

CHAPTER-II: SALES TAX & ENTRY TAX

2.1 Results of audit

Test check of the assessments, refund cases and connected documents on sales tax and entry tax of commercial tax offices during the year 2006-07 revealed under assessment of tax, incorrect grant of exemption, non/short levy of tax etc., amounting to Rs. 127.38 crore in 2,265 cases which broadly fall under the following categories :-

(Rupees in crore)			
Sl. No.	Categories	No. of cases	Amount
Sales tax			
1.	Short levy of tax due to incorrect computation of taxable turnover	33	24.21
2.	Under assessment of tax due to application of incorrect/concessional rate of tax	50	17.83
3.	Under assessment of tax due to irregular grant of exemption	26	18.48
4.	Non/short levy of surcharge/interest	6	0.43
5.	Other irregularities	99	22.69
6.	Value Added Tax Information System in Commercial Tax Department (An IT review)	1	0.00
Total		215	83.64
Entry tax			
1.	Under assessment due to incorrect computation of taxable turnover	18	2.07
2.	Under assessment of tax due to application of incorrect rate of tax	10	9.79
3.	Short levy due to irregular deduction	4	1.10
4.	Non/short levy of tax	2,008	5.14
5.	Non/short levy of penalty	7	25.60
6.	Other irregularities	3	0.04
Total		2,050	43.74
Grand total		2,265	127.38

During the year 2006-07, the department accepted under assessment and other deficiencies of Rs. 9.24 crore in 40 cases, which were pointed out in audit in earlier years and Rs. 20.24 crore in nine cases pointed out in 2006-07. Of these, the department recovered Rs. 5.21 crore in 10 cases.

A few illustrative cases highlighting important audit observations involving Rs. 36.35 crore are discussed in the following paragraphs.

2.2 Information technology audit of “Value Added Tax Information System (VATIS)” in Commercial Tax Department

Highlights:

System design deficiencies resulted in non-capturing of purchase details, incorrect entry of carry forward and refundable amount etc.

(Paragraph 2.2.7.1, 2.2.7.2)

Non-integration of modules resulted in utilisation of waybill by dealers other than the dealer to whom it was issued and before its issue date.

(Paragraph 2.2.8)

Lack of input controls led to incomplete and inaccurate database like issue of multiple registration numbers to the same dealer, entry of invalid vehicle number and waybill number, wrong entry of tax payable/due, non-entry of dealer details etc.

(Paragraph 2.2.9)

Absence of validation controls led to inaccuracies in the database like entry of refund claim without export, acceptance of payment after filing of return, exit of vehicle at the entry check gate, acceptance of unusual time to exit the border check gate, repeated utilisation of waybill etc.

(Paragraph 2.2.11)

Lack of adequate security controls resulted in multiple users having the same password, unauthorised data entry and modification of data etc.

(Paragraph 2.2.12)

Absence of online entry of ‘out-to-out’ vehicles allowed the defaulting vehicles to escape from detection of fraud/evasion of tax.

(Paragraph 2.2.13.3)

2.2.1 Introduction

The Government of Orissa repealed the Orissa Sales Tax Act, 1947 and enacted the Orissa Value Added Tax Act (OVAT), 2004 for implementation with effect from 1 April 2005. As per OVAT Act, a dealer pays tax on the value added to the purchase value of a commodity. Unlike the sales tax regime there is no statutory assessment of dealers. Instead, only 20 *per cent* of the dealers, selected on a random basis, are subjected to tax audit annually by the department.

The Commercial Taxes Department (CTD) is responsible for collection of sales tax, entry tax, entertainment tax and professional tax in the state of Orissa. The Department for International Development (DFID), UK, approved a project in support of the Government of Orissa Public Sector Reform Plans (OPSRP) in March 1999. One of the components of OPSRP was “Strengthening and Modernisation of the Commercial Taxes Organisation under Finance Department”. The DFID assistance aimed at improving the sales tax system and introducing value added tax in the state. The first phase of assistance from DFID was available during the period from 1999-2000 to 2004-05 in the field of organisational restructuring, training, publicity and computerisation. DFID provided the hardware through M/s CMC, software through M/s Mastek and training to departmental officers through M/s Price Waterhouse Cooper.

It was decided to conduct an IT audit of Value Added Tax Information System (VATIS) in the Commercial Tax Department. The review revealed a number of system and other deficiencies which are discussed in the succeeding paragraphs.

2.2.2 IT organisational structure

The IT Department in CTD is headed by the Additional Commissioner of Commercial Taxes (Revenue & IT) assisted by three officials including a system analyst. All technical personnel in the IT wing, including the system analyst, are working on a contractual basis. Besides its head office at Cuttack, the department has 10 territorial and four intelligence range offices, 44 circles, 11 assessment units, four unified check gates and 18 minor check gates geographically spread across the State for administration and collection of taxes.

2.2.3 Information systems set up

VATIS was developed using SQL server 2000 as the database on the Net framework. The IT system architecture is web based and has a distributed database system. Out of 107 offices of the CTD, 83 offices were supplied with computers as on March 2007, 60 offices were supplied with local area network (LAN) and 50 offices with wide area network (WAN) through BSNL leased lines (64Kbps). M/s Mastek Ltd has developed the software “VATIS” which contains 14 modules⁶. The CTD however, is operating only six modules viz. dealer information system (DIS), return, statutory form management, check post monitoring (CPM), personnel monitoring information system (PMIS) and security.

The DIS module captures detailed data about the dealers and their business activities and generates the registration certificate number. The return module captures the detailed data as furnished by the registered dealers manually in

6 Dealer information system (DIS); Return; Audit; Assessment; Personal management information system (PMIS); Security; Statutory form management; check post monitoring (CPM); Enforcement and intelligence; Budget and establishment; Legal; Recovery; Individual taxpayers’ ledger (IRL); MIS and performance monitoring

the prescribed forms through periodical returns. In the CPM module the inter-state movement of vehicles at the border check gates is recorded. The statutory form management module deals with issue and utilisation of statutory forms such as C form, F form, waybill etc.

