CHAPTER II

SALES TAX

2.1 Results of Audit

Test check of records of departmental offices conducted during the period from April 2003 to March 2004, revealed under-assessment, non-levy of interest/penalty, etc., amounting to Rs.73.69 crore in 1,242 cases, which broadly fall under the following categories.

(In crore of rupees)

Sl. No.	Categories	No. of cases	Amount
1	Incorrect grant of exemption from levy of tax	278	29.56
2	Application of incorrect rate of tax	345	21.97
3	Incorrect computation of taxable turnover	166	3.93
4	Non levy of penalty	148	2.54
5	Non levy of interest	163	2.39
6	Others	142	13.30
Total		**1,242**	**73.69**

During the course of the year 2003-2004, the Department accepted under assessment etc., amounting to Rs.2.98 crore in 651 cases, out of which Rs.88.50 lakh involving 455 cases were pointed out during the year and the rest in earlier years. Of these, the Department recovered Rs.1.16 crore.

A few illustrative cases involving a financial effect of Rs.37.71 crore are mentioned below:

2.2. Incorrect grant of exemption from levy of tax

2.2.1 As per entry 28 of Part C of the First Schedule to the Tamil Nadu General Sales Tax (TNGST) Act, 1959, sale of drugs and medicines is taxable at the rate of eight *per cent* at the point of first sale inside the State. As per notification issued in March 1959 under the Madras General Sales Tax Act, 1959 and modified in August 1961, sale of medicines by every private medical practitioner owning dispensaries and dispensing medicines to his patients only, whether he charges consultation fee or not, is exempt from tax. It has been judicially held[1] by the Madras High Court that where hospitals, nursing homes and dispensaries sell medicines to others, in addition to or independent of their patients, such cases would not come within the scope of the Government Order.

In Adayar-I assessment circle, in respect of an assessee, a public limited company running a hospital for medical treatment of patients, during 2001-2002, a turnover of Rs.36.15 crore was allowed exemption on sale of drugs and medicines to patients. In the instant case, the hospital also runs a chain of pharmacies across the State, wherein sale of medicines is effected to persons other than the patients of the hospital. Therefore the exemption allowed was not in order, which had resulted in non levy of tax of Rs.3.45 crore (inclusive of additional sales tax).

After this was pointed out in Audit in July 2003, the Department replied in July 2003 and January 2004 that the sale of drugs and medicines to the patients in the hospital run by a Board of Directors through paid medical practitioners is eligible for exemption. The contention of the Department was not acceptable as the notification envisaged exemption on sale of drugs and medicines by medical practitioner who own a dispensary in case such sales were made only to his patients. In the instant case, sale of drugs and medicines by the assessee was effected not only to its patients but also to others and as per the judicial decision, the case of the assessee would not fall within the scope of the Government Order. Further the hospital was owned by a public limited company and not by a medical practitioner.

The matter was reported to the Government in January 2004 and followed up with reminder in August 2004. Reply of the Government was awaited (September 2004).

2.2.2 Under the Central Sales Tax (CST) Act, 1956, the last sale or purchase occasioning the export of the goods out of the territory of India shall be deemed to be in the course of such export, if such last sale or purchase took place after and was for the purpose of complying with the agreement or order for or in relation to such export. It has been judicially held[2] that to avail of the exemption from levy of tax on such preceding sale, the goods exported should

---

1 Narayanaswami Pillai Vs. State of Tamil Nadu – 39 STC P307 (Madras).

2 Sterling Foods Vs. State of Karnataka 63 STC 239 (SC).

be the same as that purchased under the agreement. As per the Export Import (EXIM) policy of the Government of India, sandalwood logs are in the negative list whereas sandalwood chips, powder, flakes are in the restricted list of the said policy. Thus logs and chips are distinct and different commodities.

In three[3] offices, on sale of sandalwood logs amounting to Rs.40.16 crore made by the Forest Department during the years 1994-95 to 2002-03 in 16 cases, tax was not levied on the ground that the sales were made in the course of export. As export was in the form of flakes, chips, etc., the non collection of tax on the penultimate sale by the Forest Department was not in order. This resulted in non-realisation of tax of Rs.4 crore (inclusive of surcharge).

After this was pointed out, the Department replied that as per the analogy of the Supreme Court's decisions[4] the conversion of sandalwood logs into chips, flakes, etc. does not amount to manufacture and as per the clarification of the Commissioner of Commercial Taxes (CCT) issued in 1986, sandalwood logs when cut into different sizes for export do not alter the characteristic of the original commodity and therefore the exemption allowed was in order.

