

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

Highlights

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

(Paragraph 2.8.10.1)

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

(Paragraph 2.8.11.1)

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

(Paragraph 2.8.11.2)

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

(Paragraph 2.8.11.4)

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

(Paragraph 2.8.11.9)

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

(Paragraph 2.8.11.10)

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

(Paragraph 2.8.11.12)

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

(Paragraph 2.8.12.2)

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

(Paragraph 2.8.14)

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

(Paragraph 2.8.15)

2.8.1 Introduction

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

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

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

2.8.2 Information System Setup

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

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

2.8.3 Audit Objectives

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

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

2.8.4 Scope of Audit

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

2.8.5 Audit Criteria

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

2.8.6 Audit Methodology

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

2.8.7 Acknowledgement

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

⁴ Integrated Data Extraction and Analysis

⁵ Structured Query Language

Our Findings

2.8.8 Achievements of CTD through e-Governance initiatives

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

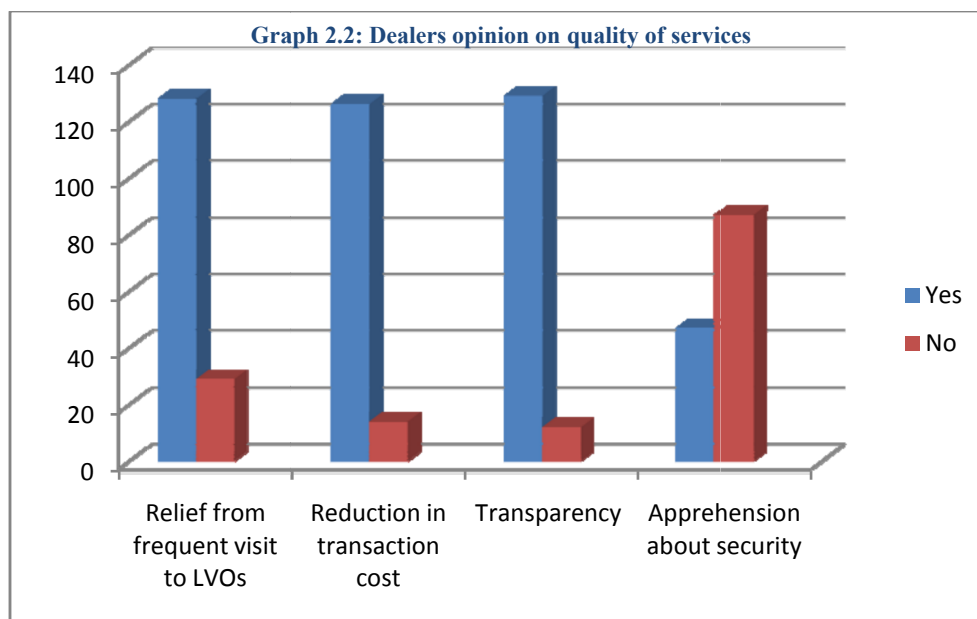
2.8.9 Response of dealers on computerisation