2.2.4 Audit objectives

The audit objectives were to assess whether:

- the system met the requirements of the OVAT Act and was synchronised with the critical business of the department;
- proper input, validation and process control existed in the system to ensure that the data captured was authentic, complete and accurate;
- the database provided sufficient, complete, reliable and authorised information for management action; and
- adequate security measures were in place.

2.2.5 Scope and methodology of audit

The review of VATIS covering five modules (DIS, return, statutory form management, CPM and security module) was conducted between November 2006 to June 2007 in three range offices (Puri, Cuttack-I and Sundargarh), two circle offices (Bhubaneswar-I and Cuttack-I-Central) and one check gate (Jamsolaghat) using a computer aided audit tool. The findings were also cross-checked with manual records on a sample basis.

2.2.6 Acknowledgement

Indian Audit and Accounts Department acknowledges the co-operation of the Commercial Tax Department in providing necessary information and records for audit. The audit findings as a result of test check of the system and the records were reported to the Government in September 2007.

The Commissioner of Commercial Taxes (CCT), Orissa while welcoming the audit findings (November 2007) attributed the lapses to incomplete hardware and Wide Area network as a result of which VATIS could not be made fully operational, shortage of officials as well as IT skilled manpower to validate the data input into the system, non-coverage of the CPM of the VATIS in all the border check posts, instability of the data circuits provided by BSNL and regular failure in connectivity, frequent changes in the VATIS due to amendment of the VAT Act and other related Acts etc. It was also stated that steps had been taken to change the software and install necessary process control/validation checks.

Audit findings

It was observed that the system had deficiencies relating to system design, input and validation controls, and security and access controls, which resulted in ineffective and inefficient management of the system and

rendered the information generated completely unreliable. The audit findings are discussed in the succeeding paragraphs.

System design deficiencies

2.2.7 Return module

2.2.7.1 The OVAT Act provides a structured format (VAT 201) for filing returns. This contains vital information for the assessment of dealer. Audit scrutiny revealed that the software did not have provision for capture of details of purchases not covered under the various categories i.e. purchases under different tax rates, inter state trade, imports, stock transfer etc., although data regarding the value of such purchases was captured. Data analysis revealed that in 1,963 returns, purchases valued as Rs. 226.54 crore were entered without such details, thereby restricting the department from obtaining vital information available from the dealer's return.

2.2.7.2 The dealer can claim refund and/or carry forward the tax amount, in case creditable input tax is more than the output tax. If output tax is more than the input tax the dealer has to pay the difference. It was, however, noticed that in 521 cases, refund/credit carried forward amounting to Rs. 378.24 lakh was entered, though there was tax payable on account of lesser input tax. Similarly, in 1,239 cases, the total of refund claim and carry forward did not tally with the difference between input tax and output tax and the difference ranged from (-) Rs. 3.70 crore to Rs. 58.54 crore. This indicated defective design and lack of validation among the respective input fields. Manual checking revealed data entry mistakes in 20 out of 22 cases.

2.2.7.3 The return form requires details of the amount of input credit tax carried forward from the previous month. However, the system does not provide for automatic carry forward of the input tax amount of the previous month. This led to reliance on the manual data entry only, due to which a difference of Rs. 6,616.39 crore was observed in 7,661 cases in two circles.

2.2.7.4 The return form prescribes columns for entry of purchase and sale value and tax thereon at one, four and 12.5 *per cent* of tax respectively with a view to work out the creditable input tax and output tax respectively. It was however, noticed that there was a difference in the tax entered amount and actual tax claimed/due thereagainst. Manual checking of 28 cases revealed that in 26 cases there was wrong data entry and in two cases, the dealers had actually filed the returns furnishing wrong information.

2.2.7.5 The dealer has to pay the tax on or before the date of filing of the return. In case of delayed payment, interest at two *per cent* per month is leviable. In 7,836 cases, the system accepted entries of payment of tax made after the prescribed period of which in 7,353 cases, interest for belated payment was not separately entered even though the system provides fields for such entry.

2.2.8 Non-integration of modules

The CPM module was not integrated with the DIS and statutory form management module, which resulted in the following:

2.2.8.1 In 6,022 cases, the system accepted utilisation of waybills by dealers other than the dealer to whom these were issued. Manual check revealed that this happened due to erroneous data entry. Lack of integration of the statutory form management module and the CPM module led to failure of the system to detect the mismatch between taxpayers identification number (TIN) as mentioned in the statutory form management module and the entries made in CPM module.

The waybills were issued by the range offices. The utilisation of these waybills was checked at the check gates. Due to lack of integration between the statutory form management module at the range offices and CPM module at the check gates, the waybills were shown as utilised before the date of their actual issue to the dealers from the range offices in 27,644 cases. Manual checking revealed that the issue details were entered into the system belatedly after the actual issue of the form.

2.2.8.2 The DIS module is maintained in the range offices for keeping the details of the dealers. The system is required to show the status of the dealer correctly i.e. registered, unregistered or casual and should not treat a particular dealer differently on different occasions of movement of goods. Audit scrutiny of the CPM module at the check gates revealed that in 517 cases the system exhibited wrong status in respect of 252 dealers indicating non-integration of the CPM module with the DIS module.

Input controls

Input controls ensure that data entered into the system is authorised, complete and correct. The audit revealed that the system lacked input controls, as it did not ensure complete and correct collection of the required primary data in its database.

