

## CHAPTER II

### SALES TAX

#### 2.1 Results of audit

Test check of the records of the departmental offices conducted during the period April 2008 to March 2009 indicated underassessments, non-levy of penalty and other observations of Rs. 229.93 crore in 1,140 cases, which broadly fall under the following categories:

(Rupees in crore)			
Sl. no.	Category	No. of cases	Amount
1.	<b>Transition from Sales Tax to Value Added Tax (A review)</b>	1	62.06
2.	<b>Computerisation of Value Added Tax Information System in Commercial Taxes Department ( A review)</b>	1	0.00
3.	Incorrect exemption from levy of tax	173	96.47
4.	Application of incorrect rate of tax	257	33.14
5.	Non-levy of penalty/interest	378	15.36
6.	Non/short levy of tax	81	11.49
7.	Incorrect computation of taxable turnover	81	3.36
8.	Others	168	8.05
<b>Total</b>		<b>1,140</b>	<b>229.93</b>

During the year 2008-09, the department accepted underassessments and other deficiencies of Rs. 5.35 crore in 780 cases, of which Rs. 1.82 crore involved in 349 cases were pointed out during the year and the rest in earlier years. Of these, the department recovered Rs. 2.93 crore during the year.

After the issue of a draft paragraph, the department recovered Rs. 11.44 lakh in two cases.

Two reviews on “**Transition from Sales tax to value added tax**” and “**Computerisation of value added tax information system in commercial taxes department**” involving Rs. 62.06 crore and few illustrative audit observations involving Rs. 10.35 crore relating to other cases are discussed in the succeeding paragraphs.

## **2.2 Transition from Sales Tax to Value Added Tax**

### **Highlights**

- Failure to formulate a time bound action plan for attaining finality in respect of matters relating to the erstwhile TNGST Act resulted in huge pendency of assessments, non-collection of arrears and non-implementation of taxation proposals.

**(Paragraph 2.2.7.1, 2.2.7.2 & 2.2.7.3)**

- Absence of provisions empowering registering authorities to exercise vital checks before granting registration or for conducting survey and lack of co-ordination with the other Government departments to elicit information about dealers resulted in non-detection of dealers liable for registration.

**(Paragraph 2.2.8.1)**

- Failure to prescribe a time frame under the TNVAT Act for finalisation of assessments has led to pendency and consequent delay in selection of cases for scrutiny.

**(Paragraph 2.2.10)**

- Failure to re-fix turnover limits for claiming exemptions/compounding rate of tax while introducing the Act in the midst of the year resulted in foregoing revenue of Rs. 13.76 crore during 2006-07.

**(Paragraph 2.2.11)**

- Incorrect allowance of input tax credit (ITC) amounting to Rs. 4.77 crore on closing stock was noticed in 39 circles.

**(Paragraph 2.2.12.1)**

- ITC of Rs. 602.77 crore in 51,120 cases was allowed without verification of original tax invoices in support of the claim.

**(Paragraph 2.2.12.2)**

- Refund of Rs. 57.29 crore was allowed in 1,567 cases without ensuring the remittance of tax into Government account.

**(Paragraph 2.2.12.3)**

- Failure to spell out the intention of the Government clearly in the notification resulted in foregoing revenue of Rs. 13.58 crore.

**(Paragraph 2.2.13.2)**

- The benefit of reduction in rate of tax on the implementation of TNVAT was not passed on to the general public by way of reduction in prices.

**(Paragraph 2.2.13.4)**

### 2.2.1 Introduction

The Government of India decided to implement State Level Value Added Tax in all States on the basis of decision taken on 23 January 2002 in the empowered committee of the States' Finance Ministers. The empowered committee submitted its White Paper in January 2005 and anticipated that the introduction of VAT will result in the following benefits:

- elimination of cascading tax burden, by providing a set off for input tax as well as tax paid on previous purchases;
- rationalisation of the over all tax burden by abolition of other incidental taxes such as surcharge and additional sales tax;
- built in self assessment by dealers; and
- simple and transparent tax structure.

The Government of Tamil Nadu repealed the Tamil Nadu General Sales Tax Act, 1959 (TNGST Act) and enacted the Tamil Nadu Value Added Tax Act, 2006 (TNVAT Act) effective from 1 January 2007. Some of the differences between the TNVAT Act and the repealed Act are as under:

(i) VAT is a multi-point taxation system, while the repealed Act had a single/double point taxation system.

(ii) The VAT system relies on the dealers to pay the tax voluntarily by furnishing the returns prescribed in the TNVAT Act; of these not more than 20 *per cent* of the completed self assessments is taken up for scrutiny whereas under the repealed Act, cent *per cent* assessments were required to be assessed/scrutinised by the department.

(iii) The VAT system simplifies the tax structure and reduces the control of the executive over the dealers whereas in the repealed Act, the incidence of various elements like surcharge and additional sales tax had made the tax structure cumbersome.

(iv) Under the TNVAT Act, the goods are taxable under the first schedule at three rates, viz., one *per cent*, four *per cent* and 12.5 *per cent*. The goods that are not taxable under the TNVAT Act are mentioned in the second schedule. The TNVAT Act provides an option for payment of tax at compounded rate in respect of hotels, restaurants and sweet stalls at the prescribed rate, where the turnover does not exceed Rs. 50 lakh during the year. The commodities which are exempted from levy of tax are listed in the fourth schedule. The sales made to international organisations are treated as zero rated sales and are listed in the fifth schedule of the TNVAT Act.

**A review on the “Transition from Sales Tax to Value Added Tax” was conducted by audit. It indicated a number of system and compliance deficiencies which are discussed in the subsequent paragraphs.**

### 2.2.2 Organisational set up

The Commissioner of Commercial Taxes (CCT) is the head of the department of Commercial Taxes (CT) and is assisted by Additional Commissioners (ADC), Joint Commissioners (JC) and Territorial Deputy Commissioners (DC) who exercise administrative control. The Deputy Commissioners of Fast

Track Assessment Circles (FTAC), Assistant Commissioners (AC)/ Commercial Tax Officers (CTO) and Assistant Commercial Tax Officers (ACTO) are the assessing authorities responsible for the levy and collection of sales tax and arrears thereof in the respective assessment circle. In addition, there is an enforcement wing, which has been formed for the purpose of conducting surprise inspection and unearthing suppression of turnover to prevent leakage of revenue. The monitoring and control at the Government level is done by the Secretary, Commercial Taxes and Registration Department.

### **2.2.3 Audit objectives**

The review was conducted with a view to ascertain that the

- planning for implementation and transition from the TNGST Act to TNVAT Act was effected timely and efficiently;
- organisational structure was adequate and effective;
- provisions of the TNVAT Act and the Rules made thereunder were adequate and enforced properly to safeguard the revenue of the State;
- reduction in prices envisaged by the empowered committee on the introduction of VAT had materialised and
- internal control mechanism existed in the department and was adequate and effective to prevent leakage of revenue.

### **2.2.4 Scope and methodology of audit**

The State has been divided into ten territorial divisions consisting of 323 assessment circles for the administration of the TNVAT Act. The review of the records of the Commercial taxes (CT) department was conducted in all the ten territorial divisions between April 2009 and August 2009. The data relating to the period from January 2007 to March 2009 were obtained from the Government Secretariat, the administrative sections of the CT department and 145 assessment circles falling in the ten divisions for an analysis. Besides, findings during the local audits conducted from April 2008 to March 2009 were also utilised. The selection of the assessment circles was based on the high revenue generation and the geographical location.

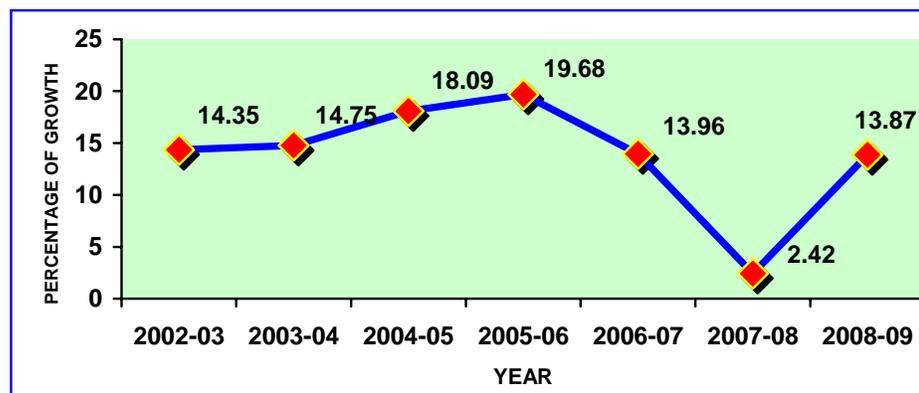
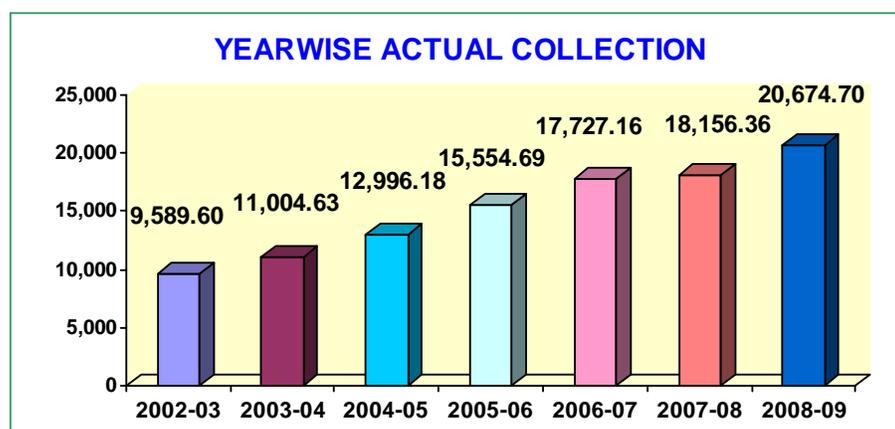
### **2.2.5 Acknowledgment**

The Indian Audit and Accounts department acknowledges the cooperation of the CT department in providing the necessary information and records for audit. An entry conference was held in April 2009 in the Office of the CCT, Chennai in which audit objectives and methodology of audit were explained. The draft review was forwarded to the department and the Government in September 2009. The exit conference was held with the Commissioner of Commercial Taxes on 12 November 2009 in which the results of audit and recommendations were discussed. The replies of the department given during exit conference and at other times have been appropriately reflected in the review report.