The reply is not tenable in view of the subsequent clarification of the CCT issued in September 1997 that sale of sandalwood to the exporter was not eligible for exemption under the CST Act, as sandalwood logs were not exported as such, and were converted into different commodity. The judicial decisions rendered with reference to other commodities, could not be extended to sandalwood, a commodity covered by the restrictions of the EXIM policy.

The matter was reported to the Government in May 2004 and followed up with reminder in August 2004. Reply of the Government was awaited (September 2004).

2.2.3 As per the CST Act, inter-state sale of goods not covered by declarations in Form 'C' is taxable at the local rate applicable to such sale inside the appropriate State or 10 *per cent*, whichever is higher. It has been judicially held[5] by the Madras High Court that supply of goods by All India Skin and Hides Tanners and Merchants Association (Association) to its members would constitute a sale. As per the TNGST Act, sale of raw materials, packing materials and consumable goods to 100 *per cent* Export Oriented Unit (EOU) in the State is exempt from tax.

---

3 Salem, Sathyamangalam and Tirupathur.

4 Lal Kurwa Stone Crusher (P) Ltd. Vs. Commissioner of Sales Tax, Uttar Pradesh – 118 STC P287 (SC)
Ram Babu Tagore (P) Ltd. Vs. Coffee Board, Bangalore – 80 STC P199 (SC).

5 All India Skin and Hides Tanners and Merchants Association Vs. Commercial Tax Officer – 127 STC P491 (Mad).

Test check of records in five assessment circles, revealed that exemption was incorrectly granted between April 1998 and February 2003 to six dealers on a turnover of Rs.6.05 crore during the years between 1994-95 and 2001-2002. The non levy of tax in these cases, amounted to Rs.62 lakh as detailed below:

(in lakh of rupees)

Sl. No	Assessment circle (No. of dealers)	Year of transactions/ (Month/Year of assessment)	Nature of irregularity	Tax-able Turn-over	Tax leviable
1	Chinglepet (One)	1997-98 to 2000-01 (between July1999 and August 2002).	Inter-State sale of EXIM scrip/ duty entitlement pass book licence was incorrectly exempted treating the same as stock transfer.	455.96	48.29
Remarks: The Department replied that the transaction was branch transfer and, therefore, not exigible to tax. The reply is not tenable as independent cross verification in audit revealed that the branch office was not in the computerised master register of dealers maintained at the office concerned at Kolkata. The transaction was, therefore, to be construed as one of sale not covered by declaration in form 'C'.					
2	Ooty (North) (One)	2001-02 (February 2003)	Turnover on account of airtime charges representing right to use the facility of cellular service provider was erroneously allowed exemption.	62.95	6.92
Remarks: After this was pointed out in audit in September 2003, the Department contended in December 2003 that the turnover represented air time charges only and was not liable to tax. The reply is not tenable in view of the decision of the Kerala High Court[6] that the supply of SIM card and activation represents transfer of property in goods and the entire consideration moving from the subscriber to the service provider including the activation charges, would be exigible to tax.					

[6] Escotal Mobile Communications Ltd. Vs. Union of India and others – 126 STC P.475 (Ker.)

(in lakh of rupees)

Sl. No	Assessment circle (No. of dealers)	Year of transactions/ (Month/Year of assessment)	Nature of irregularity	Tax-able Turn-over	Tax leviable
3	Nagercoil (Rural) (One)	1997-98 (January 1999)	Last purchase of wattle extract, sale of capacitors and sale of raw materials to 100% EOU situated outside the State was erroneously allowed exemption	18.68	2.05
	Ranipet (Two)	1994-95 (April 1998) 1995-96 (March 2000)		48.30	2.65
	Manali (One)	1997-98 (December 2000) 1998-99 (July 2002)		19.03	2.09
Remarks: The Department revised the assessments during July/August 2003 and January 2004 and raised additional demand of Rs.4.70 lakh. Reply of the Department in respect of Manali was awaited (September 2004).					
Total				**604.92**	**62.00**

The matter was reported to the Government between November 2003 and May 2004 and followed up with reminder in August 2004. Reply of the Government was awaited (September 2004).

2.3. Application of incorrect rate of tax

2.3.1 As per TNGST Act, on sale of any goods, tax is leviable at the concessional rate of three *per cent* on turnover of such sale, under certain conditions and subject to the production of declarations in prescribed form obtained from the purchaser. As per clarification issued in October 2001 by the CCT, water purifying machine and parts thereof are taxable as electrical appliances. The CCT has also clarified in June 2003 that wood sealer is taxable at the rate of 16 *per cent* under entry 18 of Part E of the First Schedule at the point of first sale inside the State.