2.2.9 Inaccuracies in Data

Absence of various input controls led to entry and acceptance of incorrect data in the database which made the system unreliable as is evident from the cases cited below:

DIS module

2.2.9.1 A dealer should not be issued more than one certificate of registration for his business in the State. Analysis of the database revealed that in 184 cases the system generated more than one registration number for a dealer even though the details like the name of the dealer, father's name, address, phone number and even PAN were same. Test check of the manual records also corroborated the facts.

2.2.9.2 It was further revealed that commodities dealt with by the dealers were not entered correctly, which is a vital information to prevent evasion of tax as different commodities are taxed differently. Test check of 25 manual records corroborated the facts.

CPM module

2.2.9.3 The success of the CPM module largely depends upon the correct entry of the vehicle number. In case of a new vehicle, the system asks for the owner's name, address and telephone number, which is saved in the 'Vehicle Master File'. Once any data is entered in the master file, no modification can be made. Due to lack of proper input control, 498 invalid vehicle numbers were entered, where the number of digits in the vehicle number was more than eight or last digit was ending with alphabets or number of two vehicles were entered as one number or the vehicle number in a series was more than 9,999 or the vehicle number started with a numeric. In addition to this, the owner's name, address of the owners of the vehicle etc., were also not entered.

2.2.9.4 In case a vehicle does not exit through the declared check gate in case of 'out-to-out' movements (where the originating and destination state is not Orissa), the system should not allow data entry of that particular vehicle for any type of movement on subsequent occasions. It was, however, noticed that the system accepted entry on subsequent occasions in respect of 42 vehicles which had not exit on the last occasion as the data entry was erroneously made. One such example is given below:

Vehicle Number AP-05, U-9969 entered through Jamsola check gate on 2 February 2007 and declared that it would exit through Girisola check gate on 4 February 2007 but did not exit through the declared check gate. However, the same vehicle again entered with Vehicle number AP5U9969 through Jamsola check gate as 'out-to-in' movement (where the destination state is Orissa).

This indicated that due to lack of proper input control, the system allowed manipulation of data. Thus, the purpose of monitoring out-to-out movement of vehicles with a view to avoid tax evasion through the computerised system has not yielded the desired result.

2.2.9.5 The total way bill serial number in any series can not exceed 10 lakh and contains two alphabetical series code initially like AD, AE, AF, AG, AH etc. The system accepted 289 waybills having invalid serial numbers carrying goods worth Rs. 48.81 crore due to absence of proper input control.

Statutory form management module

2.2.9.6 Statutory form management module prescribes for online requisition and issue of various statutory forms. **It was, however, observed that all the procedures are being followed manually and data entry is being done subsequently, rendering the computerisation effort meaningless.** Test check of the records revealed that the names of the dealers to whom forms were actually issued were different from those entered in the database due to errors in subsequent data entry.

2.2.10 Incomplete data entry

Absence of input controls also led to incomplete database making the system unreliable as is evident from the cases cited below:

DIS module

2.2.10.1 In order to obtain automatic registration number of a dealer, certain information is required to be entered. Such information being important, data capture in these fields should have been made mandatory. Analysis of the database, however, revealed that the registration number was being generated without entering the required information as detailed in the **Annexure I**. This resulted in incomplete database in respect of the registered dealers.

Return module

2.2.10.2 It was observed that in 23,319 records, purchase/sale details were not entered, though the dealer had declared that he had affected purchases or sales.

2.2.10.3 The return form provides for information regarding various types of input tax credit, details of which are required to be entered. It was, however, observed in 1,806 out of 1,873 cases, the details were not entered in the system.

2.2.10.4 Every dealer is required to pay the full amount of tax payable according to the return on or before the due date. Scrutiny of the database revealed that in 7,329 cases, only details of payment of tax was entered without the corresponding entry of purchase and sale details. Therefore, the database was incomplete.

CPM module

2.2.10.5 In case of out-to-out vehicles, entry of registration number of the dealer transporting the goods using a particular vehicle is required for tracking the vehicle in order to prevent evasion of tax. However, in most of the cases, registration number of the dealer was not entered. Similarly, in case of in-to-out and out-to-in vehicles, waybill numbers and total invoice value of goods transported were not entered in 769 cases. This resulted in an incomplete database.

2.2.10.6 For out-to-out vehicles, the date of exit and the exit check gate name are required to be entered. It was noticed that the system accepted incomplete data entry as in 258 cases the exit date was not entered and in 843 cases the names of exit check gates was not entered.

Validation controls

2.2.11 Lack of validation controls were also noticed in the software in various modules, which are discussed below:

DIS module

2.2.11.1 The system accepted the date of tax liability before the date of commencement of the business in 388 cases.

Return module

2.2.11.2 When a dealer exports goods, he is entitled to claim refund. It was, however, seen that though there was no entry regarding export, the software accepted entry for refund in 287 cases due to lack of validation controls. Manual verification revealed that out of 10 cases, in seven cases the data entry was erroneous. Manual intervention prevented payment of refunds in these cases.

2.2.11.3 Every dealer is required to file a return accompanied by a receipt towards the tax paid for the full amount of tax payable as per the return. Thus, the dealer has to pay the tax on or before the date of filing of return in any case. In 84 cases, the system accepted payment of tax after the return was filed due to lack of validation control.

CPM module

2.2.11.4 The CPM module is required to generate a mismatch report in the event of a vehicle exiting through a check gate other than the declared gate. An out-to-out vehicle cannot exit through the entry check gate. Scrutiny of the database revealed that in 1,635 out of 3,20,160 cases, the vehicle exited through the entry gate, which happened due to lack of proper validation control.

2.2.11.5 Further, in no case can the date of exit precede the date of entry. In 331 cases the software accepted the date of exit as prior to the date of entry due to lack of validation control.