**Audit findings****2.2.6 Pre-VAT and post-VAT tax collection**

The comparative position of pre-VAT sales tax collection (2002-03 to 2005-06), composite sales tax and VAT collection (2006-07) and post-VAT tax collection (2007-08) including annual growth rate is mentioned below:

Pre-VAT			Post -VAT		
Year	Actual collection (Rs. in crore)	Percentage of growth	Year	Actual collection (Rs. in crore)	Percentage of growth
2002-03	9,589.60	14.35	2006-07 <sup>2</sup>	17,727.16	13.96
2003-04	11,004.63	14.75	2007-08	18,156.36	2.42
2004-05	12,996.18	18.09	2008-09	20,674.70	13.87
2005-06	15,554.69	19.68			



Thus, though the collections increased in absolute terms, the growth rate in the post VAT period registered a decrease, the rate being as low as 2.42 per cent in 2007-08. The reasons attributed by the department for the low growth rate in 2007-08 were the lowering of revenue neutral rate which was more than 16.5 per cent under the pre-VAT regime to less than 12.5 per cent under the VAT, the increase in the threshold limit for the levy of tax under the VAT and the concept of ITC set off on the out put tax. The department further stated

<sup>2</sup> Composite period of pre-VAT and post-VAT.

that manufacturing States stand to lose more as the concept of the ITC and its set off will reduce the VAT revenue.

### 2.2.7 Preparedness and transitional process

The department formed a VAT cell as early as August 2001 to attend to the VAT related issues such as drafting the TNVAT Act, organising training, interaction with the other states, etc. The draft TNVAT Bill 2003 received the assent of the President of India in March 2003 and it was published in the Extraordinary Gazette on 13 March 2003.

The Government had published the Draft VAT Act in the Gazette in October 2006 and uploaded it on the official website for the benefit of the public, besides establishing 39 Help Desks. The traders were imparted training by senior officers of the department.

The TNVAT Act, however, was introduced in the State with effect from 1 January 2007. The reason for the delay in implementation was attributed to the requirement of arriving at a broad consensus among all sections of the society to the major tax reform.

Though the TNVAT Act was introduced after a period of nearly five years since the formation of VAT Cell, the department failed to formulate a time bound action plan for attaining finality in respect of matters relating to the erstwhile Act by overlooking the following issues.

#### 2.2.7.1 Time limit for finalisation of assessments pending under TNGST Act

Section 12C of the TNGST Act, 1959 and Section 87A of the TNVAT Act empower the assessing officers to make deemed assessment, without calling for the accounts of the dealers, in respect of assessments pending upto 31 December 2006. Despite these enabling provisions, a large number of assessments under the erstwhile Act are kept pending as detailed in the table below:

Year	Opening balance	Cases which became due for assessment	Total	Cases disposed	Cases pending	Percentage of disposal
2005-06	54,292	1,77,496	2,31,788	1,62,872	68,916	70
2006-07	68,916	1,82,457	2,51,373	1,51,825	99,548	60
2007-08	99,548	1,78,414	2,77,962	76,814	2,01,148	28
2008-09	201,148	-	2,01,148	55,381	1,45,767	28

The percentage of finalisation of assessments pertaining to the TNGST Act has fallen sharply after the implementation of VAT. Although the poor pace of finalisation of assessments is likely to affect the collection of taxes adversely, **yet no action plan for fixation of targets in terms of number of cases for each assessing authority and the time period within which the pending cases should be disposed has been devised by the department.**

**The Government may formulate an effective action plan to facilitate the finalisation of assessments and closely monitor its implementation.**

### 2.2.7.2 Arrears of revenue

A scrutiny of the joint commissioner's performance review report indicated that Rs. 6,738.60 crore involved in 1,27,077 cases pertaining to the period upto 2005-06 was pending collection as on 31 March 2009. The year wise break up is indicated in the following table:

Period	Upto 2002-03	2003-04	2004-05	2005-06
No. of cases	83,821	11,136	14,871	17,249
Amount (Rs. in crore)	3,443.53	992.88	1,242.25	1,059.94

The huge amount of the arrears indicates that concerted and effective efforts are not being made towards recovery of arrears.

**The Government may consider fixing targets for collection of old arrears for each assessing authority in a time bound manner and closely monitor the performance of the assessing authorities.**

### 2.2.7.3 Non-implementation of taxation proposals

The Enforcement Wing, after inspection of the premises of the assessee, forwards its findings in the form of proposals, known as 'D3' proposals (taxation proposals) to the assessing authorities for implementation. **No time limit has been prescribed for the implementation of taxation proposals.**

Audit noticed that 3,839 taxation proposals involving Rs. 3,219.33 crore and pertaining to the period up to 2006-07 were pending as on 31 March 2009 as mentioned below:

Period	Upto 2003-04	2004-05	2005-06	2006-07	Total
No. of cases	2,323	536	486	494	3,839
Amount (Rs. in crore)	3,071.68	99.71	33.11	14.83	3,219.33

**The Government may consider formulating a time bound action plan for finalisation of the pending taxation proposals and monitoring should be made effective to ensure that no proposal escapes implementation beyond the prescribed time.**

### 2.2.7.4 Analysis of the staff requirement and reorganisation of the department

The overall position of sanctioned strength and vacancies in the cadres from Group A to Group D as furnished by the CCT is given below:

As on	Category of post	Sanctioned strength	Person in position	Vacancy	Percentage of vacancy
1 April 2007	DCs and above	143	114	29	20
	CTOs and ACs	2,453	1,712	741	30
	Record keeper to ACTOs	5,562	3,736	1,826	33
	Others	2,266	1,189	1,077	48
<b>Total</b>		<b>10,424</b>	<b>6,751</b>	<b>3,673</b>	<b>35</b>

1 April 2008	DCs and above	143	102	41	29
	CTOs and ACs	2,453	1,666	787	32
	Record keeper to ACTOs	5,562	3,672	1,890	34
	Others	2,266	1,182	1,084	48
<b>Total</b>		<b>10,424</b>	<b>6,622</b>	<b>3,802</b>	<b>36</b>
1 April 2009	DCs and above	143	86	57	40
	CTOs and ACs	2,453	1,459	994	41
	Record keeper to ACTOs	5,562	3,529	2,033	36
	Others	2,266	1,126	1,140	50
<b>Total</b>		<b>10,424</b>	<b>6,200</b>	<b>4,224</b>	<b>41</b>

The above table indicates an increasing trend in vacancies. The department may carry out a detailed analysis of staff requirement considering the requirement under VAT and also the effect of computerisation.

## System deficiencies

### 2.2.8 Registration of dealers

#### 2.2.8.1 Absence of provision for conducting survey

According to the TNVAT Rules, every application for registration shall be accompanied by two recent passport size photographs alongwith the proof of payment of registration fee. The registering authority shall, on satisfying itself that the application is in order, assign TIN and issue a certificate of registration. **Unlike the TNGST Act, the registering authority is not required to call for the physical appearance of the person signing the application for registration or making or causing to make such enquiry as it may consider necessary before the grant of the registration certificate (RC). The TNVAT Act also does not provide for conducting of survey or cross verification with other departments for the purpose of identifying fresh cases of assessments.**

- Audit noticed that on the orders of the CCT, the department had conducted a survey of the premises of the dealers in October 2008 and November 2008 and found that in 234 cases, the dealers were not available in their places of business. This has resulted due to the absence of a statutory provision for making necessary enquiry by the assessing authorities before the grant of RCs and on account of the ease with which RC could be obtained under the TNVAT Act.

- As per the Section 38(3) (g) of the TNVAT Act, every dealer who, in the course of his business, obtains or brings goods from outside the State or effects export of goods out of the territory of India/State shall get himself registered under the Act, irrespective of the quantum of his turnover in such goods.

Audit obtained the list of the exporters registered with the Chemical & Allied Products Exports Promotion Council, Plastic Exports Promotion Council and a few listed in the India Yellow Pages, and cross verified these with the data base of the registered dealers in the department's web site. Such verification

indicated that 59 exporters had not obtained registration under the TNVAT Act. This indicates that the departmental authorities had failed to undertake the requisite exercise to detect unregistered dealers. The lack of co-ordination and cross verification with the records of the other Government departments/organisations to elicit information about the dealers, resulted in non detection of the unregistered dealers liable for registration.

**The Government may consider incorporating a specific provision in the Act to enable the registering authority to exercise certain basic and vital checks before granting registration to ensure authenticity of the application for registration. Similarly, suitable measures may be instituted for undertaking mandatory cross verification with the records of other departments for detecting unregistered dealers.**

### 2.2.9 Returns

Section 21 of the TNVAT Act deals with filing of returns. Rule 7 of the TNVAT Rules prescribes different returns for different classes of dealers and the due dates within which the returns are to be filed.

#### 2.2.9.1 Deficiencies in the format of the prescribed forms for submitting returns

The Act enables the dealers to make self assessment and accounts are not required to be produced by the dealers except in cases selected for scrutiny. It is, therefore, necessary that the returns which form the basis for determination of tax payable by the dealers should have adequate columns/fields for eliciting the requisite information and to ensure the correctness of the claim of ITC and output tax payable by the dealers. The following deficiencies in the formats of the return were noticed by the audit.

- The return in 'Form-I' prescribed for dealers other than those who opt to pay tax at the compounded rates does not have a column to exhibit the exemption/reduction in rates of tax granted to commodities by issue of notifications. Hence, there may be a mismatch between the commodity code and the rate of tax adopted in the return.
- The TNVAT Act provides for claim of ITC within 90 days from the date of purchase or before the end of the financial year, whichever is later. The monthly return, however, does not have a column for accommodating a claim if it is not made immediately in the month of purchase.
- Under the TNVAT Act, dealers who effect second and subsequent sale of goods purchased within the State and whose total turnover for a year was less than Rs. 50 lakh could opt for payment of tax at the compounded rate. The return in 'Form-K' meant for such dealers does not have a provision to exhibit the seller's TIN, in the absence of which the correctness of the claim as local purchases cannot be ensured. A column for exhibition of cumulative monthly turnover in the return would be useful to easily identify the dealer's claim for payment of tax at the compounded rate.

**The Government may consider modifying the prescribed format, in order to make them more compatible with the provisions of the Act/Rules.**

**2.2.9.2 Absence of deterrent measure for submission of incorrect returns**

The TNVAT Act places faith on voluntary payment of tax by the dealers by permitting them to make self assessments. The Act, however, does not provide for levy of penalty for submission of incorrect/incomplete returns. This results in a dealer committing an offence being placed on par with an honest tax payer and is hence discriminatory.