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

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

2.8.9.1 Quality of Services

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



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

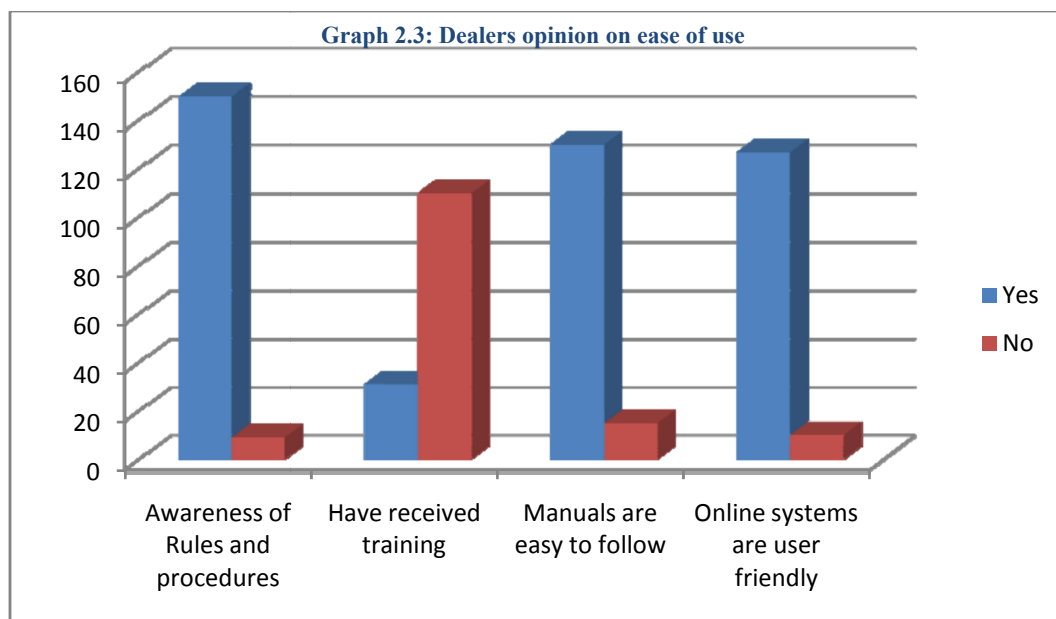
Dealers have also expressed satisfaction over the reduction in the response time for various services. They recorded an average reduction of up to 11 days for e-registration and three days for online issue of statutory forms in comparison with the erstwhile manual system. The issue of delivery notes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

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

2.8.9.2 Ease of use

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

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



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

2.8.9.3 Selection of Banks for e-payment

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

2.8.9.4 Incorrect debits

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

2.8.9.5 Need for online account

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

2.8.9.6 Specific suggestions

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

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

2.8.10 System Security

2.8.10.1 Failure to deactivate accounts after deregistration

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

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

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

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

2.8.11 Online Filing of VAT Returns

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

Inadequacy of Input Controls

2.8.11.1 Excess representation of tax paid in original returns

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

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

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

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

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

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

2.8.11.2 Incorrect amounts brought forward from previous period

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

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

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

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

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

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

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

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

2.8.11.4 Short payment of tax by Hoteliers opting for composition

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

same (Box no.4.6).

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

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

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

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

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

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

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

Inadequacy of Processing Controls

2.8.11.8 Inability of the system to validate exceptions on subcontract turnover

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

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

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

in 6,556 cases.

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

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

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

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

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

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

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

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

Non-Mapping of Business Rules

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

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

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

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

of ` 30.12 crore.

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

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

2.8.11.11 Dealers Opting for Composition

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

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

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

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

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

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

of transactions of this kind:

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

2.8.11.13 Refund approved in excess of request

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

2.8.12 Online payment of taxes

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

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

Inadequate Input Controls

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

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

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

Inadequate processing controls

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

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

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

the sections quoted above.

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

2.8.12.3 Short payment of tax

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

2.8.13 Online issue of statutory forms for interstate trade

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

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

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

2.8.13.1 Lack of integration between modules resulting in reduced efficiency

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

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

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

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

2.8.13.2 Inadequacy of input controls

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

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

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

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

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

2.8.14 Online issue of delivery notes

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

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

following control inadequacies.

⁶ Simple Uploading of Goods Arrival and Movement

2.8.14.1 Inadequacy of controls to enforce validity period

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

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

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

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

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

2.8.14.2 Lack of validation controls

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

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

2.8.14.3 m-sugam

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

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

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

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

2.8.15 Management Information System (MIS) Reports

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

2.8.15.1 Inadequacy of Output Controls – Reliability of MIS Reports

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

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

⁷ Mobile based Simple Uploading of Goods Arrivals and Movements

⁸ Short Message Service

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

2.8.16 Online Complaint Redressal

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

2.8.16.1 Underutilisation due to inadequate publicity measures

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

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

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

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

2.8.17 Conclusion

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

2.8.18 Recommendations

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

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

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

2.8.19 Response of the Department

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

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