2.2.11.6 The distance between various check gates as well as the probable time taken to cover such distance are known to the department. These details, however, have not been incorporated in the software, resulting in acceptance of unusual expected time period (3 to 20,820 days) to exit from the state of Orissa. Further, it was seen that in 5,261 cases, the vehicles actually took between 11 to 3,653 days to exit. **Lack of entry of parameters in the system led to lack of proper validation control, which resulted in improper monitoring of such vehicles.**

2.2.11.7 The registration number (TIN) should be a number comprising eleven digits. The first two numbers being the State code should be 21 and the fifth and sixth numbers should be 11 to 20 being the range code. This is required to be mentioned in the waybills. **Due to lack of integrated modules (CPM and DIS) registration numbers had to be fed again in the CPM module at the check gates.** It was noticed that due to poor validation control, the software accepted invalid registration number in respect of 3,614 registered dealers.

2.2.11.8 Waybills issued by the department are a vital document for inter state transactions and should be utilised only once. Unregistered dealers are not issued waybills by the department. Due to lack of validation control, the system allowed repeated use of 81 numbers of waybills. The system also allowed use of waybills by 237 unregistered/casual dealers. Manual check of 10 cases pertaining to Jamsola check gate revealed that such type of irregularities occurred due to wrong entry of waybill serial number.

2.2.12 IT Security

The SQL server has inbuilt security measures. **The application software, however, has not incorporated some of the security aspects, resulting in unauthorised entry of data. Besides this, necessary access controls were also not embedded in the software.** The inadequate security measures observed are narrated below: -

2.2.12.1 The system does not force change of password at regular intervals. It was observed that 105 out of 121 users were sharing the same password. The passwords have remained unchanged since the installation of the system.

2.2.12.2 The application continued to have users with active privileges even after their transfer and data entry was being done using their user IDs.

2.2.12.3 In one check gate contractual data entry operators are using the Commercial Tax officer's user ID for data entry.

2.2.12.4 In 5,939 cases, the same user made both the entry as well as the exit details of the vehicle, though the exit gate was located several hundred kilometers away from the entry gate.

2.2.12.5 **There is inadequate provision of function specific users under each module in the system.** Taking advantage of that, users were making data entry in some functions, which were not allowed to them as per the Act. It was seen in audit that the assignment of officials for scrutiny and survey and disposal of registration application in the system were being conducted not by the range officers but the clerks/stenos etc.

2.2.12.6 The system provides for an unique function in the return form, where, after entry of all details furnished by the dealer the data is saved in the database with a flag indicating complete data entry. No changes are accepted by the system once this flag was activated. In the absence of the flag, the data could be modified. Analysis of the database revealed that 19,751 out of 75,671 returns were not entered completely for upto 553 days, thus leaving scope for subsequent modification of the data. Audit analysis further revealed that in 3,080 cases, the returns data was modified subsequently, of which in 2,408 cases other user IDs were used.

2.2.12.7 **The system does not provide an audit trail for recording the details of the modification of data in between the first creation and last modification.**

Other deficiencies

2.2.13 Non-utilisation of the system

2.2.13.1 The system was designed to capture the complete workflow of the process of issue of the registration certificate, like the assignment of officer for site survey, scrutiny of documents etc. The system allowed issuing of registration certificate on the same day of the receipt of the application for registration even though these manual processes were not completed in 6,802 cases. Verification of 100 cases revealed that data was entered in the system after all the required procedures were completed manually which defeated the objective of computerisation.

2.2.13.2 Every dealer is required to file a return within 21 days from the date of expiry of the tax period. In 41,453 out of 75,671 cases, the returns were filed beyond the prescribed period of 21 days, which ranged upto 599 days. Manual records revealed that in 7 out of 22 cases, the data entry was made after the actual receipt of return and in 15 cases the dealer had filed the return belatedly. In this connection it was seen that the returns are filed in the circle offices where they are received, stamped and passed on for data entry. The acknowledgement is supposed to be generated through the system. However, the manual system of acknowledgement of receipt is still in vogue, which can be seen from the delays in the entry of the returns received earlier. Thus the automated workflow as envisaged through the system was absent and manual intervention and input errors made the data unreliable.

2.2.13.3 It was noticed that the data entry of out-to-out movements are not made on-line due to insufficient number of data entry operators at the check gates. The vehicles are allowed to exit the check gate on receipt of the transit pass issued at the entry check gate without entering the data into the system. As per the system requirement, in case a vehicle has not exited through the declared check gate on a previous occasion, the system should not accept data entry of any type of subsequent movement in respect of such vehicles. The fact of non-exited vehicles on previous occasions can be known only when the data entries are made in the system. However, due to belated data entry, the offending vehicle would already have been allowed by the check gate authority to exit the gate. Thus absence of online entry of vehicles resulted in allowing the defaulting vehicles to escape detection of fraud/evasion of tax without any audit trail in the system.

2.2.14 Generation of wrong report

2.2.14.1 Audit observed that the system generates an erroneous MIS report in the event of a dealer filing a revised return. It is showing an excess amount as received taking into account the tax initially paid and the total tax paid including additional tax as per the revised return, thus leading to erroneous MIS report apart from increasing the revenue collected.

2.2.14.2 The software provides 90 days as the time period for the disposal of an application for registration. In 821 cases, the registration application was disposed after the prescribed period and time period ranged upto 321 days.

Manual check of 30 cases revealed that the registration application was actually disposed of within 90 days. In these cases, the applications were received much after their date of receipt shown in the software. This indicated that the receipt of application for registration was entered without the actual availability of the application for registration.

2.2.15 Conclusion

Computerisation was undertaken with a view to enhance the efficiency of the organisation in implementing the OVAT Act and Rules made thereunder. The provisions of OVAT Act and Rules, however, were not incorporated fully into the application software (VATIS), resulting in various irregularities such as acceptance of wrong entries, generation of wrong reports, acceptance of invalid registration number, vehicle number, waybill number etc. Besides, the integrity of the data was questionable in view of lack of proper security and access control. The IT system was, thus, unable to address the business needs and the computerisation efforts did not yield the expected results.