**The Government may consider prescribing a provision in the Act for levy of penalty for submission of incorrect/incomplete returns which would act as an effective deterrent against any attempt of tax evasion by the dealers.**

**2.2.10 Absence of time limit for finalisation of assessments**

According to the Section 22(2) of the TNVAT Act, the assessing authority shall accept the returns submitted by a dealer for the year if they are accompanied by the proof of payment of tax and other prescribed documents and pass orders on the basis of such returns. **The Act, however, does not prescribe any time limit for passing of assessment orders.**

Audit noticed large pendency of assessments under the TNVAT Act as mentioned in the following table.

Year	Opening balance	Cases due for assessment	Total	Cases disposed	Cases pending	Percentage of disposal
2007-08	-	1,44,759	1,44,759	22,108	1,22,651	15
2008-09	1,22,651	1,85,270	3,07,921	95,047	2,12,874	31

The low rate of disposal in the two years has increased the pendency of the assessments. The CCT had issued instructions in November 2007 and August 2008 directing the assessing authorities to pass assessment orders immediately on acceptance of the returns. A monthly return was also being submitted by the assessing authorities to the CCT through their controlling officers. The huge pendency of assessment cases despite these measures indicates that the monitoring system requires strengthening.

**2.2.10.1** The TNVAT Act provides for selection of not more than 20 per cent of the assessment cases where orders are passed on the basis of the returns, for detailed scrutiny. **The Act, however, does not prescribe a time limit within which the scrutiny of the returns has to be made.**

Audit noticed in 13 assessment circles that only 249 assessments had been checked out of 772 selected for scrutiny. Scrutiny in the balance 523 cases had not been done because of non-production of accounts by the dealers.

**The Government may consider prescribing a statutory time limit for passing of the assessment orders, production of the accounts by the dealers selected for detailed scrutiny and completion of the scrutiny under the TNVAT Act.**

### **2.2.11 Absence of provision for proportionate fixation of turnover**

The sale of certain commodities like vegetable oil upto a turnover of Rs. 500 crore for a year was exempt under the TNGST Act. The exemption was continued under the TNVAT Act. Section 3(4) of the TNVAT Act affords an option of paying compounded rate of tax of 0.5 *per cent* to dealers whose turnover for a year is less than Rs. 50 lakh. The TNVAT Act, however, did not provide for proportionate restriction of turnover limit for claim of exemption/compounding payment of tax to Rs. 125 crore/Rs. 12.5 lakh respectively for the year 2006-07 as it was introduced with effect from 1 January 2007. The absence of such a provision had resulted in foregoing of revenue of Rs. 13.76 crore as detailed below:

- Two dealers of vegetable oil in Washermanpet-II and Virudhunagar-I assessment circles were granted exemption from payment of tax, though the turnover of the dealers under the TNVAT Act for the year 2006-07 was Rs. 126.96 crore and Rs. 181.75 crore respectively. This resulted in foregoing of revenue of Rs. 12.35 crore.
- Audit noticed that in 23 assessment circles<sup>3</sup>, 75 dealers whose turnover under the TNVAT Act for the year 2006-07 was in excess of Rs. 12.5 lakh had exercised the option to pay tax at the compounded rate of 0.5 *per cent* instead of at the scheduled rates. This resulted in foregoing of revenue of Rs. 1.41 crore.

The details of exemption granted in respect of similar commodities though called for in August 2009, were not furnished (January 2010).

### **Compliance deficiencies**

#### **2.2.12 Input tax credit**

##### **2.2.12.1 Incorrect allowance of claim of the ITC on closing stock**

The TNVAT Act provides for allowance of the ITC to a registered dealer for the sales tax paid under the TNGST Act on the goods (excluding capital goods) purchased between 1 January 2006 and 31 December 2006 and held in stock on the date of commencement of the Act, subject to certain prescribed conditions. The dealer claiming the ITC on closing stock shall submit a stock inventory statement in duplicate in Form V alongwith photostat copies of related purchase invoices within 59 days from the commencement of the VAT Act.

- Test check of the records in 11 assessment circles<sup>4</sup> conducted between April 2008 and March 2009 indicated that the assessing authorities, while allowing ITC in 17 cases, failed to ensure that the conditions like submitting a stock inventory statement in duplicate in Form V, photocopies of the invoices

<sup>3</sup> Avinashi Road, Dindigul I, Erode (Rural), Mailamchandai-II, Palayamkottai, Park Road, Nethaji Road, Salem (Bazaar), Sathy Road, Sivakasi-I & II, Srirangam, Tambaram-I Thiruverumbur, Tirunelveli (Junction), Tuticorin I, II & III, Udumalpet (North), Vellore (Rural) and Virudhunagar-I, II & III.

<sup>4</sup> Adyar-I, FTAC-I (Coimbatore), FTAC-III & IV (Chennai), Hosur (North) & (South), Saidapet, Shevapet, Tiruchengode, Tiruvanmiyur and Tiruvottriyur.

stipulated in the Act for claim of the ITC etc. were followed by the dealers. This resulted in excess allowance of ITC of Rs. 3.70 crore.

After this was pointed out, the assessing authority reversed the excess credit and collected Rs. 1.57 lakh in one case. The reply in respect of the remaining cases has not been received (January 2010).

- Section 88(6)(a) of the TNVAT Act provides that every registered dealer shall be entitled to claim the ITC for the sales tax paid under the TNGST Act on the goods held in stock excluding capital goods.

Test check of the records in 28 assessment circles<sup>5</sup> indicated that the ITC allowed on closing stock included the amount of surcharge paid under the TNGST Act. This resulted in incorrect allowance of the ITC of Rs. 1.07 crore.

- The TNVAT Rules require the assessing authority to scrutinise the stock inventory in the Form V filed by the dealers and pass orders within seven months from the date of commencement of the Act.

Test check of the records in 13 assessment circles indicated (August 2009) that the assessing authorities did not pass orders in 439 cases involving the ITC of Rs. 10.31 crore required to be passed within seven months from 1 January 2007. Thus, the correctness of the claim of the ITC could not be verified.

#### **2.2.12.2 Incorrect allowance of ITC in the absence of original tax invoices**

According to the Section 19(1) of the TNVAT Act, the registered dealer who claims the ITC shall establish that the tax due on the purchases has been paid by him in the manner prescribed. Section 22(2) of the TNVAT Act provides that the returns shall be accompanied by proof of payment of the tax and the prescribed documents. Rule 10(2) of the TNVAT Rules stipulates that every registered dealer who claims the ITC shall produce the original tax invoice in support of the claim.

Information received from 102 assessment circles indicated that the ITC of Rs. 602.77 crore had been allowed in respect of 51,120 cases during 2006-07 though the claims were not supported by original tax invoices.

After this was pointed out, the assessing authorities contended (between October 2008 and March 2009) that calling for invoices was not warranted in a self assessment regime and the correctness of the claim would be verified at the time of scrutiny of assessment with reference to accounts.

The reply is not in consonance with the TNVAT Rules, which provide for compulsory filing of original tax invoices in support of the claim of the ITC.

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<sup>5</sup> Brough Road, Chokkikulam, FTAC-II & IV(Chennai), Ganapathy (Coimbatore), Hosur (North), Kamarajar Salai, Karur (East) & (North), Madurai (Rural)(South), Mettur, Nethaji Road, Ramanathapuram, Salem (Bazaar), Salem (North), Salem (Rural), Shevapet (North), Sivakasi-II, Tirunelveli (Bazaar), Tuticorin-I & II, Tirunelveli (Junction), Tirupparankundram, Virudhunagar-I, II & III, West Tower Street circle and West Veli Street Circle.

### **2.2.12.3 Issue of refunds in violation of procedure**

According to Section 18 of the TNVAT Act, export sales and sales in the course of export are classified as zero rate sales. Section 18(2) provides that the dealer, who makes zero rate sales, shall be entitled to refund of input tax paid or payable by him on purchase of those goods which are exported as such or consumed in the manufacture of other goods that are exported. Rule 11 (2) of the TNVAT Rules stipulates that the assessing authority after verification of the correctness of the claim of refund preferred by the dealer, shall issue the refund within ninety days of receipt of application from the claimant.

Test check in 30 assessment circles<sup>6</sup> indicated that the refund amounting to Rs. 57.29 crore had been made in 1,567 cases, without ensuring that the tax in respect of the purchases relating to zero rate sales had been remitted to the Government account.

After this was pointed out, the assessing authorities stated that the CCT had clarified in August 2007 that the refunds could be made after ensuring the existence of the sellers and the verification of the tax payment by them is not necessary. The clarification was not in consonance with the rule which stipulates that the refund should be issued after proper verification.

### **2.2.13 Other points of interest**

#### **2.2.13.1 Absence of definition for the term “accrual of claim” in respect of zero rate sales**

According to section 18 (3) of the TNVAT Act, claim for refund of ITC in respect of zero rate sales shall be made within one hundred and eighty days from the date of accrual of the ITC. The term “accrual of claim” has neither been defined in the Act nor in the Rules. The CCT had clarified in August 2007 that “accrual of claim” was from the date of filing of the returns. The CCT had again clarified in September 2007 that it was from the date of zero rate sales. The two clarifications are contradictory.

After this was pointed out, the CCT stated (November 2009) that “accrual of claim” was from the date of export and an amendment in this regard was being proposed by the department.

#### **2.2.13.2 Revenue foregone due to issue of incorrect notification**

According to entry 8 of Part B of the First Schedule to the TNVAT Act, as it existed on 1 January 2007, bakery products including biscuits with or without brand name were taxable at the rate of four *per cent*.

Audit noticed that the department had proposed an amendment for levy of tax at 12.5 *per cent* in respect of branded bakery products by deletion of the words “with or” appearing in entry 8 of Part B. The proposal was approved by the Government but while carrying out the proposed amendment, a separate

<sup>6</sup> Adyar I, Alwarpet, Amaindakarai, Ayyanavaram, Egmore I & II, Evening Bazaar, Esplanade I & II, Guindy, Harbour II, Loansquare I, Mannady (East) & (West), Luz, Manali, Nandanam, Nungambakkam, Peddunaickenpet (North), Purasawalkam, Royapettah I & II, Tambaram II, T.Nagar, (North), (South) & (East), Tondiarpet, Tiruvanmiyur, Vallalarnagar and Valluvarkottam.

notification was issued in March 2007 reducing the rate of tax on unbranded biscuits. Accordingly, biscuits sold with brand name continued to be taxed at four *per cent*. Later, the Government amended entry 8 of Part B of the first schedule in June 2007 by deletion of the words “with or” appearing therein. This notification was given retrospective effect from 1 January 2007. Based on the opinion of the CCT that the retrospective amendment would result in hardship to the dealers in branded biscuits, as they would have collected tax at lower rate, the Government issued a notification in July 2007 reducing the rate of tax on sale of branded biscuits to four *per cent* for the period from 1 January 2007 to 7 June 2007.