In nine assessment circles, while finalising the assessments between March 1998 and March 2003, tax was levied short due to application of incorrect rate of tax on a turnover of Rs.9.29 crore involving 10 dealers during the years 1995-96, 1997-98 to 2000-2001. The short levy of tax, worked out to Rs.55.70 lakh as detailed below:

(in lakh of rupees)

Sl. No.	Assessment circle (No. of dealers)	Year of transaction (Month/ year of assessment)	Commodity	Taxable turnover	Rate of Tax *(per cent)*		Amount short levied
					Appli-cable	App-lied	
1	Saibaba colony, Coimbatore (One)	1995-96 (March 1998)	Electronic water purifier	97.80	12	3	28.57
		1998-99 (December 2002)		200.91	16	11	
		1999-00 (April 2002)		142.63 27.19	16	11 12	
Remarks: The Department stated in December 2003, that in the absence of specific entry in the Schedule for water purifier, the assessment was made at three *per cent* treating it as electronic goods during 1995-96 and at 11/12 *per cent* as residuary item during 1998-99 and 1999-2000. The reply is not tenable in view of clarification of CCT that electronic water purifier would fall within the scope of "electrical appliances" and taxable accordingly. Further reply was awaited (September 2004).							
2	Rock Fort Trichy (Two)	1997-98 (December 1998) 1998-99 (September 1999) 1999-00 (June 2001) 2000-01 (January 2002)	Date Syrup sold under brand name.	203.24	16	11	10.16
Remarks: The Department contended in December 2000 and August 2002 that the assessments were based on the clarification of the CCT in July 1998, that date syrup would fall under the entry relating to 'squashes and essences', and therefore in order. The CCT further contended in August 2002 that as per judicial decision[7] when there are competing entries in the Schedule to the Act, the lower rate was applicable. The reply is not tenable as date syrup cannot be termed as squash, as unlike other squashes, date syrup is capable of direct consumption and date syrup, being a preparation of fruit is taxable under the specific entry, viz., entry 4 of Part E of the First Schedule and there being no ambiguity regarding the classification of date syrup, the judicial decision quoted by the Department is not applicable to the instant case. Further reply was awaited (September 2004).							

[7] Bharat Vijay Mills Ltd. Vs. Commissioner of CT- 85 STC P22 (Kar.)

(in lakh of rupees)

Sl. No.	Assessment circle (No. of dealers)	Year of transaction (Month/ year of assessment)	Commodity	Taxable turnover	Rate of Tax *(per cent)*		Amount short levied
					Appli-cable	App-lied	
3	Aranthangi (One)	2000-01 (April 2002)	Confec-tionery sold under brand name.	12.23	11	4	0.86
	Kangeyam (One)	1997-98 (February 2000)	MIG CO_2 MS wire (Soldering wire).	25.79	11	4	1.81
		1999-00 (April 2001)	MIG CO_2 MS wire, not covered by Form XVII declaration.	10.13	11	3	0.81
	Thallakulam (One)	2000-01 (September 2002)	Catering sale of food and drinks.	42.11	8	2	2.53

Remarks: In the case of Kangeyam, the Department contended that the assessment was made in accordance with the clarification of the CCT issued in December 2000 that copper coated mild steel wire was a declared good, taxable at four *per cent*.

The reply is not tenable as scrutiny of excise invoice revealed the commodity as MIG CO_2 welding wire of size 0.88 mm, which was nothing but soldering wire, taxable at the rate of 11 *per cent*.

In the case of Thallakulam, the Department revised the assessments in December 2003, raising an additional demand of Rs.2.53 lakh. Reply of the Department in respect of the other case was awaited (September 2004).

(in lakh of rupees)