The VAT scheme envisages selective audit of dealers. The department has to rely entirely on the system generated details for selection of dealers for assessment. This entails correct and complete data entry, stringent validation controls, proper program logic, accurate output control and integration of the relevant modules to enforce these controls. The system in the present shape was not in a position to deliver the desired results as adequate assurance cannot be reposed in the system due to incomplete, inaccurate and unreliable data. The department, therefore, should address the system deficiencies in order to reap the intended benefits of computerisation.

2.2.16 Recommendations

The Government may consider the following:

- a designated official in each data entry centre should check the data entry as correct and complete and provision for such certification should be embedded in the system. Unless such certification is available, data should not be allowed to be processed further;
- stringent input and validation controls should be built into the system to ensure that unauthorised, invalid and non-existing data is not fed into the system;
- the system being spread all over the state, the existing leased lines (64Kbps) should be upgraded for uninterrupted data flow among check gates and field offices;
- distinct user identification and authentication should be provided to all the users for better security and monitoring. The system administrator should ensure cancellation of password at periodical intervals and users should be prompted to create their own passwords; and
- integration of the relevant modules should be ensured.

Sales Tax

2.3 Under assessment of tax due to short determination of taxable turnover

Under the Orissa Sales Tax (OST) Act, 1947, transfer of property in goods involved in works contract is exigible to tax. Further, as held⁷ by the Supreme Court, value of goods at the time of incorporation in the works, constitutes the measure for levy of tax. Works contract is taxable at eight *per cent* under the Act.

During the audit of Koraput-I circle in January 2007, it was noticed that while finalising the assessment of a registered dealer engaged in works contract for the year 2004-05, the assessing officer (AO) determined the taxable turnover as Rs. 172.13 crore and finalised the assessment in October 2005. Scrutiny of the profit and loss account of the dealer for the year 2004-05 revealed that the dealer disclosed consumption of raw material valued as Rs. 272.49 crore in works and proportionate profit on the material component was Rs. 13.15 crore. Thus, taxable turnover on the basis of actual utilisation of material in works and proportionate profit works out to Rs. 285.64 crore. This resulted in short determination of taxable turnover of Rs. 113.51 crore (Rs. 285.64 crore – Rs. 172.13 crore) and consequent under assessment of tax of Rs. 9.99 crore including surcharge.

After the case was pointed out, the AO reassessed the dealer in February 2007 determining the profit element as Rs. 25.04 crore and levied tax and surcharge of Rs. 2.20 crore while mentioning in the reassessment order that there was no short levy of tax on account of the value of material in the original assessment. The contention of the AO is not tenable as the dealer himself disclosed the value of material consumed in works as Rs. 272.49 crore in the certified profit and loss account, copy of which was furnished to the AO at the time of assessment.

After the case was pointed out, the Government in May 2007 stated that demand of Rs. 2.20 crore had been raised. The dealer while depositing tax of Rs. 1.32 crore had filed an appeal. A report on further development has not been received (November 2007).

2.4 Non-levy of tax on royalty

Under the provisions of the OST Act, transfer of right to use any goods for any purpose for cash, deferred payment or other valuable consideration is a sale. The amount received towards royalty for allowing the use of a trade mark comes under the said class of receipts and is taxable at 12 *per cent* as unspecified item under the Act. Further, if a dealer conceals any part of his taxable turnover or furnishes incorrect return of turnover, he shall be liable to

⁷ M/s. Ganon Dunkerly & Co Vs. State of Rajasthan (88 STC-P/204)

pay a penalty equal to one and half times of tax so assessed on the concealed turnover.

During the audit of Bhubaneswar-II circle in October 2006, it was noticed that a State Government undertaking, registered as a dealer, had filed 'nil' returns for the years 2001-02 and 2002-03 and was assessed accordingly in March 2005 and March 2006 respectively. Verification of annual accounts of another dealer, a manufacturer of cement at Bargarh revealed that the dealer of Bhubaneswar received Rs. 22.15 crore and Rs. 5.21 crore towards royalty from the manufacturer during the years 2001-02 and 2002-03 respectively for the use of its trade mark. This resulted in under assessment of taxable turnover of Rs. 27.36 crore and consequent non-levy of tax of Rs. 3.61 crore including surcharge. Besides, penalty of Rs. 4.93 crore was also leviable for deliberate concealment of turnover.

After the case was pointed out, the AO completed the reassessment proceedings in January 2007 raising a demand of Rs. 3.09 crore including penalty. It was, however, seen from the reassessment order that the AO determined royalty of Rs. 4.17 crore during 2001-02 against Rs. 22.15 crore received by the dealer as shown in the certified profit and loss account for that year.

On the matter being pointed out, the Government in August 2007 confirmed the fact of reassessment and stated that the dealer while depositing Rs. 30 lakh had filed an appeal. A report on further development in respect of the appeal case and reply on the reason for variation of Rs. 17.98 crore (Rs. 22.15 crore-Rs. 4.17 crore) has not been received (November 2007).

2.5 Irregular grant of exempted sale

Under the delegated provision of the Central Sales Tax (CST) Act, 1956, inter state sale of goods exempted from payment of tax under the State Act is also exempted from CST. Such exemption is, however, admissible against the submission of declarations in form C with effect from 14 May 2002. Sale of processed iron ore is taxed at four *per cent* and if not supported by form C is taxable at the rate of 10 *per cent* under the CST Act.