The issue of an erroneous notification in March 2007 had resulted in foregoing of revenue of Rs. 13.58 crore in respect of four dealers in four assessment circles<sup>7</sup> on the sales turnover of branded biscuits of Rs. 159.75 crore for the period from 1 April 2007 to 7 June 2007.

### **2.2.13.3 Deficiencies in uploading of data in the TINXSYS**

The Empowered Committee of State Finance Ministers authored a website named TINXSYS (Tax Information Exchange System) as a repository of interstate transactions. This is mainly aimed at helping the commercial tax department to monitor interstate trade effectively.

The details regarding the number of ‘C’ and ‘F’ forms issued to the dealers and the information regarding utilisation of the forms as obtained from the TINXSYS indicate that as against the issue of 44,61,925 forms, details of utilisation of 1,82,617 forms were uploaded on the website. This was because details of utilisation of forms from the dealers had not been obtained before issuing the forms.

Audit scrutiny in eight assessment circles indicated that the forms were again issued to 156 dealers without obtaining the details of usage of 10,270 forms issued to them earlier.

The delay/omission to upload the details of utilisation of forms would tend to defeat the very purpose of the creation of the website, viz., effective monitoring of inter state trade. In the absence of verification of used forms, the possibility of misuse and consequent evasion of tax cannot be ruled out.

**The department may consider issuing instructions for submission of utilisation certificates by the indenting dealers before the issue of fresh declaration forms.**

### **2.2.13.4 Absence of mechanism to evaluate the prices**

The Empowered Committee envisaged fall in prices of the commodities on the introduction of the VAT.

Audit undertook a study of the maximum retail sale price (MRP) rates of commodities governed by Section 4A of the Central Excise Act. Test check indicated that 13 manufacturers of commodities falling under the categories of cosmetics, aerated drinks, pharmaceutical products, paints, bakery products and food preparations had not reduced the MRP rates. The benefit of

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<sup>7</sup> Fast Track Assessment Circle-IV (Chennai), Hosur (North), Tindivanam and Tiruvottriyur.

reduction of taxes not passed on to the general public by the manufacturers of these goods during the period from January 2007 to March 2007 worked out to Rs. 40.28 crore.

The department had no mechanism to check if the benefit of reduction in tax rates had been passed on to the general public.

**The Government needs to monitor these prices so that the benefit of reduction in tax rates is passed on to the general public.**

#### **2.2.13.5 VAT compensation**

The Government of India had agreed to compensate the State Governments for the loss of revenue consequent to the implementation of the VAT. The Government of Tamil Nadu preferred a claim of Rs. 2,962.35 crore for the calendar year 2007.

Audit scrutiny of the compensation claim indicated that while the amount of deferred sales tax and entry tax realised during the years 1999-2000 to 2003-04 were included for the purpose of arriving at the projections for the year 2007, these receipts were not included in the computation of the actual revenue realised during the calendar year 2007. The Government of India restricted the claim amount to Rs. 1,515.45 crore for 2007 based on the observation of audit. The Government of Tamil Nadu, however, continued with the same practice in working out a claim of Rs. 2,062.39 crore for the calendar year 2008. The Government of India has restricted the claim to Rs. 1,498.96 crore.

The Government needs to compute the compensation claim correctly.

#### **2.2.14 Enforcement wing**

Under the TNVAT Act, the departmental officers authorised by the Government are empowered to conduct inspection of the business premises of the dealers to unearth evasion of the tax.

The data gathered in the review indicate that the enforcement wing had remained almost dormant after introduction of the Act, as observed from the decline in their activities as detailed below:

Year wise details of shop inspection/test purchases of the Enforcement Wing					
Functions	2005-06	2006-07	Percentage with reference to pre-VAT period (2005-06)	2007-08	Percentage with reference to pre-VAT period (2005-06)
Shops inspected	9,313	1,572	16.87	7	0.01
Test purchase made	2,829	Nil	Nil	Nil	Nil

The reasons for ineffectiveness of the wing though called for in August 2008 have not been received (January 2010).

### **2.2.15 Internal audit**

Internal audit, which provides reasonable assurance of proper enforcement of the laws, rules and departmental instructions, is a vital component of internal control. It is generally defined as the control of all controls to enable an organisation to assure itself that the prescribed systems are functioning reasonably well.

Audit observed that internal audit of the assessments, receipts and refunds was not being conducted by the department. The department stated in September 2009 that under the VAT regime, no internal audit was conducted due to vacancies in the internal audit wing. The department added that internal audit was being conducted only in the assessment circles where the assessing officers were due to retire.

**The Government may strengthen the internal audit mechanism. The scope, extent and modality of monitoring of internal audit need to be defined and implemented.**

### **2.2.16 Conclusion**

The review revealed that the department had failed to formulate a time bound action plan for attaining finality in respect of the matters relating to the erstwhile Act. It had not put in place a system for recovery of the arrears of revenue and for implementation of taxation proposals. The department did not foresee the implications of certain terms/definitions in the Act while introducing the Act in the midst of a year. The transitional issues were not addressed adequately and this led to a number of system and compliance deficiencies. The VAT Act did not provide for conducting of surveys or cross verification with other departments for identification of fresh cases of assessments. The returns under the Act were found deficient in accommodating the claim of ITC, if not made in the month of the purchase. The VAT Act did not provide for a deterrent measure to prevent submission of incorrect returns and time limit for finalisation of assessments. Refunds were made without ascertaining their correctness. Issue of an erroneous notification resulted in foregoing of revenue. The review also indicated that the department did not gear up adequately to meet the requirements/challenges to ensure smooth transition. Audit also noticed that the compensation claimed by the Government of Tamil Nadu was incorrect. The internal controls of the department need to be strengthened to enable the authority at the apex level to keep a close watch on the implementation of the Act.

### **2.2.17 Summary of recommendations**

Government may consider:

- formulating an effective action plan to facilitate and monitor the finalisation of assessments at the earliest;
- fixation of targets for collection of arrears of tax due and monitoring of the performance of the assessing authorities;

- formulation of a time bound action plan for finalisation of the pending taxation proposals to ensure that no proposal escapes implementation beyond the prescribed time;
- bringing a specific provision in the Act to enable the registering authority to exercise certain basic and vital checks, before granting registration to ensure the authenticity of the application for registration. Similarly, suitable measures may be instituted for undertaking cross verification with the records of other departments for detecting unregistered dealers;
- modification of the formats of the prescribed returns in order to make them compatible with the provisions of the Act/Rules;
- prescribing a statutory time limit for passing of assessment orders, production of accounts by dealers selected for detailed scrutiny and for completion of scrutiny under the TNVAT Act; and
- prescribing penalty for submission of incorrect/incomplete returns to act as an effective deterrent against any attempt of tax evasion by the dealers.

## **2.3 Computerisation of Value Added Tax (VAT) Information System in Commercial Taxes Department**

### **Highlights**

- Lack of URS, system design and its documentation while switching over to the new environment of VAT computerisation exposed the lack of preparation at the time of customisation.

**(Paragraph 2.3.6.1)**

- Absence of proper connectivity between the client and server resulted in non generation of notices at circle level and consequent delay in realisation of revenue.

**(Paragraph 2.3.7.3)**

- Absence of input and validation controls in vital fields like TIN, rate of taxes resulted in lack of the data integrity and reliability.

**(Paragraph 2.3.8)**

### **2.3.1 Introduction**

The Commercial Taxes department, as part of its e-governance initiatives, planned to achieve a smooth transition to the VAT system by introducing e-services like e-registration, e-filing of returns, e-request for supply of forms and e-assessment by upgrading the existing hardware, software and network. It also planned to achieve upgradation of the facilities to capture return information quickly, avoiding manual data entry and safeguard against false claim of input tax credit and refund claim of the exporters.

With a view to implement the above objective, the Government of Tamil Nadu engaged M/s. Pallavan Transport Consultancy Services as its consultant in 2003. The department undertook the implementation of computerisation in various stages at a cost of Rs. 37.41 crore.

- The stand alone applications<sup>8</sup>, which were customised in-house and installed in all the 323 assessment circles, comprise registration module and return processing module under the VAT Act.
- The internet applications<sup>9</sup> comprise a website developed by the National Informatic Centre (NIC) and offer the following services, viz., online application for registration, e-filing of monthly returns, e-request of the saleable forms, online facility to know the details of a dealer, rate and schedule of a commodity, status of the refunds and the availability of the saleable forms.
- The intranet applications<sup>10</sup> are used for generation of live reports on revenue collection, MIS reports like return filed status, return audit, scrutiny of the data already entered in the offices, online cross

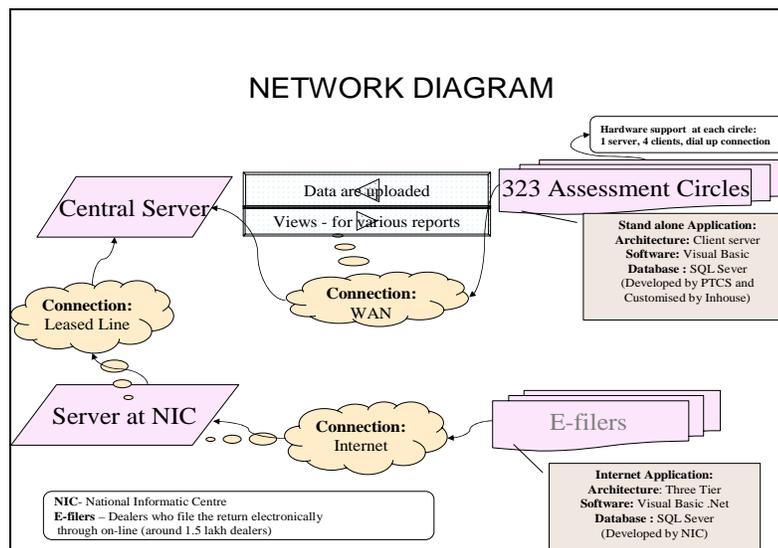
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<sup>8</sup> using Oracle as back end and Visual basic as front end.

<sup>9</sup> using Oracle as back end and VB.NET as front end.

<sup>10</sup> using Oracle as back end and VB.NET as front end.

verification of ITC<sup>11</sup> availed by the dealers, generation of notice for wrong claim and uploading of annexure to Form I and statutory forms.