Sl. No	Assessment circle (No. of dealers)	Year of transaction (Month/ year of assessment)	Commodity	Taxable turnover	Rate of Tax *(per cent)*		Amount short levied
					Appli-cable	App-lied	
4.	Adayar-I, (One)	2000-01 (March 2003)	Modular Kitchen	67.11	11	4	4.70
	Esplanade-I (One)	2000-01 (July 2002)	Roller Bearings	23.09	8	3	1.15
Remarks: In respect of Adayar-I, the Department replied in December 2003 that the transaction was one of works contract and the assessment made at four *per cent* on the basis of option exercised by the dealer was in order. The reply is not tenable as it had been observed by the Supreme Court[8] that whether a particular contract was one for sale of goods or for work and labour depends upon the main object of the parties found out from an overview of the terms of the contract, the circumstances of the transaction and custom of the trade. The Apex Court had accordingly held that if the thing has any individual existence before the delivery as the sole property of the party who was to deliver it, then it was a sale. If the major component of the end product was the material consumed in producing the chattel to be delivered and skill and labour were employed for converting the main components into the end products, the skill and labour are only incidentally used, the delivery of the end product by the seller to the buyer would constitute a sale. In the case of Esplanade-I the Department revised the assessment in May 2003 and raised an additional demand of Rs.1.15 lakh; the collection particulars of which was awaited (September 2004).							
5	Kilpauk, (One)	2000-01 (September 2001)	Wood sealer,	45.84	16	11	2.29
	Guindy (One)	2000-01 (March 2002)	Disposable diapers	31.35	20	11	2.82
Remarks: In respect of Kilpauk, the Department replied in December 2002 that the assessment made by treating the product as unclassified was in order. The reply is not tenable as "wood sealer" used for surface preparations was taxable at the rate of 16 *per cent*. The Department revised the assessment in the case of Guindy assessment circle in August 2003, raising an additional demand of Rs.2.82 lakh of which an amount of Rs.0.71 lakh had been collected. The appeal preferred by the dealer against the revision of assessment was pending. Further reply was awaited (September 2004).							
Total				**929.42**			**55.70**

The matter was reported to the Government between August 2003 and April 2004 and followed up with reminder in August 2004. Government, in the case of Rock Fort assessment circle, while endorsing the views of the Department, stated in July 2004 that date syrup, not being a solid nourishment

[8] Hindustan Shipyard Ltd. Vs. State of A.P. – 119 STC P533 (SC).

cannot be termed as food and date syrup is not a preparation of fruits but is only a syrup obtained from fruits. The reply of the Government is not tenable as it had been held[9] by the Supreme Court that "food" may either be solid or liquid, but it should possess the quality to maintain life and its growth; it must have nutritive value so as to enable growth, repair or maintenance of body. Date syrup has been marketed by the dealers themselves as a syrup and nutritious drink. Further, date syrup is capable of being directly consumed as an energy substitute and was accordingly classifiable as food preparation only. Reply of the Government in respect of other cases was awaited (September 2004).

2.3.2 Under the provisions of the CST Act, on inter-State sale of declared goods not covered by valid declarations in Form 'C', tax is leviable at double the rate applicable to sale of such goods inside the State and on inter-State sale of goods other than declared goods, tax is leviable at four *per cent*, if the sales are covered by valid declarations in Form 'C'. Where such sales are not covered by declarations in Form 'C', the rate of tax applicable is 10 *per cent* or the local rate, whichever is higher. By a notification issued in March 1997, the rate of tax on inter-state sale of man-made staple fibres, fibre yarn, filament yarn and waste of any of these commodities was reduced to two *per cent*, provided the dealer had not effected any branch transfer or consignment transfer during the year.

In Manali and Tambaram-I assessment circles, while finalising the assessments between May 2002 and January 2003, tax was levied short due to application of incorrect rate of tax on a turnover of Rs.7.29 crore involving two dealers during the years 1996-97 and 1998-99. The short levy of tax, pointed out by audit worked out to Rs.22.04 lakh.

After this was pointed out, the Department accepted in October 2003 under assessment of Rs.6.30 lakh in one case. Further reply was awaited (September 2004).

The matter was reported to the Government between November 2003 and April 2004 and followed up with reminder in August 2004. Government accepted the audit observations in one case. Reply of the Government in respect of other was awaited (September 2004).

2.4 Non levy of additional sales tax

Under the Tamil Nadu Additional Sales Tax Act, 1970, additional sales tax was leviable at the rate of three *per cent* on the taxable turnover, where the taxable turnover of a dealer exceed three hundred crore of rupees in a year (with effect from 1 April 1998). As per the TNGST Act, lottery ticket was taxable at four *per cent* at the point of first sale in the State. As per the

[9] S. Samuel Vs. Union of India – 134 STC P610 (SC).

provisions of Section 7-D of the TNGST Act, a dealer in lottery tickets has been given the option of paying compounded amount of tax determined on the basis of type of draw and the rate per draw. Where a dealer has paid compounded amount in respect of sale of a particular name and type of lottery tickets, the tax in respect of the sale of such lottery tickets by any other dealer or person liable to pay tax shall be deemed to have been paid in the same manner.

In Thudiyalur assessment circle, while finalising in April 2000 the assessments of two subsequent dealers of lottery tickets, in respect of which compounded amount of tax had been paid earlier, the turnovers of Rs.919.38 crore representing sale of lottery tickets, effected during 1999-2000 was not considered for assessment, by treating it as second sales. The incorrect allowance of exemption has resulted in non levy of additional sales tax amounting to Rs.27.58 crore.