During the audit of Keonjhar circle in May 2006, it was noticed that a registered dealer engaged in manufacture and processing of iron ore and enjoying exemption benefit under the State Act effected inter state sale of goods valued as Rs. 36.65 crore during the year 2003-04. The AO while completing the assessment in October 2005 incorrectly allowed the said turnover as exempted sale though the dealer did not furnish declaration in form C. This irregular grant of exemption resulted in under assessment of CST of Rs. 3.66 crore.

After the case was pointed out, the AO admitted the audit observation and raised a demand of Rs. 3.66 crore after reassessment in January 2007 disallowing the exempted sales during the year 2003-04.

On the matter being pointed out, the Government in August 2007 confirmed that a demand of Rs. 3.66 crore was raised and stated that the dealer while depositing Rs. 1 crore had filed an appeal. A report on further development has not been received (November 2007).

2.6 Irregular grant of exemption

The OST Act provides that a medium scale industrial (MSI) unit needs to be certified by the State Director of Industries to avail exemption under the Industrial Policy (IP) 1996. The status of an industrial unit is decided by the Union Ministry of Industries and according to the notification of the Ministry dated 10 December 1997, units with fixed capital investment (FCI) upto Rs. 3 crore are considered as small scale industrial (SSI) units. Thus, a unit having an investment exceeding Rs. 3 crore comes under the category of MSI and requires eligibility certificate (EC) from the Director of Industries to avail exemption from tax.

During the audit of Rourkela-II circle in September 2006, it was noticed that an existing MSI, a manufacturer of cement, established a second unit with an FCI of Rs. 6.86 crore as fixed capital. On the basis of the EC issued by the Project Manager, District Industries Centre (DIC), Rourkela, the dealer claimed exemption of sales tax of Rs. 3.22 crore for the years 2001-02 and 2002-03. Though the EC was not issued by the designated authority i.e., Director of Industries, the AO while completing the assessments between September 2002 and September 2004 allowed the exemption in contravention of the provisions of the OST Act. This resulted in irregular grant of exemption of Rs. 3.22 crore.

After the case was pointed out, the Government in August 2007 intimated that the AO has reopened the case in March 2007 and raised a demand of Rs. 3.22 crore. A report on recovery has not been received (November 2007).

2.7 Irregular exemption on export sales

Under the CST Act, a dealer is not liable to pay tax on any sale of goods if the sales made are in the course of export. Sales in the course of export, according to the provisions of the Act, are sales which are effected for the purpose of complying with an order or agreement in relation to such export provided the same goods are exported out of the territory of India. Sale of cast iron castings (ingot moulds) being declared goods is taxable at eight *per cent* without declaration in form C under the CST Act.

During scrutiny of the records of Rourkela-II circle in September 2006, it was noticed that while finalising the assessments of a dealer in Rourkela II circle between March 2004 and March 2006 for the period from 2002-03 to 2004-05, sale of cast iron castings valued as Rs. 30.92 crore was exempted from levy of tax as sales in the course of export. Cross verification with the records of the concerned central excise range at Kalunga under the Assistant Commissioner

of Central Excise, Rourkela and a copy of ARE-I⁸ of central excise range, Kolkata available in the assessment records maintained in Rourkela-II sales tax circle, revealed that the goods despatched by the Orissa based dealer were further processed in Kolkata and finally exported as articles of cast iron. Since the goods had not been exported in the same form, the conditions underlying sales in course of exports were not fulfilled. This resulted in irregular exemption and consequent non-levy of tax of Rs. 2.47 crore.

After the case was pointed out, the CCT, Orissa stated in September 2007 that the Assistant Commissioner of Sales Tax (ACST), Sundergarh Range had initiated *suo motu* proceedings to revise the assessments. Further reply in the case has not been received (November 2007).

2.8 Under assessment of tax due to misclassification of goods

Under the OST Act, perfumed oil and coconut oil are taxable at the rate of 20 *per cent* and four *per cent* respectively.

During the audit of Bhubaneswar-I circle in June 2006, it was noticed that a registered SSI unit engaged in the manufacture of coconut oil and perfumed oil was assessed in February 2005 for the year 1998-99 and tax of Rs. 40.55 lakh was levied at the rate of four *per cent* on the turnover of Rs. 10.13 crore. Verification of records, however, revealed that out of Rs. 10.13 crore, turnover of Rs. 7.58 crore pertained to the sale of perfumed oil and was taxable at the rate of 20 *per cent*. Thus, assessment of the entire turnover at four *per cent* resulted in under assessment of tax of Rs. 1.40 crore including surcharge.

After the case was pointed out, the CCT in October 2007 intimated that on completion of revision of assessment a demand of Rs. 1.45 crore had been raised. A report on recovery has not been received (November 2007).

2.9 Excess grant of exemption

Under the OST Act read with the IP 1996, an SSI unit located in zone-C⁹ is eligible for the exemption of sales tax on the purchase of raw material, machinery, spare parts, packing material and sale of finished products subject to a ceiling of 100 *per cent* of FCI for a period of five years from the date of commercial production. There is no provision for exemption of tax on any expansion/modernisation/diversification for the new units established under the IP 1996.

During the audit of Jajpur circle in June 2006, it was noticed that a registered SSI unit engaged in the manufacture of sponge iron started its commercial production in March 1999 with FCI of Rs. 3.71 crore which was also its

8 Application for removal of excisable goods manufactured in a factory for export.

9 The State of Orissa is divided into zones depending upon their industrial backwardness. Zone-C locations- Angul, Balasore, Bargarh, Berhampur, Bhubaneswar, Chatrapur, Cuttack, Dhenkanal, Jajpur, Jharsuguda, Panposh, Rayagada, Sambalpur and Talcher.

ceiling of exemption. Of this, the dealer availed exemption of Rs. 2.83 crore upto 2002-03 leaving a balance of allowable exemption of Rs. 88 lakh. The AO while completing the assessment in June 2005 for the year 2003-04, assessed tax liability of the dealer as Rs. 1.59 crore and adjusted it against FCI of Rs. 6.67 crore enhanced on the basis of a revised certificate issued by the Director of Industries in March 2002. Since this unit was not entitled to any exemption benefit for expansion, modernisation or diversification, the grant of exemption in excess of initial FCI of Rs. 3.71 crore was irregular and resulted in excess grant of exemption of Rs. 70.84 lakh.