At present, the filing of monthly returns by the assesseees is being done both manually and also through e-filing. The data captured in the stand alone database is exported to the central server through Wide Area Network (WAN)<sup>12</sup>. Capturing of the details of purchase and sales annexed to the monthly returns for the period pertaining to the previous two years has been outsourced. As regards e-filing, the return is entered online and the details regarding purchase and sales are uploaded as 'Excel file attachment' to the NIC server<sup>13</sup>, a copy of which is transmitted to the central server<sup>14</sup>. At present, 1.5 lakh dealers out of 5 lakh registered dealers (30 %) utilise the online facility to file their monthly returns.

**A review of the computerisation of the Value Added Tax Information System in the Commercial Taxes Department was conducted by Audit. It indicated a number of system and compliance deficiencies which have been discussed in the subsequent paragraphs.**

### 2.3.2 Organisational structure

The Secretary, Commercial Taxes and Registration department (CT department) is the head of the department at the Government level. The Commissioner of Commercial Taxes (CCT) is the head of the Commercial Taxes department and is assisted by the Additional Commissioners, Joint Commissioners and Deputy Commissioners who exercise administrative

<sup>11</sup> Input tax credit – Section 19(1) of TNVAT Act provides for input tax credit of the amount of tax paid or payable under this Act, by the registered dealer to the seller on his purchases of taxable goods specified in the First schedule. The registered dealer, who claims input tax credit, shall establish that the tax due on such purchases has been paid by him in the manner prescribed.

<sup>12</sup> WAN- A wide area network (WAN) is a computer network that connects a broad area.

<sup>13</sup> located in the NIC premises.

<sup>14</sup> located in department's premises.

control. The Central Computer centre of the CT department is headed by the Joint Commissioner (Computer Systems) and functions with three programmers, four deputy programmers and eight assistant programmers.

### **2.3.3 Audit objective**

The information technology audit of computerisation of VAT was undertaken with a view to ascertain that

- there exists proper documentation for system design, user requirement specification and system requirement specification;
- proper acceptance testing such as programme testing, system testing, user testing and quality assurance testing was done;
- the system meets the requirements of the TNVAT Act and is synchronised with the critical business rules of the department;
- proper input, validation and process controls exist in the system to ensure the authenticity, completeness and accuracy of the data;
- the database provides sufficient, complete, reliable and authorised information for management action; and
- there exists adequate security controls and disaster recovery plan.

### **2.3.4 Scope and methodology of audit**

Test check of the records of five assessment circles<sup>15</sup> was conducted to study the system in place. Further, the data available for the period from January 2007 to October 2008 in the central server of the department was obtained and examined using structured query language (SQL) to check their adequacy and reliability. The mapping of business rules and the controls available in the application software were ascertained through an examination of the data entry screens.

### **2.3.5 Acknowledgement**

The Indian Audit and Accounts Department acknowledges the co-operation of the CT department in providing necessary information and records for audit. An entry conference was held in April 2009 in which audit objectives and methodology were explained. The exit conference was held in August 2009 with the Commissioner and officers of the CT department and officials of NIC in which results of audit and recommendations were discussed. The draft review was forwarded to the department and the Government in August 2009 and replies received from the department during the exit conference and at other times have been appropriately reflected in the review report.

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<sup>15</sup> Fast Track Assessment Circle (FTAC) I, Chennai, FTAC II, Chennai, Sowcarpet I, Sowcarpet II and Manali.

**Audit findings****System deficiencies****2.3.6 General controls**

General controls relate to the environment within which the development and implementation of IT systems are carried out. The objectives of the controls are to ensure effective development, implementation and maintenance of the IT systems. An assessment of these controls indicated the following deficiencies.

**Planning**

**2.3.6.1** As a preparatory step towards introduction of the TNVAT Act, the Government sanctioned an amount of Rs. 1 crore for consultancy and development work and the same was entrusted to M/s. Pallavan Transport Consultancy Services (PTCS) in January 2003. As the vendor expressed difficulty to continue with the project (January 2005), the department paid an amount of Rs. 0.57 crore for the completed modules<sup>16</sup>. Further, under the e-governance plan (August 2004), the Government sanctioned Rs. 15.80 crore, out of which Rs. 13.09 crore was spent for extending e-services<sup>17</sup> through NIC.

The TNGST modules developed by the PTCS were further customised by in-house developers for VAT. This was implemented in all the 323 assessment circles for capturing information of manual filers. In the absence of the documentation<sup>18</sup>, audit could not find out whether the issues brought out in the succeeding paragraphs were due to user requirements not being identified initially or due to deficiency in the stages of development of the software. Later, the department paid Rs. 0.45 crore (March 2007) to M/s. Electronics Corporation of Tamilnadu Ltd. (ELCOT) for the development of the integrated web based software<sup>19</sup>.

Audit scrutiny indicated that the department was already using a web based application developed by the NIC to enable online e-filing of the monthly returns by the dealers. The department could have customised this existing web based application developed by the NIC after rectifying the deficiencies noticed and utilised it by creating more users and providing appropriate access rights. Instead, the department opted for developing a new application through M/s. ELCOT which was a duplication of the work. Further, no URS was prepared or timeframe set while entrusting the work to the ELCOT. It was also noticed that the vendor had not prepared SRS or SDD and was yet to deliver the software (August 2009).

<sup>16</sup> For TNGST, Check post movement and appellate wing.

<sup>17</sup> Like e-registration, e-filing of returns, e-payment, e-assessment, e-request for supply of forms.

<sup>18</sup> User requirement specification (URS), System requirement specification (SRS) or System design document (SDD).

<sup>19</sup> Covering the functions such as On-line dealer registration, e-return filing and capturing of data contained in the manual return filed by the assessee at the circle office, tax collection and refund, saleable form, self assessment order.

**2.3.6.2** Based on the project report submitted by PTCS, the department had an initial plan of adopting ICR<sup>20</sup> and VPN<sup>21</sup> technology and sanctioned Rs. 1.24 crore during 2006 for capturing the data of monthly returns. However, the department did not procure the required hardware. Instead, it diverted (March 2009) Rs. 1.20 crore for procurement of other hardware and enhancing the infrastructure of NIC server after three years.

The essence of the VAT is the concept of the ITC. The details of purchase and sales furnished with the returns have to be cross checked with the other returns of same/other circles to verify the correctness of the claims.

Due to non-adoption of the initial plan, the data pertaining to the period from January 2007 to June 2008 (approx 15 crore records) were pending to be captured in the system and the ITC amounting to Rs. 9,586 crore in respect of returns filed is yet to be verified. Failure of the department to execute its initial plan had resulted in delay in capturing the data, besides expenditure of Rs. 5.25 crore on outsourcing of the manual data entry of voluminous pending records. The work was yet to be completed.

**2.3.6.3** In the absence of documentation, the various stages of system development, back up, physical and logical security could not be analysed.

The department while accepting the non-existence of necessary documentation, stated (October 2009) that this would be carried out in the web based software being developed by the ELCOT.

### **2.3.7 Application controls**

#### **2.3.7.1 Acceptance testing**

The process of acceptance testing is to identify, as far as possible, the errors and deficiencies which can exist in the software supporting the system, the user interface, the procedure manuals, the job design and the organisational structure design, if any, prior to its final release for putting into use. Acceptance testing is carried out to identify these errors or deficiencies before these errors cause a widespread adverse impact.

Audit scrutiny indicated that acceptance tests like the programme and the system user quality assurance were not carried out by the department.

The department replied (August 2009) that quality assurance testing was not carried out in the existing software and it would be carried out in the Web based software being developed by the ELCOT.

#### **2.3.7.2 System design**

The return processing module captures the tax payable details (tax due from the dealers) from the monthly return furnished by the dealers. The collection module captures the details of tax collected from the dealer. Tax collected may be on account of tax paid under TNVAT, CST, interest for belated payment of tax, if any, penalty, if any, cost of forms, etc. The collection module does not

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<sup>20</sup> Intelligent character recognition (ICR) is process that translates handwritten text into machine readable characters. ICR technology permits data capture software to automatically read information from all types of documents.

<sup>21</sup> Virtual private network.

have separate head wise provision for capturing the details of collection of various components like entry tax, TDS, VAT, CST, advance tax at check post, interest, etc. The tax collection could not, therefore, be correlated with the tax due.

Data analysis indicated that in 11,078 returns the details of tax paid in the monthly returns was at variance with the details of the tax collected.

After this was pointed out, the department attributed (August 2009) the variance to the non-availability of separate provisions for entry tax, TDS, advance tax at check post, payment of interest, etc.

**The Government may consider providing for a separate provision in the system for capturing the details of various taxes/various elements to ensure the correctness of tax collection.**

### **2.3.7.3 Mapping of business procedures**

The responsibility of the cross verification of information furnished by the dealers rests with the assessing officers at the circle level. However, it was noticed that the facility of the cross verification was not provided at the circle level. Instead, after cross verification, notices were generated at the central level where the central server was located. The officials at the central levels are not responsible for issuing the notice and they communicate it to the circles through email. Thus, though the responsibility had been vested with the concerned assessment officials of the circles they are solely depended upon the information provided to them by those at the central level.

Audit scrutiny indicated (August 2009) that in June 2009, 9,909 notices were generated at the central level and sent to the concerned circles. Out of these, only 1,987 notices were issued to the dealers by the assessment circles. Non-mapping of this business procedure in the IT environment by generation/issue of notices at the circle level resulted in deficient assurance on the correctness of the claim/tax paid.

- Online monthly return required to be filed by the dealer contains information like tax paid during the period for purchases, tax payable through sales and these are supported by the details of purchase and sales. However, the tax credit and the tax payable were not generated through the system from the details of the purchase and sales. Instead, users were required to manually enter the details once again in the return format. This indicated that the process of capturing information for the main return from the details given against the purchases and sales was not mapped in the system.

Audit observed that in 64,061 returns, the ITC claimed in the return was in excess of the eligible amount of VAT paid as exhibited in the details of purchase/sales.

The department replied (August 2009) that efforts had been made to ensure the correctness of information through generation of notices after cross verifying the details and corrective action taken in many cases and in the absence of the provision for correcting the errors, the corrections could not be incorporated in the system.

- Further, the system also allowed the users to manually enter the amount of VAT instead of it being derived automatically from purchase/sales turnover and commodity codes furnished by the dealer using the tax rates available in the system. As a result, the arithmetical accuracy for the amount of VAT paid i.e., the amount of purchase multiplied by the tax rate was not ensured by the system in respect of 99,838 instances in 94,376 returns.