After this was pointed out in June 2002, the Government replied in June 2004, that as the compounded amount of tax had already been paid previously on such lottery tickets, the exemption allowed as second sales was in order. The reply is not tenable as the previous dealer had only paid compounded amount on the basis of draws. Therefore exemption as second sale was not applicable in respect of subsequent sale of such lottery tickets. Legislature also perceived this and hence the proviso was introduced under Section 7-D of TNGST Act, to the effect that tax due under Section 3(2) on subsequent sale, shall be deemed to have been paid. The proviso does not grant exemption to subsequent sale of lottery tickets, in respect of which only compounded amount had been paid earlier inside the State. This clearly indicates that there shall be determination of taxable turnover and corresponding levy of tax, additional sales tax etc. The amount of tax shall be deemed to have been paid as per the proviso and in the absence of such provision in respect of additional sales tax, the same shall be payable by the assessee.

2.5. Non levy of interest for belated payment of tax

As per the TNGST Act and CST Act, if a dealer fails to pay tax due by the prescribed date, he shall be liable to pay interest at the prescribed rate.

In three[10] assessment circles, tax dues of Rs.1.82 crore relating to the years 1987-88, 1988-89, 1992-93 to 1995-96, 1997-98 and 1998-99, the assessments of which were finalised between March 1998 and March 2002, were paid belatedly by four dealers, the delay ranging from one month and 19 days to 53 months, for which interest amounting to Rs.1.08 crore though leviable, was not levied.

After this was pointed out in audit between December 1999 and October 2003, the Department levied interest of Rs.14.36 lakh in three cases of which an amount of Rs.12.57 lakh in one case was collected in July 2000. In another

[10] Avinashi Road, Coimbatore, Fast Track Assesment Circle-III, Chennai and Vandavasi.

case, the Department replied in October 2003 that the assessee had paid the tax due on clause 5-A[11] price within 30 days from the date of determination of such price and interest was not attracted. The reply is not tenable as it had been judicially held[12] that the tax on the amount paid over and above the minimum cane price[13] under clause 3 should be paid along with the monthly returns. The levy of interest on the belated payment of tax on clause 5-A price included in the supplementary returns was upheld. This decision was affirmed by the Madras High Court which held[14] that the levy of interest for the period between the date of filing the incorrect original return and the date on which the revised return was filed and tax was paid, was lawful.

The matter was reported to the Government during February/March 2004 and followed up with reminder in August 2004. Reply of the Government was awaited (September 2004).

2.6. Short levy of penalty

As per the CST Act, read with the TNGST Act, if the return filed by a dealer is found to be incorrect or incomplete, the assessing authority shall assess the dealer to his best of judgment. In addition, the assessing authority shall also levy penalty depending on the percentage of difference between tax assessed and tax paid as per returns.

In Brough Road Assessment Circle, Erode, while finalising in January 2000 and December 2001, the assessments of two dealers for the years 1994-95 and 1995-96, for short payment of tax, as against the amount of Rs.59.95 lakh leviable as penalty, an amount of Rs.40.27 lakh was levied. This resulted in short levy of penalty of Rs.19.68 lakh.

After this was pointed out in audit in November 2002, the Department revised the assessments in August 2003, levying penalty of Rs.19.68 lakh; the collection particulars of which was awaited.

The matter was reported to Government in December 2003. Government replied in April 2004 that as per the provisions introduced with effect from 1 April 1996, penalty was not leviable on additions made to turnover without any specific concealment, and on any turnover on which tax was paid at concessional rate, subject to the furnishing of any declarations but where such declaration forms could not be furnished and this provision was applicable in respect of cases finalised after the date of amendment. It was further mentioned therein that the proposals of the Enforcement Wing and adhoc additions were not on sound data and levy of penalty was not enforceable.

---

11 Additional price notified by the Director of Sugar under clause 5-A of the Sugarcane (Control) Order, after the closure of each sugar season.

12 EID Parry (India) Ltd., Vs. Assistant Commissioner (CT)– 113 STC P.233 (TNTST).

13 Statutory minimum price payable by the sugar mills to the growers as per the Sugarcane (Control) Order.

14 Order of TNTST affirmed in respect of the same assessee in 126 STC P.399 (Madras).

The reply of the Government is not tenable as the amended provisions was applicable only in respect of transactions subsequent to the date of amendment, and the dealers also had not contested the additions made.

The matter was reported to the Government in June 2004 and followed up with reminder in August 2004. Further reply of the Government was awaited (September 2004).