After the case was pointed out, the Government stated in August 2007 that the AO had completed the reassessment proceedings in October/December 2006 raising an extra demand of Rs. 1.25 crore based on the audit observation and other relevant information available with him. A report on recovery has not been received (November 2007).

2.10 Non-levy of tax on lease rental

Under the OST Act, lease rental of machinery for use in manufacturing, mining or generation and distribution of electricity is taxable at the rate of eight *per cent* upto February 2002.

Test check of the records of Bhubaneswar-II circle in January 2007 revealed that a registered dealer received Rs. 6.41 crore as lease rental during the year 2000-01 but did not disclose it in the returns though it was reflected in the annual accounts. The AO accepted the returns and assessed the dealer to 'nil' tax in March 2004. This led to under assessment of taxable turnover of Rs. 6.41 crore resulting in non-levy of tax of Rs. 56.37 lakh including surcharge.

After the case was pointed out, the CCT while accepting it, intimated in February 2007 that the case was being revised. A report on further development has not been received (November 2007).

The matter was reported to the Government in February 2007; their reply has not been received (November 2007).

2.11 Under assessment of tax due to allowance of irregular transit sale

Under the CST Act, sale of any goods in the course of inter state trade effected by transfer of documents of title to such goods, are exempted from levy of tax. In support of such transit sales, certificates in forms E-I or E-II and declarations in form C are required to be furnished by the dealers causing the movement and taking delivery of the goods respectively. In the absence of proper certificates in form E-I and E-II, the dealer is only entitled to the concessional rate of four *per cent* if the transactions take place while the goods are in transit and are covered by valid C form.

During the audit of Bhubaneswar-I circle in October 2006 it was noticed that a registered dealer purchased electrical goods valued at Rs. 7.07 crore during 2002-03 in course of inter state trade from dealers outside the State and claimed to have sold these for Rs. 10.49 crore while the goods were in transit. To avail the benefit of transit sale, the dealer was required to submit certificates in form E I for Rs. 7.07 crore. Scrutiny of the E-I forms furnished by the dealer revealed that E-I forms supporting transactions of Rs. 3.64 crore did not bear the transportation particulars substantiating the claim that the transfer of documents of title to such goods had taken place while the goods were in transit. In addition, the dealer had not submitted E-I forms for Rs. 3.36 crore. Thus, transit sale of Rs. 7 crore was not supported by proper declarations and remained unauthenticated. While completing the assessment in March 2006 the AO, however, levied tax and surcharge on turnover of Rs.3.33 crore only instead of the entire sale of Rs. 10.49 crore. This resulted in irregular exemption of turnover of Rs. 7.16 crore and under assessment of tax of Rs. 28.66 lakh calculated at the rate of four *per cent*.

After the case was pointed out, the Government in June 2007 stated that the case had been reopened. Further development has not been reported (November 2007).

2.12 Under assessment of tax due to non-inclusion of entry tax in the taxable turnover

According to Rule 18(1) of the Orissa Entry Tax (OET) Rules, 1999, a dealer in motor vehicles, two wheelers and three wheelers becomes liable to pay tax under the OST Act by virtue of sale of such motor vehicles and his sales tax liability under the Act is reduced by the tax paid under the OET Rules. As clarified by the Finance Department, entry tax paid and allowed set off shall form part of the sale price of the motor vehicle. Motor vehicles, two wheelers and three wheelers are taxable at the rate of 12 *per cent* under the OST Act.

During the audit of Sambalpur I and Cuttack I (West) circles between July 2006 and January 2007, it was noticed that three registered dealers purchased motor vehicles valued as Rs. 29.14 crore between 2001-02 and 2004-05 on which entry tax of Rs. 3.53 crore was paid. Thus, taxable turnover of these dealers including entry tax element should not have been less than Rs. 32.67 crore. The dealers, however, disclosed taxable turnover of Rs. 30.35 crore which was accepted by the AOs and assessed accordingly between December 2002 and February 2006. This resulted in under assessment of taxable turnover of Rs. 2.32 crore and consequent under assessment of sales tax of Rs. 30.67 lakh including surcharge.

After the cases were pointed out, the Government stated between June and September 2007 that reassessment proceedings had been initiated in respect of two dealers and demand of Rs. 15.49 lakh raised in the third case after completion of reassessment. A report on further development has not been received (November 2007).

2.13 Under assessment due to application of lower rate of tax

Under the OST Act, goods not specified in the schedule of the Act are taxable at 12 *per cent*. Coal tar pitch is not specified in the schedule and hence is taxable at 12 *per cent*.

During the audit of Sambalpur I circle in December 2006, it was noticed that the AO while finalising the assessment of a registered manufacturer of bitumen and coal tar product in February 2006 for the period 2004-05, incorrectly levied tax at four *per cent* on the sale turnover of coal tar pitch valued as Rs. 2.82 crore instead of 12 *per cent*. This resulted in under assessment of tax of Rs. 24.85 lakh including surcharge.

After the case was pointed out, the Government intimated in August 2007 that reassessment has been completed and an extra demand of Rs. 62.13 lakh including penalty had been raised. A report on recovery has not been received (November 2007).

2.14 Short levy of tax due to incorrect classification of supply contract as works contract

Under the OST Act, if transfer of property in goods takes place in course of execution of a works contract, the turnover is taxed at eight *per cent* after allowing deduction towards labour and service charges. In other cases of sale/supply, goods are taxed at the rate specified under the OST Act. Lift being an unspecified item is taxable at the rate of 12 *per cent* under the OST Act.