**The Government may consider providing a system which automatically captures the return information from the details of purchases and sales entered manually and ensure mapping of business procedures and restricting repeated manual entry to improve integrity of data.**

### **Compliance deficiencies**

#### **2.3.8 Input control/validation checks**

Input controls ensure that the data received for processing is genuine, complete, properly authorised and entered accurately without duplication. It was observed that both in manual data entry and e-filing of returns, the software captures data as such and no controls were programmed to check and validate the data. The discrepancies in input/validation checks noticed are mentioned below:

##### **2.3.8.1 Input control**

- **Tax payers Identification Number (TIN)**

Audit scrutiny of the purchase details furnished by the dealers alongwith the 'I' return<sup>22</sup> indicated that in 8,30,142 purchases mentioned in 1,11,825 returns, the seller's VAT number contained invalid TIN, alphabets and undefined state codes which were not between 01 and 35. Similarly, the sales details furnished by the dealers alongwith the monthly returns were found to contain invalid TIN, alphabets and undefined state codes in 44,48,986 instances in 2,82,800 returns.

The department replied (August 2009) that the cases of invalid TIN, lesser digits, alphabets and undefined state codes had been identified by the department and notices had been generated and sent to the circles.

The genuineness of the TIN registration, the details of the dealers, inter state purchase, eligibility of ITC could be verified only with proper entry of TIN. The system did not validate the data entered, as was evident by the mistakes noticed in the returns. The lack of supervisory input controls has resulted in accepting returns with large number of errors and also made verification of the above facts difficult.

- **Commodity codes and tax rates**

The system contained the data relating to various commodity codes, their description and the rates of tax. In the absence of input controls, the system allowed capture of incorrect commodity codes and failed to validate both commodity codes and tax rates with reference to details available in the system.

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<sup>22</sup> 'I' return - Value added tax Monthly Return furnished by the assessee to the department.

- It was noticed during data analysis that the system accepted data entry of 398 invalid commodity codes in 31,440 instances.

After this was pointed out, the department accepted (August 2009) that the software did not have the provision for validating the commodity codes.

- It was also noticed that in 360 instances in 144 returns, tax in excess of the applicable rate of one *per cent*; in 1,51,570 instances in 7,714 returns, tax in excess of the applicable rate of four *per cent* and in 5,598 instances in 1,018 returns, tax in excess of the applicable rate of 12.5 *per cent* were allowed to be entered in the returns. It was also noticed that instead of the applicable tax rates i.e. (one *per cent*/four *per cent*/12.5 *per cent*), various incorrect rates such as 8,301, 2.82, etc. were also allowed to be entered in respect of the commodity codes 2001 to 2150 and 301 to 369.

After this was pointed out, the department stated (August 2009) that these errors were due to wrong entry of commodity code and also stated that the errors were communicated to the circles for rectification.

**The Government may consider incorporating proper input control to avoid incorrect data entry.**

#### 2.3.8.2 Validation checks

- **Carry forward of the ITC**

The closing balance of the ITC of the previous month has to be automatically considered as the opening balance of ITC in the succeeding month. Audit noticed a difference of Rs. 960.48 crore between the opening balance and closing balance of the ITC in 1,28,147 returns including 11,924 returns of e-filers.

After this was pointed out, the department accepted (August 2009) the absence of validation in this regard.

**The Government may consider modifying the software to ensure that the closing balance of the ITC of the previous month is the opening balance of the succeeding month.**

- **Reverse credit**

The details regarding the claim relating to reversal of the ITC<sup>23</sup> during the month should also be annexed separately alongwith the monthly return. Data analysis indicated that in 44 returns, the ITC reversal amount shown in the annexure varied with the reverse credit amount shown in the monthly return. In respect of 23 returns, the reverse credit amount as per the return was less than the reversal amount as per the annexure, resulting in excess credit of Rs. 1.74 lakh. This indicated deficient validation checks in this regard.

The department replied (August 2009) that the cases would be reviewed.

<sup>23</sup> Reverse credit – Where a purchasing dealer has returned the goods to the seller for any reason, the input tax credit claimed already on the purchase by the dealer shall be liable to reversal of tax credit on such goods returned, in the manner as may be prescribed.

- **ITC on closing stock**

ITC available on the closing stock held by the dealers on 31 December 2006 under the TNGST Act<sup>24</sup>, was allowed to be availed within the next six months and the closing stock as on 31 December 2006 was captured in the system.

Audit scrutiny indicated that the software did not have provision to restrict the availing of the ITC on closing stock against the eligible closing stock while permitting the dealer to avail of such credit in the next six months. Data analysis showed that in 1,648 returns, the ITC availed of by the dealers in the monthly returns was more than the eligible amount of the ITC on closing stock resulting in excess claim of the ITC of Rs. 47.20 crore. Failure to validate the ITC credit availed of after the implementation of TNVAT Act against the ITC as per closing stock declared initially resulted in availing of excess ITC.

The department replied (August 2009) that this was due to data entry error initially while feeding the data and those cases had been referred to the assessment circle concerned. The differential amount had been collected in other cases. The fact remains that the data entry errors are yet to be corrected in the system.

- **Exempted goods**

The TNVAT Act stipulates that no input tax credit shall be allowed in respect of sale of goods specified in the Fourth Schedule which are exempt under Section 15. The system did not have the provision to validate/disallow the ITC claimed for the purchase of exempted goods.

Data analysis indicated that in respect of 1,032 returns, claim of ITC for Rs. 9.80 crore had been preferred by the dealers in respect of the exempted goods.

After this was pointed out, the department stated (August 2009) that the claim may be due to error in entry of commodity codes. The fact remains that the system should have been so designed that any ITC claim in respect of the exempted goods should have been derived from the details available rather than allowing for data entry.

- **Capital goods**

The TNVAT Act provides for allowance of the ITC credit on capital goods and the capital goods were identified with a specific commodity code, viz., 2025. The system allowed entry of commodity codes other than 2025, viz., 301, 2067, 2041 etc to indicate the capital goods.

Data analysis indicated that in 4,136 returns, the software allowed ITC credit for goods with codes other than 2025 indicating the absence of validation check in the program.

After this was pointed out, the department replied (August 2009) that in respect of goods under commodity code 301, notices were issued to disallow the claim of the ITC. The reply is not tenable as though all these three

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<sup>24</sup> Tamil Nadu General Sales Tax Act – The Act which was in existence prior to implementation of TNVAT Act (1.1.2007).

commodities are eligible for the ITC, the same could not be classified as capital goods.

**The Government may consider incorporating proper input/validation control to avoid incorrect data entry.**

### **2.3.9 Other points of interest**

#### **2.3.9.1 Saleable Forms**

Saleable forms viz., Form C is issued for interstate purchases, Form F is issued during stock transfer between branches. These are issued to the dealers during inter state purchases for availing of concessional rate of tax.

Audit observed the following discrepancies:

- The database has the details about the cost of different types of the saleable forms. The cost of a form is to be extracted by the system automatically from the database to populate the relevant field. However, it was noticed that the system allowed manual intervention to input the cost of the saleable forms and that too at the rates even lower than the prescribed rate. This resulted in short collection of revenue of Rs. 2.08 lakh in 67,466 forms.
- Though the saleable forms were issued to 63,737 dealers, the usage details were available only for 5,597 dealers. As the information of usage of the saleable forms is incomplete, proper usage of these forms could not be verified through the system.
- Audit noticed the existence of 158 different types of dummy values in the book series number of the saleable forms. Further 11,761 forms valuing Rs. 2.27 lakh were also sold using these dummy book series number.

After this was pointed out, the department replied (August 2009) that the dummy series entered were data entry errors and since the issues were made using dummy series numbers, the usage detail of such forms could not be verified through system.

**The Government may consider capturing complete information regarding usage of saleable forms in the system to verify their genuineness. Necessary input control may be put in place to avoid entry of dummy series number.**

#### **2.3.10 Conclusion**

Audit observed that user requirement specifications were not identified nor was there any documentation of the system development. Thus, it could not be identified whether the control deficiencies pointed out in audit were due to deficient identification of user requirement or inadequacies in system development. Absence of any testing of the system indicated a deficient system implementation strategy by the department. Deficient mapping of business procedure, deficient input control and validation checks have made data incomplete, inaccurate and unreliable. In the absence of provision to

make corrections of errors made during e-filing of returns, the accuracy and utility of the data available in the system could not be verified.

### **2.3.11 Summary of recommendations**

The Government may consider:

- providing a separate provision in the system for capturing the details of various taxes/various elements to ensure the correctness of tax collection;
- providing a system which automatically captures the return information from the details of purchases and sales entered manually and ensure mapping of business procedures and restricting repeated manual entry to improve integrity of the data;
- incorporating proper input control to avoid incorrect data entry;
- redesigning the software to adopt the closing balance of the ITC of the previous month as the opening balance of the succeeding month and putting in place suitable controls at higher level for effecting corrections; and
- incorporating proper input/validation control to avoid incorrect data entry.

## **2.4 Other audit observations**

*Scrutiny of the records in the offices of the Commercial taxes department indicated several cases of non-observance of the provisions of the Acts/Rules resulting in application of incorrect rates of tax, incorrect grant of exemption/concessional rate of tax, non/short levy of interest/penalty and other cases as mentioned in the succeeding paragraphs in this chapter. These cases are illustrative and based on test check carried out in audit. Although such omissions are pointed out every year, the irregularities do persist; and remain undetected till the next audit is conducted. There is need for improving the internal control mechanism so that such omissions can be detected and rectified at the very beginning.*

## **2.5 Incorrect grant of exemption from levy of tax**

Under Section 8(2)(b) of the Central Sales Tax Act, 1956 (CST Act), interstate sale of goods other than declared goods, not covered by valid declarations in Form 'C' is assessable to tax at the rate of 10 *per cent* or at the rate applicable to the sale of such goods inside the State, whichever is higher.

Section 6A of the CST Act provides for exemption where the movement of any goods from one state to another was occasioned by reason of transfer of such goods to the other state and not by reason of sale. The burden of proving that the movement of those goods was so occasioned shall be on the dealer. For this purpose, the dealer shall produce declaration in the Form 'F' duly filled and signed by the principal officer of the other place of business or his agent or principal as the case may be. In case of disallowance of exemption, in addition to tax, the assessing authority shall also levy penalty depending on the percentage of difference between the tax assessed and paid as per returns.

Test check of the records in Bodinayakanur assessment circle indicated that the assessing authority while finalising the assessments of four dealers for the years 2003-04 and 2004-05 in April 2006, had allowed exemption on the transfer of cardamom and pepper valued at Rs. 12.02 crore to a dealer of Delhi against declaration in the Form 'F'. Cross verification of the records of Bodinayakanur assessment circle with those of the Commercial Tax Department, Delhi indicated (April 2005) that the agent at Delhi was a bogus dealer. His registration number was incorrect and the declaration Form 'F' submitted by him with the claim had not been issued by the commercial tax office at Delhi. Hence, the exemption allowed on a turnover of Rs. 12.02 crore to the dealer was not in order and resulted in non-levy of tax of Rs. 3 crore, including penalty of Rs. 1.80 crore.

