

CHAPTER-II

TAXES/VAT ON SALES, TRADE ETC.

2.1 Tax administration

Kerala General Sales Tax (KGST)/Kerala Value Added Tax (KVAT)/Goods and Services Tax (GST) laws and rules made thereunder are administered at the Government level by the Secretary, Taxes. The Commissioner, State Goods and Services Tax (SGST) Department is the head of the SGST Department who is assisted by Additional Commissioner, Joint Commissioners (JCs), Deputy Commissioners (DCs), Assistant Commissioners (ACs) and State Tax Officers. The assessment, levy and collection of tax are done by ACs and State Tax Officers.

KGST is leviable on sale of Ganja, opium, foreign liquor and certain petroleum products. KVAT was leviable on the intra-state sale of remaining commodities and Central Sales Tax (CST) on inter-State sales. GST came into effect from 01 July 2017 subsuming VAT, CST etc.

2.2 Internal audit

The Internal Audit Wing (IAW) in the SGST Department commenced functioning from 1 June 2009. The wing headed by the Deputy Commissioner is assisted by six ACs and 15 State Tax Officers along with subordinate staff. During 2017-18, the wing planned audit of 181 units but could audit only 116 units. All returns filed by tax payers having turnover above ₹ 60 lakh are compulsorily scrutinised electronically by the wing. Out of an overall outstanding of 9,824 paras in respect of the shortcomings/ deficiencies pointed out by the IAW, only 1,641 paras (16.70 *per cent*) were cleared by the department. This indicated the inadequate response of the Commissioner, SGST Department to the observations of the IAW and in enforcing clearance of the paras by addressing the shortcomings/deficiencies pointed out by the wing. The reason for low clearance of observations made by IAW, though called for (May 2018) was not furnished by the Commissioner, SGST Department (September 2019).

2.3 Results of audit

There are 184 auditable units in the SGST Department. Out of these, audit selected 166 units for test check during the year 2017-18. Test check of 19,293 KGST/KVAT/CST assessment files out of the total 2,69,905 registered assessees in the State revealed underassessment and other irregularities in 795 cases relating to non/short levy of tax/interest, irregular allowance of Input Tax Credit, escape of turnover from assessment, application of incorrect rate of tax and non-observance of provisions of Acts/Rules etc. amounting to ₹ 533.32 crore. These cases are illustrative only as these are based on the test check of records. As this was a test audit in the test checked cases and the audit observation is of a nature that may reflect in other cases not covered in test audit, the Department may therefore, like to internally examine the position in rest of the units with a view to ensure that the

instances of non-compliance are taken care of by taking remedial measures, and may also fix responsibility for the lapses in all such cases. Audit pointed out some of the similar omissions in the earlier years also. Not only do these irregularities persist, but they also remain undetected till the next audit is conducted. Underassessment of tax and other irregularities involving ₹ 963.03 crore in 797 cases which fall under the following categories including a paragraph on GST are given in **Table - 2.1**.

Table - 2.1
Details of cases and money value of audit paras

(₹ in crore)			
Sl. No.	Categories	Number of cases	Amount
1	Mechanism of disposal of Appeals and Implementation of Appellate orders in SGST Department	1	383.17
2	Short payment of tax due to escape of turnover from assessment	245	130.25
3	Grant of irregular exemption	46	3.10
4	Short payment of tax due to excess availing of input tax credit	106	9.67
5	Short payment of tax due to misclassification/incorrect rate of tax	41	15.47
6	Others	358	421.37
Total		797	963.03

Source: Figures compiled by AG(E&RSA).

During the course of the year, the Department accepted under assessment and other deficiencies amounting to ₹ 479.74 crore in 225 cases, which were pointed out by Audit. An amount of ₹ 8.77 crore pointed out in 322 cases was realised during the year.

The Department recovered the entire amount of ₹ 20.71 lakh in a case pointed out by Audit during 2017-18. A few Audit observations involving ₹ 451.45 crore are given in the following paragraphs.

2.4 Mechanism of disposal of Appeals and Implementation of Appellate orders in SGST Department

As per the provisions of the erstwhile KVAT Act, 2003, and CST Act, 1956, the dealer aggrieved by any orders of the registering/assessing authorities can challenge the legality and reasonableness of such orders before the appellate forum. There are two stages of appeal. The right of first appeal is open to the assessee only. It is preferred before the designated DC/AC (Appeals) sitting in judgement.

The assessee as well as the State, if aggrieved by orders of the first appellate authority, can prefer a second appeal before the Appellate Tribunal. Both the State and the assessee are at liberty to file a tax revision case before the Hon'ble High Court, if there is any question of law involved in the issue before the Tribunal. With the insertion of Section 58-A in KVAT Act, 2003, vide Kerala Finance Act 2016, the Commissioner may *suo motu* call for and examine any orders passed or proceedings recorded under this Act by any officer/authority.