During the audit of Bhubaneswar I circle in June 2006, it was noticed that a registered dealer received Rs. 2.62 crore during 2000-01 and 2001-02 towards supply and installation of lifts. While completing assessments in March 2004 and February 2005, the AO considered the receipt as amount received in the course of execution of a works contract and levied tax at the rate of eight *per cent* on a turnover of Rs. 1.70 crore after allowing deduction of Rs. 92.10 lakh towards labour and service charges. Since this was a contract for supply, the turnover of Rs. 1.70 crore should have been taxed at the rate of 12 *per cent*. Incorrect classification of supply contract as works contract resulted in short levy of tax of Rs. 7.49 lakh calculated at the differential rate of four *per cent* including surcharge.

After the case was pointed out, the Government stated in August 2007 that the assessment had been reopened and demand of Rs. 20.48 lakh had been raised. A report on recovery has not been received (November 2007).

Entry Tax

2.15 Loss/non-realisation of entry tax

Under the OET Rules read with the schedule of rates appended to the OET Act, motor vehicles are taxable at the rate of two *per cent* on their purchase value with effect from 1 June 2004. The Finance Department in June 2005 advised the Transport Commissioner (TC), Orissa about the need for sustained co-operation between the Transport and Commercial Tax departments and requested him to issue necessary guidelines to the Regional Transport Offices (RTOs) for ensuring recovery of entry tax at the time of the registration of vehicles. TC, Orissa instructed in his circular of June 2005 that when vehicles purchased from outside the State are presented before the registering authority for registration, the applicant should be asked to furnish proof of payment of entry tax. These instructions reiterated the instructions issued by the TC in January 2003.

Test check of the records of 12 RTOs¹⁰ between July 2006 and March 2007 revealed that 1,986 motor vehicles purchased from outside the State were registered between June 2004 and March 2006 on which entry tax was not realised. Of these, the owners of 69 motor vehicles were issued no objection certificate (NOC) to other States without payment of entry tax. The RTOs neither insisted upon furnishing the proof of such payment before registration/granting NOC of the vehicles nor referred the cases to the concerned commercial tax officers (CTOs) for recovery of the dues. Non-observance of the departmental instructions thus led to loss of revenue of Rs. 20.28 lakh in 69 cases calculated at two *per cent* of the cost of the motor vehicle and non-realisation of revenue of Rs. 3.79 crore in the remaining 1,917 cases. Further scrutiny of the records revealed that the vehicles were registered in the RTOs without noting the detailed address of the owners of vehicles in the GR. In the absence of detailed address, scope of recovery of entry tax of Rs. 3.79 crore from the owners of these vehicles seems to be remote.

After the cases were pointed out, the Government stated in August 2007 that RTOs after registration of vehicles brought from other states, intimated the details to the concerned CTOs for collection of entry tax at their level. The reply is not tenable since the RTOs should have ensured payment of entry tax before registration of vehicles. Moreover, in the absence of correct address of the vehicle owners, scope of recovery of tax by the CTOs also appears to be impossible. Further reply has not been received (November 2007).

10 Angul, Bargarh, Dhenkanal, Ganjam, Jharsuguda, Keonjhar, Koraput, Nawarangpur, Nuapada, Rourkela, Sambalpur and Sundargarh.

2.16 Under assessment of entry tax

Under the OET Act and Rules made thereunder, goods specified in Part-I and II of the schedules shall be exigible to tax at a concessional rate of 50 *per cent* of the appropriate rate when such goods are brought for use as raw material. Under the Act *ibid*, coke is exigible to tax at the rate of one *per cent*.

Scrutiny of the records of Jajpur circle in June 2006, revealed that while finalising the assessment in February 2006 for the year 2002-03 of a dealer engaged in the manufacture and sale of pig iron, the AO levied entry tax on the purchase value of low ash metallurgical (LAM) coke worth Rs. 155.58 crore at a concessional rate of 0.5 *per cent*. LAM coke being fuel does not come under the purview of raw material and concessional rate of tax was not applicable in respect of purchase of the said goods. Application of a lower rate resulted in under assessment of entry tax of Rs. 77.79 lakh.

After the case was pointed out, the AO reopened the case in February 2007 and raised an extra demand of Rs. 77.79 lakh.

On the matter being pointed out, the Government in April 2007 confirmed the fact of raising of demand. A report on recovery has not been received (November 2007).

2.17 Under assessment of entry tax due to short determination of taxable turnover

Under the provisions of the OET Act, if scheduled goods are acquired or obtained otherwise than by way of purchase, then the purchase value shall be the value or the price at which the scheduled goods of the same kind or quality is sold or is capable of being sold in an open market. Cosmetics, soaps, toothpaste, tooth powder etc., are taxable at the rate of one *per cent* under the OET Act.

During the audit of Bhubaneswar-II circle in September 2006, it was noticed that a registered dealer received scheduled goods viz. cosmetics, soaps, toothpaste, tooth powder etc., worth Rs. 9.94 crore during the year 2002-03 by way of stock transfer from outside the State. These goods were sold for Rs. 20.88 crore at a profit of 110 *per cent*. While completing the assessment in March 2006, the AO did not consider the sale price of Rs. 20.88 crore but levied tax on stock transfer value of Rs. 9.94 crore which was contrary to the statutory provision. This led to short determination of taxable turnover of Rs. 10.93 crore and consequent under assessment of entry tax for Rs. 10.93 lakh.

After the case was pointed out, the CCT in November 2007 intimated that on completion of revision of assessment a demand of Rs. 10.93 lakh had been raised. A report on recovery has not been received (November 2007).