After this was pointed out in August 2008, the assessing authority replied that the revision of assessment would be considered after verification. Further action taken has not been reported (January 2010).

The matter was reported to the department and to the Government in April 2009; their reply has not been received (January 2010).

## 2.6 Application of incorrect rates of tax

**2.6.1** Under the provisions of the TNGST Act, tax is leviable on the sale or purchase of goods at the rates and at the points mentioned in the relevant schedules to the Act.

Test check of the records in two assessment circles indicated that the assessing authorities, while finalising the assessments of two dealers for the years 2003-04 to 2005-06 between May 2006 and June 2007 applied incorrect rates of tax on the turnover of Rs. 1.61 crore. This resulted in short levy of tax of Rs. 15.21 lakh (inclusive of surcharge) as mentioned below:

(Rupees in lakh)							
Sl. no.	Assessment circle (No. of dealers)	Year of transaction (Month/ Year of assessment)	Commodity/ Transactions	Tax-able turn-over	Rate of tax (per cent)		Amount short levied
					Applicable	Applied	
1	Ramnagar (1)	2003-04 2004-05 (May 2006)	Fruit jam sold with a brand name	64.27	16	4	8.10
<p>After this was pointed out in January 2008, the assessing officer stated (January 2008) that the higher rate of tax was not applicable in this case as in the preparation of fruit jam, additives like chemicals and essence were added. Besides, the brand name "senthu" under which the commodity was sold was not registered under the Trade and Merchandise Marks Act.</p> <p>The reply is not in consonance with the provisions of the Act, which envisages that fruit jam with or without additives and sold under brand name is taxable at 16 per cent. Further, as per the entry relating to food and food preparations, the brand name is not required to be registered for the purpose of levy of tax.</p>							
2	Ice House (1)	2005-06 (May/June 2007)	Sale of printed cartons	96.70	10	3	7.11
<p>After this was pointed out in April 2008, the assessing officer replied (April 2008) that the cartons sold by the assessee were only printed material, as without the printed matter, the cartons could not be used by the purchasers.</p> <p>The reply is not in consonance with entry 5(1) of Part C of the First Schedule, according to which cartons are taxable at the rate of 10 per cent. The CCT had also clarified in February 2003 that printing information of the products contained in the cartons was only incidental and the cartons could serve the purpose even without printing. Hence they were taxable at 10 per cent under entry 5(i) of Part C of the first schedule to the TNGST Act.</p>							
<b>Total</b>				<b>160.97</b>			<b>15.21</b>

The matter was reported to the department and the Government between July 2008 and February 2009; their replies have not been received (January 2010).

**2.6.2** Under Section 8(2)(b) of the CST Act, inter-state sale of goods other than declared goods, not covered by valid declarations in Form 'C' is assessable to tax at the rate of 10 per cent or at the rate applicable to the sale of such goods inside the State, whichever is higher. The elements of surcharge and additional sales tax, wherever applicable, are also to be taken into consideration to arrive at the local rate of tax.

Test check of the records in Villupuram-I and Thiruverumbur assessment circles indicated that the assessing authorities, while finalising the assessments of two dealers for the years 1999-2000 and 2003-04 during April 2005 and December 2006 respectively, applied incorrect rates of tax on the inter state sale of goods valued at Rs. 2.96 crore. This resulted in short levy of tax of Rs. 8.68 lakh.

After the cases were pointed out in August 2007 and January 2009, the assessing authority, Thiruverumbur assessment circle revised the assessment in March 2008 and raised an additional demand of Rs. 3.06 lakh; of which Rs. 1.25 lakh has been collected. Report on recovery of the balance amount and reply in respect of the remaining case have not been received (January 2010).

The matter was reported to the Government between January 2009 and April 2009; their reply has not been received (January 2010).

## **2.7 Incorrect grant of concessional rate of tax**

**2.7.1** Section 3(5) of the TNGST Act provides that notwithstanding anything contained in Section 3(2), the tax payable by a dealer in respect of sale of any of the goods mentioned in the Eighth Schedule shall be at the rate of three *per cent* of the turnover relating to such sale. Imported machinery is not eligible for the concessional rate of tax and is chargeable to tax at the rate of 20 *per cent* under Section 3-C of the TNGST Act. The concessional rate is also not eligible for sale of goods like air handling units, weighing machines and electrically operated cranes (EOT cranes) which are not mentioned in the Eighth schedule and which are taxable at the rate of 20 *per cent* and 12 *per cent*.

**2.7.1.1** Test check of the records in three assessment circles<sup>25</sup> indicated that the assessing authorities while finalising the assessments of three dealers for the years 2004-05 to 2006-07 between April 2006 and March 2008, had erroneously assessed the sale of imported machinery valued at Rs. 1.22 crore at the concessional rate of three *per cent* instead of the applicable rate of 20 *per cent*. This resulted in short levy of tax of Rs. 21.72 lakh.

The Government, to whom the matter was reported between November 2008 and April 2009, replied (August 2009) that the concessional rate of tax allowed was in order as “machineries of all kinds” are mentioned in the Eighth Schedule to the Act and the CCT had clarified in May 2006 that imported machinery could be sold against Form XVII under Section 3(5) of the TNGST Act. The Government further stated that the Section 3(5) was introduced prior to the introduction of the Section 3(2-C) and hence no mention of the Section 3(2-C) was made in the Section 3(5) of the TNGST Act. The reply is not in consonance with the provisions of the Act. The entry at serial number 9 of schedule XI of the TNGST Act provides for levy of tax at the rate of 20 *per cent* in respect of items falling under Part D and Part E of schedule I of the Act. The machinery of all kinds fall under entry number 20 of the Part D of the schedule I. As such tax is leviable at the rate of 20 *per cent*. This entry

<sup>25</sup> Purasawalkam, T.Nagar (East) and Villivakkam.

has not been deleted or amended till date and should have been applied in the interest of the revenue.

**2.7.1.2** Test check of the records in four assessment circles<sup>26</sup> indicated that the assessing authorities, while finalising the assessments of four dealers for the years 2004-05 and 2005-06 between January 2007 and December 2007, had erroneously allowed the concessional rate of tax of three *per cent* on the sale of goods not mentioned in the Eighth Schedule, viz., air handling units, weighing machines and EOT cranes. The erroneous allowance of the concessional rate of tax on the turnover of Rs. 4.40 crore, instead of levying tax at the rates of 20 *per cent* and 12 *per cent* resulted in short recovery of tax of Rs. 46.56 lakh (inclusive of surcharge).

After the cases were pointed out between September 2007 and November 2008, the assessing authority, Guindy assessment circle replied that the concessional rate allowed was in order as the sales were covered by Form XVII declarations. The reply is not in consonance with the provisions of the Act as the air handling unit is not specified in the Eighth Schedule and sale thereof is not eligible for the concessional rate of tax. The assessing authorities, T. Nagar (North) and Ganapathy assessment circles replied that the concessional rate allowed was in order as the CCT had clarified in October 2000 and June 2002 that cranes were classifiable as machinery. The reply is not tenable as the CCT, in the latest clarification issued in September 2006, viz., prior to the finalisation of the assessments, had clarified that EOT cranes did not find a place in the Eighth Schedule and, therefore, could not be sold at concessional rate against Form XVII declaration. Reply in respect of the remaining case has not been received (January 2010).

The matter was reported to the Government in March/April 2009; their reply has not been received (January 2010).

**2.7.2** Section 3(3) of the TNGST Act provides for concessional rate of tax of three *per cent* on sale of goods by a dealer to another dealer for use by the latter in the manufacture inside the State and for sale by him of any goods other than the goods falling under Part A of the third schedule to the Act. The concessional rate is subject to the filing of Form XVII declaration obtained from the purchaser. Thus, the concessional rate on sale of goods is not applicable where the goods manufactured fall under Part A of the third schedule.

Test check of the records in Fast Track Assessment Circle-IV, Chennai indicated that the assessing authority, while finalising the assessment of a dealer for the year 1999-2000 in July 2003, had allowed concessional rate of tax on sale of lubricants valued at Rs. 66.08 lakh, though the product to be manufactured as mentioned in the Form XVII declaration was sugar, a commodity falling under Part A of the third schedule to the TNGST Act. The incorrect grant of concessional rate of tax resulted in short levy of tax of Rs. 8.59 lakh.

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<sup>26</sup> Ganapathy (Coimbatore), Guindy, Korattur and T.Nagar (North).

After this was pointed out in December 2006, the assessing authority replied in May 2008 that since the Form XVII declaration had been filed, there was no further obligation on the part of the seller and the purchasing dealer alone was liable for levy of the differential rate of tax and penalty. The reply is not in consonance with the provisions of the Act, which specifically precludes the sale of goods at concessional rate, where the manufactured goods fall under Part A of the third schedule.

The matter was reported to the Government in April 2009; their reply has not been received (January 2010).

### **2.8 Erroneous treatment of sale as works contract**

Under entry 22 of Part D of the First Schedule to the TNGST Act, 1959, in respect of bodies built on chassis of motor vehicles belonging to others, tax is leviable at the rate of 12 *per cent* on the turnover relating to bodies.

Test check of the records in Alandur assessment circle indicated that a dealer had purchased the requisite material and undertaken the work of building bodies on the chassis supplied by the customers. The assessing authority, while finalising the assessments of the dealer for the years 2002-03 to 2006-07 between June 2004 and June 2007, instead of levying tax at the rate of 12 *per cent* on the turnover of Rs. 19.99 crore relating to the bodies built on the chassis, had erroneously treated the transaction as works contract not involving transfer of property in goods. The erroneous treatment of sale as works contract resulted in short levy of tax of Rs. 2.33 crore (inclusive of surcharge).

After this was pointed out in December 2008, the assessing authority replied that the dealer had received labour charges from the customers for body building and there was no outright sale of body built on the chassis. The reply is not tenable as audit scrutiny indicated that the dealer had purchased the requisite raw material and used these in the work of building bodies on the chassis belonging to the customers. The transaction was, therefore, one of sale attracting levy of tax at 12 *per cent*.

The matter was reported to the Government in March 2009; their reply has not been received (January 2010).

### **2.9 Short levy of tax on goods sold by trade mark holders**

According to Section 3-J of the TNGST Act, whenever a dealer holding the trade mark or patent thereof sells goods at any point of sale other than the first point of sale, he shall be deemed to be the first seller in the State and shall be liable to pay tax accordingly. For determining the tax due to be paid by him, the tax levied and collected at the immediate preceding point of sale on the same goods shall be deducted from the tax payable by him at the point of sale.