The objective of the Audit was to ascertain whether the appellate authorities processed the appeals as per the Acts and Rules. Pendency of appeals and revision cases relating to the period 2014-15 to 2017-18 (up to 30 June 2017 i.e., pre-GST period) having a direct impact on the Government revenue, were taken. Audit scrutinised the files and related documents in the Taxes Department, Office of the Commissioner, 11¹ offices (39.29 *per cent*) selected out of 28 DCs/ACs (Appeals) where cases disposed were more than 500 and 89 out of 114 Assessment Circles (78.07 *per cent*) under the selected DCs/ACs (Appeals). A total of 26,473 appellate cases involving ₹ 1,88,981.30 lakh were disposed by the appellate authorities in the State. Out of the total disposals, 19,484 cases (73.60 *per cent*) involving ₹ 1,45,172.10 lakh were disposed by the selected appellate authorities. Audit had scrutinised 2,923 (15 *per cent*) cases out of which 10 *per cent* of cases were having tax effect of above ₹ 10 lakh and five *per cent* below ₹ 10 lakh.

2.4.1 Non-availability of appellate module in KVATIS

With the intention of streamlining the disposal of appeal cases, a link was also developed in KVATIS system. But this option was not made functional by the Department and all the appellate cases were dealt by the Department manually, as a result of which the Department could not monitor the receipt and disposal of appeals at appellate authority level and its implementation at the level of assessing authorities, leading to the huge backlog of pending appellate cases. Database regarding receipt and disposal of appeals is not properly maintained in the Appellate Offices and Appellate Orders registers are also not properly maintained in assessing circles. Audit noticed poor file management systems and the absence

¹ Deputy Commissioner (Appeals) Thiruvananthapuram, Kollam-I & II, Ernakulam-I & II, Kottayam, Kozhikode, Assistant Commissioner (Appeals) Ernakulam, Kozhikode, Thrissur & Palakkad.

of management information system with regards to the disposal and pendency of appeals in the assessing circles.

2.4.2 Non-recovery of disputed tax even though appeal was not filed by the assessee

According to the second proviso below sub section 4 of Section 55 of KVAT Act, 2003, as amended by the Kerala Finance Act 2016, where the appellant remits 20 *per cent* of the disputed amount of the tax along with the collected tax, if any, further proceedings against recovery shall stand stayed till disposal of the appeal. Hence, the stay is deemed to have been granted subject to the condition that the appeal is preferred before the appellate authority after remittance of 20 *per cent* of disputed tax. However, if no appeal is filed within one month from the date on which the order was served to the assessee, the case would be treated as 'tax not paid'.

Audit identified that 557 dealers in 42 Assessment Circles had not filed any appeal after remitting 20 *per cent* of the disputed tax for the period from April 2016 to June 2017 and the Department had not started revenue recovery proceedings for recovery of the amount resulting in non-realisation of revenue amounting to ₹ 10.57 crore (**Appendix V**).

The Government stated (April 2019) that out of 557 cases pointed out, 326 cases have been verified and the remaining cases are being verified. It is also stated that out of verified cases, in 177 cases, assesseees have filed the appeal, in 137 cases revenue recovery action has been initiated and in 11 cases, the assesseees have remitted the amount. Further reply in the remaining 231 cases were not received (September 2019).

2.4.3 Non-initiation of action by the assessing authorities on the orders of first appellate authorities

As per Section 60 of the KVAT Act, 2003 and Rule 86 (2) of the KVAT Rules, 2005, the revised/ modified order should be issued within 150 days i.e. (60 days + 90 days), if the second appeal is not preferred by any of the parties in a higher forum.

Audit observed that in respect of 43 out of 89 Assessment Circles test checked, 479 appellate cases disposed by the first appellate authorities were pending modification/disposal with the concerned assessing authorities. The non-implementation of the appellate orders resulted in non-realisation of revenue amounting to ₹ 372.59 crore (**Appendix VI**).

The Government stated (April 2019) that out of 479 cases pointed out, 49 cases were verified and verification of the remaining cases are underway. Out of verified cases, assessments were modified in 40 cases and in five cases RR action was

initiated to recover the amount. In the remaining four cases, second appeal was filed by the Department. Further progress is awaited (September 2019).

2.5 Short levy of tax

Out of the 795 cases observed by the Audit in respect of KGST/KVAT/CST during 2017-18, some illustrative cases on the application of incorrect rate of tax, escape of turnover from assessment and calculation error in assessment are shown in **Table - 2.2**.

