitted by him within the time prescribed,

[41] CTOs - Ashoknagar, Gowliguda, Mancherial, N.S.Road and Peddapalli.
[42] CTOs - Ashoknagar, Mancherial, N.S.Road and Peddapalli.

he shall pay, interest in addition to the amount of such tax, calculated at the rate of 1.25 *per cent*[43] per month for the period of delay.

Under Section 51(1) of the VAT Act, a dealer who fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, shall be liable to pay tax and a penalty of 10 *per cent* of the amount of tax due.

Audit observed (between February 2015 and March 2016) during the test check of VAT records of seven Divisions[44] and 56 circles[45] for the period from April 2010 to March 2015, that in 257 cases the dealers had paid tax belatedly with delays ranging from 1 to 674 days and therefore liable for penalty and interest. However, the AAs did not levy any penalty or interest. This resulted in non-levy of penalty of ₹ 5.99 crore and interest of ₹ 2.64 crore.

After audit pointed out the cases, AAs[46] in three cases stated (between August 2014 and March 2016) that the assessment files would be submitted to DCs concerned for taking further action. In 21 cases, AAs[47] stated (between February 2015 and March 2016) that amounts would be collected. In 11 cases AAs[48] stated (between August 2015 and January 2016) that notices would be issued to the dealers. In seven cases, AAs[49] stated (between March and May 2015) that action had been initiated. In one case, CTO, Khairatabad replied (September 2016) that an amount of ₹ 0.67 lakh had been recovered towards interest and notice had been issued for levy of penalty. In the remaining cases, AAs stated (between May 2015 and March 2016) that the matter would be examined.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

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43 One *per cent* before 15 September 2011.

44 DCs - Abids, Begumpet, Hyderabad (Rural), Nizamabad, Punjagutta, Saroornagar and Warangal.

45 CTOs - Adilabad, Ashoknagar, Balanagar, Basheerbagh, Begumpet, Barkatpura, Fatehnagar, Ferozguda, Gandhinagar, Hyderguda, Hydernagar, Jagityal, Janagaon, Jedcherla, Jeedimetla, Jubilee Hills, Kamareddy, Karimnagar-I, Karimnagar-II, Khairatabad, Khammam-II, Khammam-III, Kodad, Kothagudem, Madhapur, Mahaboobabad, Mahabubnagar, Mahankali Street, Marredpally, Market Street, Medak, Miryalaguda, MJ Market, N.S.Road, Nalgonda, Nampally, Narayanguda, Nirmal, Nizamabad-I, Nizamabad-II, Pedapalli, Punjagutta, R.P.Road, Rajendranagar, Ramannapet, Ramgopalpet, Ranigunj, S.D.Road, Sanathnagar, Siddipet, Somajiguda, Special Commodities, Tarnaka, Vanasthalipuram, Vidyanagar and Warangal.

46 CTOs - Khammam-II, Madhapur and Nizamabad-II.

47 CTOs - Begumpet, Jedcherla, Karimnagar, Nalgonda and Nampally.

48 DC Warangal; CTOs - Miryalaguda, Punjagutta and R.P.Road..

49 CTOs - Sanathnagar and Special commodities.

2.13.3 Non-levy / Short Levy of Penalty on Wilful Under-declaration of Tax

Under Section 53(3) of VAT Act, any dealer who has under-declared tax and where it is established that fraud or wilful neglect has been committed he shall be liable to pay penalty equal to the tax so under-declared.

Audit observed (between March 2015 and January 2016) during the test check of the VAT audit files of Charminar DC office and five circles[50] that during the period from 2007-08 to 2013-14, in six cases the dealers had under-declared tax of ₹ 1.64 crore wilfully. The AAs in five cases[51] short levied penalty and in one case[52], no penalty was levied in contravention of the provisions of the Act. This resulted in non-levy and short levy of penalty of ₹ 1.62 crore.
After audit pointed out the cases, the AAs stated (between March 2015 and January 2016) that the matter would be examined and reply submitted in due course.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.13.4 Non-levy / Short Levy of Penalty on Under-declaration of Tax

As per Section 53(1) of VAT Act, where any dealer has under-declared tax, and where it has not been established that fraud or wilful neglect has been committed, if under-declared tax is (i) less than 10 *per cent* of the tax, a penalty shall be imposed at 10 *per cent* of such under-declared tax; (ii) more than 10 *per cent* of the tax due, a penalty shall be imposed at 25 *per cent* of such under-declared tax.

Audit observed (between June 2015 and March 2016) during the test check of the VAT audit files in two Divisions[53] and 24 circles[54] that during the period from 2009-10 to 2013-14, in 46 cases, where the dealers under-declared tax/claimed excess input tax credit of ₹ 9.44 crore for reasons other than due to fraud or wilful neglect, the AAs did not levy penalty in 24 cases and short levied penalty in the remaining cases. This resulted in non-levy / short levy of penalty of ₹ 1.50 crore.

After audit pointed out the cases, in six cases, AAs[55] stated (between August 2015 and March 2016) that assessment files would be submitted to DCs concerned. In one case, CTO Punjagutta stated (January 2016) that notice

[50] CTO - Barkatpura, Begumpet, Gadwal, Jubilee Hills and Mahankali Street.
[51] CTO - Barkatpura, Begumpet, Gadwal and Mahankali Street.
[52] CTO - Jubilee Hills.
[53] DCs - Abids and Punjagutta.
[54] CTOs - Basheerbagh, Begumpet, Bhongir, Fortroad, Jagityal, Jubilee Hills, Khammam-II, Kodad, Mancherial, Marredpally, Medak, Mehdipatnam, Nacharam, Narayanguda, Nizamabad-I, Nizamabad-II, Nizamabad-III, Peddapalli, Punjagutta, R.P.Road, Siddipet, Srinagar Colony, Tarnaka and Warangal.
[55] CTOs - Bhongir, Fortroad, Khammam-II, Nizamabad-I, Nizamabad-II and S.D.Road.

would be issued to the dealer. In the remaining 39 cases AAs[56] stated (between June 2015 and March 2016) that the matter would be examined.

The matter was referred to the Department in June and July 2016 and to the Government in October 2016; replies have not been received (December 2016).

2.13.5 Non-levy of Penalty for belated filing of Returns

As per Section 50(3) of VAT Act, if a dealer files return, after the last day of the month in which it was due, he shall be liable to pay penalty of 15 *per cent* of the tax due.

During the test check of VAT records of two circles[57] for the year 2014-15, Audit observed (between May 2015 and February 2016) that in seven cases the dealers had filed returns after the last day of the month in which these were due, where taxes declared by the dealers totalled ₹ 1.98 crore. However, AAs did not levy any penalty. This resulted in non-levy of penalty of ₹ 29.67 lakh.

After Audit pointed out the cases, in three cases, CTO Nalgonda stated (May 2015), that penalty notices were issued and amount would be collected on confirmation of orders. In the remaining cases, CTO Marredpally stated (February 2016) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in August 2016 and to the Government in October 2016; replies have not been received (December 2016).

[56] DCs – Abids and Punjagutta; CTOs - Basheerbagh, Begumpet, Jagityal, Jubilee Hills, Kodad, Mancherial, Marredpally, Medak, Mehdipatnam, Nacharam, Narayanguda, Nizamabad-III, Peddapalli, Punjagutta, R.P.Road, Siddipet, Srinagar Colony, Tarnaka and Warangal.

[57] CTOs -Marredpally and Nalgonda.