Section 3-H of the TNGST Act provides for the levy of resale tax of one *per cent* on the turnover of resale of goods specified in the First Schedule and the Eleventh Schedule at a point other than the point of levy specified therein.

In Nandanam and Ganapathy assessment circles, while finalising the assessments for the years 2003-04 to 2005-06 (upto 25 September 2005) between April 2006 and March 2008 of two dealers who held trade mark<sup>27</sup>/brand name<sup>28</sup> in respect of goods sold by them, the assessing officers erroneously levied resale tax under Section 3-H at one *per cent* on the second sales turnover of goods sold under a brand name, instead of levying tax at the schedule rates applicable to the sale of goods as provided under Section 3-J of the TNGST Act. This resulted in short levy of tax of Rs. 1.13 crore.

After the cases were pointed out in December 2007/July 2008, the assessing authority, Ganapathy assessment circle replied that the certificate of registration of trade mark was issued to the dealer on 26 September 2005 and hence the assessment made at one *per cent* prior to such date was in order. The reply is not in consonance with the provisions of Section 23 of the Trade Marks Act, 1999 which specifies that the trade mark shall be registered as of the date of making of the application and that date shall be deemed to be the date of registration. In the instant case, the Certificate of registration of trade marks specified that it was issued as of 3 June 1999 and hence tax was to be levied at 12 *per cent* for the period from 2003-04 to 2005-06. The reply in respect of the remaining case has not been received (January 2010).

The matter was reported to the Government in November 2008; their reply has not been received (January 2010).

## **2.10 Non-levy of differential rate of tax**

Section 3(3) of the TNGST Act, 1959 provides for purchase of goods at concessional rate of three *per cent* for use in the manufacture of any goods for sale, subject to the furnishing of declaration in the Form XVII by the purchaser. The Act further provides that the purchasing dealer shall be liable to pay the difference of tax payable on the turnover relating to sale of such goods, if he fails to make use of the goods so purchased for the purpose specified in the declaration. Under the TNGST Act, chemicals are taxable at the rate of 12 *per cent* at the point of first sale in the State.

The Tamil Nadu Sales Tax Appellate Tribunal (Additional Bench), Chennai has held<sup>29</sup> in October 2005 that the process of conversion of wet blue leather (semi finished leather) into finished leather does not involve manufacture and has upheld the levy of differential rate of tax in respect of chemicals purchased at concessional rate and used in such conversion.

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<sup>27</sup> Motor vehicle parts sold under the trade mark "Roots Auto".

<sup>28</sup> Washing soap and detergent sold under the brand name "Henkel".

<sup>29</sup> State of Tamil Nadu Vs. Tvl. A. Ahmed & Co. – STA No.298/04 TNTST (AB), Chennai.

Test check of the records in Vepery and Thyagaraya Nagar (North) assessment circles indicated that two dealers had purchased chemicals at the concessional rate by furnishing the Form XVII declarations for Rs. 1.30 crore and utilised the chemicals for processing of wet blue/semi finished leather into finished leather. The assessing officers, while finalising the assessment for the years 2004-05 and 2005-06 in July 2006 and February 2007 respectively, failed to levy the differential rate of tax, though no manufacturing activity was undertaken by the assesseees. The omission resulted in non-levy of tax of Rs. 12.26 lakh (inclusive of surcharge).

After this was pointed out in September 2007 and November 2007, the assessing officers stated that the conversion of semi finished leather (wet blue) into finished leather involved manufacture. The reply is not in consonance with the decision of the Appellate Tribunal mentioned above according to which the process does not involve manufacture.

The matter was reported to the Government in April 2009; their reply has not been received (January 2010).

### **2.11 Non-levy of additional sales tax**

As per the provisions of the Tamil Nadu Additional Sales Tax Act, 1970, every dealer whose taxable turnover for a year exceeds Rs. 10 crore is liable to pay additional sales tax at the prescribed rate on the turnover. As per the explanation under Section 2(1)(aa) of the Act, the taxable turnover shall not include the turnover of resale, taxable under section 3-H of the Tamil Nadu General Sales Tax Act (TNGST Act).

Under Section 3(2-A) of the TNGST Act, in the case of cement mentioned in the fifth schedule, the tax is payable by a dealer at the first and every other point of sale in the State. Thus, the turnover relating to sale of cement at a point other than the first point of sale is also a taxable turnover and is, therefore, subject to levy of the additional sales tax.

In Tambaram I assessment circle, while finalising the assessment of a dealer for the year 2004-05 in June 2006, the turnover of sale of cement amounting to Rs. 7.25 crore assessed to tax at the second point of sale was omitted to be considered as taxable turnover. The turnover of cement assessed to tax at first sale point was Rs. 2.97 crore. Thus, the total turnover liable for levy of additional sales tax of one *per cent* was Rs. 10.22 crore. The assessing officer did not levy the additional sales tax of Rs. 10.22 lakh.

After the case was pointed out in October 2008, the assessing officer issued notice for revision of the assessment. Further report has not been received (January 2010).

The matter was reported to the Government in January 2009; their reply has not been received (January 2010).

## **2.12 Non/short levy of tax**

Under Section 3(2-C) of the TNGST Act read with entry 18 of the Eleventh Schedule, white kerosene (superior kerosene oil) is assessable to tax at the rate of 25 *per cent* at the point of first sale in the State. Under Section 3-I of the TNGST Act, surcharge is leviable at the rate of five *per cent* on the tax levied under Section 3(2-C) of the Act.

Test check of the records in Omalur assessment circle indicated that the assessment of a dealer for the year 2003-04 finalised in June 2007 comprised a turnover of Rs. 3.22 crore representing local sale of superior kerosene oil camouflaged as inter-state sale by the assessee. The assessee was liable to pay a tax of Rs. 80.62 lakh on the said turnover. The department, however, levied a tax of Rs. 69.62 lakh. Further, the assessing authority omitted to levy surcharge on the first sales turnover of superior kerosene oil valued at Rs. 7.75 crore, including the turnover of Rs. 3.22 crore mentioned above. This resulted in non/short levy of tax of Rs. 20.68 lakh.

This was pointed out to the department in November 2008 and the Government in February 2009; their reply has not been received (January 2010).

## **2.13 Non-levy of interest for belated payment of tax**

According to Section 24(3) of the TNGST Act, a dealer shall pay in addition to the tax amount due, interest as prescribed from time to time for the entire period of default on any amount remaining unpaid after the due date. The provisions relating to levy of interest for belated payment of tax under the TNGST Act also apply in respect of the tax payable under the Central Sales Tax Act.

In ten assessment circles<sup>30</sup>, tax of Rs. 7.55 crore relating to the assessment years 1996-97 and 1999-2000 to 2005-06 was paid belatedly by 12 dealers between June 2002 and March 2008. The delays ranged from one day to 55 months and 17 days. As against the interest of Rs. 1.24 crore leviable for such belated payment of tax in all these cases, the assessing authorities had levied interest of Rs. 14.06 lakh in two cases. This resulted in non/short levy of interest of Rs. 1.10 crore.

After the cases were pointed out between January 2008 and August 2008, the assessing authorities levied interest of Rs. 64.83 lakh in seven cases; of which Rs. 17.77 lakh had been collected. Further report regarding collection of the balance amount and reply in respect of the remaining cases have not been received (January 2010).

The matter was reported to the Government between July 2008 and April 2009. The Government accepted the audit observation in six cases. Reply of the Government in the remaining cases has not been received (January 2010).

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<sup>30</sup> Ariyalur, Cuddalore (Taluk), Hosur (North), Porur, Sriperumbudur, Tiruvanmiyur, T.Nagar (East), Trichy (Road), Vadapalani-I and Villupuram-I.

## 2.14 Non-levy of penalty

**2.14.1** Section 12(3)(b) of the TNGST Act provides for levy of penalty at prescribed percentage of the short fall in payment of tax, where the tax paid by a dealer as per his returns falls short of the tax assessed by the assessing authority.

Test check of the records in Ramnagar and Trichy Road assessment circles indicated that two dealers had paid tax of Rs. 3.55 lakh alongwith the returns for the years 2003-04 and 2004-05. The tax assessed as per the final assessment was Rs. 9.02 lakh. The shortfall in payment of tax attracted levy of penalty of Rs. 8.35 lakh calculated at the rate of 125 *per cent* of the balance tax due. Similarly, in Ambattur assessment circle, test check of records in audit indicated that the assessee had paid tax of Rs. 18.65 lakh as per returns, whereas the tax assessed for the years 2002-03 and 2003-04 was Rs. 31.97 lakh. The shortfall in payment of tax attracted levy of penalty of Rs. 13.32 lakh calculated at the rate of 100 *per cent* of the balance tax due. The assessing authority, however, omitted to levy penalty of Rs. 21.67 lakh.

After the cases were pointed out between January 2008 and March 2009, the assessing authority, Ambattur assessment circle replied in March 2008 that since the books of accounts were not produced by the assessee, the correctness or otherwise of the returns filed could not be ascertained and hence penalty was not attracted. The reply is not in consonance with the provisions of the Act which envisages levy of penalty in case of shortfall in payment of tax. Reply in respect of the remaining cases has not been received (January 2010).

The matter was reported to the Government between November 2008 and February 2009; their reply has not been received (January 2010).

**2.14.2** According to Section 12(3)(c) of the TNGST Act, in case of submission of the monthly returns by a dealer after ten days after the expiry of the prescribed period, the assessing authority shall levy penalty calculated at the rate of two *per cent* of the tax payable for every month or part thereof during which the default in the submission of the return continued. According to Rule 18(2) of the TNGST Rules, the return for each month in respect of a dealer whose taxable turnover in the preceding year was Rs. 200 crore and above shall be submitted so as to reach the assessing authority on or before the 12<sup>th</sup> of the succeeding month.

Test check of the records in the Fast Track Assessment Circle-IV, Chennai indicated that a dealer had filed returns in respect of certain months after 10 days after the expiry of the prescribed period. The assessing authority, while finalising the assessments of the dealer for the years 2002-03 to 2004-05 between June 2007 and August 2007, however, failed to levy penalty of Rs. 1.13 crore for the belated submission of the returns.

After this was pointed out in December 2008, the assessing authority replied that interest had already been levied and collected. The reply is not in consonance with the provisions of the Act as the levy of penalty under the Section 12(3)(c) of the Act mentioned above is independent of the interest levied under Section 24(3) of the TNGST Act for belated payment of tax.

The matter was reported to the Government in April 2009; their reply has not been received (January 2010).