Table – 2.2

Sl. No.	Nature of Objection	Office	Section under KVAT/CST/KGST Act	Short levy (₹ in crore)	Government Reply
1	Application of incorrect rate of tax	STO (WC<), Ernakulam	Section 6(1)(f) of KVAT Act, 2003	9.73	Government stated (March 2019) that the assessment was completed considering other defects also and created additional demand of ₹ 89.33 crore.
2		STO, Special Circle, Palakkad	Rule 6(7) of CST (Kerala) Rules, 1957 Section 9 of CST Act, 1956 Section 6(1)(a) and 25 of KVAT Act	8.25	The Government stated (October 2018) that the judgement is challenged before the Divisional bench of High Court.
3	Escape of turnover from assessment	STO (WC<), Ernakulam	Rule 10(2) (a) of the KVAT Rules, 2005	1.97	The Government stated (October 2018) that the assessment was completed creating additional demand of ₹ four crore.
4		STO (WC<), Palakkad	Section 8(a)(i) of KVAT Act, 2003	0.34	The Government stated (October 2018) that the assessment was completed considering other defects also and an additional demand of ₹ 38.78 lakh was created. The assessee remitted ₹ 21.13 lakh towards short remittance of tax.
5		STO, I Circle, Kannur	Section 42 of KVAT Act, 2003, Rule 60 of KVAT Rules 2005	0.19	The Government stated (November 2018) that the assessment was completed for the years 2014-15 and 2015-16 and an additional demand of ₹ 17.54 lakh was created. The assessee remitted ₹ 2.86 lakh.
6		STO, II Circle, Palakkad	Section 6(2) of the KVAT Act, 2003, Rule 12 A of KVAT Rules	0.07	The Government stated (March 2018) that the assessment was completed creating additional demand of ₹ 6.68 lakh. This additional demand is under Revenue Recovery.

Sl. No.	Nature of Objection	Office	Section under KVAT/CST/KGST Act	Short levy (₹ in crore)	Government Reply
7	Calculation error in assessment	STO, III Circle, Thiruvananthapuram	Section 25(1) of KVAT Act, 2003	1.04	Government stated (November 2018) that the assessment was revised creating additional demand of ₹ 1.66 crore. The revised demand is under Revenue Recovery.
8		STO, Special Circle, Thrissur	Section 7 of KGST Act, 1963, Section 5(2) of KGST Act, 1963	0.15	The Government stated (November 2018) that the assessment was completed for the years 2011-12 to 2013-14 and an additional demand of ₹ 15.37 lakh was created. The assessee remitted ₹ 1.99 lakh.
Total				21.74	

2.6 Non-payment of GST on inward supply of ENA (Extra Neutral Alcohol) by the Distilleries

Under Entry No. 25 of Schedule-III of the Notification No.1/2017-Central Tax (Rate) dated 28 June 2017 and 1/2017-State Tax (Rate), dated 30 June 2017, Ethyl alcohol and other spirits, denatured, of any strength with HSN² 2207 are to be taxed at the rate of 18 per cent GST. Extra Neutral Alcohol (ENA) a variant of ethyl alcohol, typically contains 95 per cent alcohol by volume, is a key raw material or ingredient in producing alcoholic beverages. The distilleries/ bottling units in the State import ENA from outside the State for manufacturing Indian made Foreign Liquor (IMFL).

In the distilleries/bottling units³ all over the state, Audit verified 3,138 consignments of ENA valuing ₹ 275.11 crore brought from outside the state during July 2017 to March 2018 and noticed that Integrated Goods and Services Tax (IGST) was levied only in 200 consignments valuing ₹ 16.54 crore. Thus, non-levy of IGST on the inward supply of ENA valuing ₹ 258.57 crore worked out to ₹ 46.54 crore as given in the **Appendix VII**. As the supply of ENA took place in the state of Kerala, fifty per cent of IGST is to be received as apportionment to Government

² HSN Stands for Harmonised System of Nomenclature, developed by World Customs Organisation (WCO) with the vision of classifying goods all over the world in a systematic manner. HSN contains six-digit uniform code for each product.

³ Out of the 19 distilleries/bottling units in the State, three units were not functioning and the functional units were M/s. Amrut Distilleries, Palakkad, M/s. Devicolam Distilleries Pvt. Ltd, Ernakulam, M/s. Indo - Scottish Distilleries Ltd, Ernakulam, M/s. Empee Distilleries Ltd., Palakkad, M/s. Cassanova Distillery, Kottayam, M/s. KS Distilleries, Kannur, M/s Polsons Distillery, Chalakudy, M/s. Seven Seas Distillery Pvt. Ltd, Thrissur, M/s. Normandy Breweries and Distilleries Pvt Ltd, Kasaragod, M/s. SDF Industries Ltd., Thrissur, M/s. Travancore Sugars and Chemicals Ltd, Thiruvalla, M/s. Kerala Alcoholic Products Private Ltd, Palakkad, M/s United Distilleries, Kozhikode, M/s Elite Distilleries, Thrissur, M/s Imperial Spirits, Palakkad and M/s Kaycee Distilleries, Thrissur.

of Kerala as per Section 17 of IGST Act 2017. The non-levy of IGST resulted in total loss of revenue of ₹ 46.54 crore out of which ₹ 23.27 crore is due to the Government of Kerala in terms of apportionment of IGST.

The Government stated (June 2019) that the issue was raised in the 31st GST Council Meeting held on 22 December 2018. The Council decided that status quo would continue until the matter was decided by the Council. However, in the opinion of the Learned Attorney General of India sought as per the decision taken in the 20th meeting of GST Council, it was stated that the Centre or the States have the power to levy GST on ENA that is used to manufacture alcoholic liquor for human consumption.