

CHAPTER-II: TAX ON SALES, TRADE ETC.

2.1 Tax administration

Department of Commercial Taxes is under the control of the Principal Secretary, Taxes at the Government level and collection of tax under the KGST, KVAT and CST Acts is governed by the Commissioner of Commercial Taxes (CCT). Levy and collection is administered at grass root level by Commercial Tax Officers and Assistant Commissioners. Movement of goods into the territory of the State is regulated through check posts established at the border. Audit wing of the department conducts internal audit of KVAT returns and assessments under the KGST.

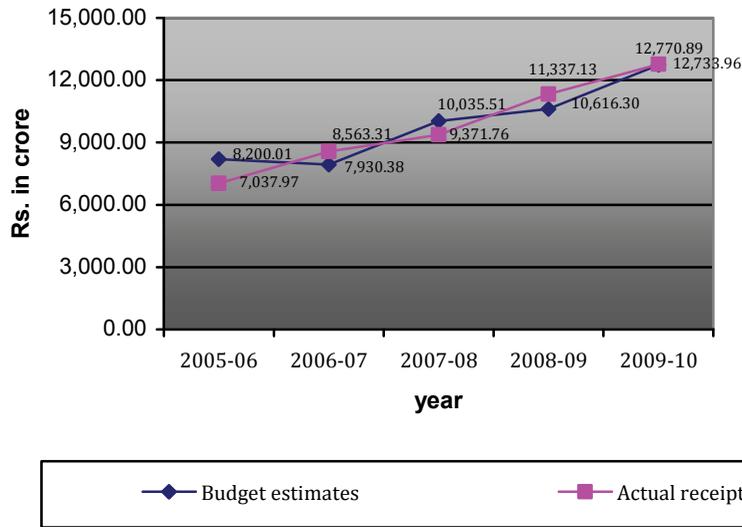
2.2 Trend of receipts

Actual receipts from tax on sales, trade etc. during the last five years (2005-06 to 2009-10) along with the budget estimates during the same period is exhibited in the following table and graph.

(Rupees in crore)

Year	Budget estimates	Actual receipts	Variation excess (+)/ shortfall (-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts	Percentage of growth rate
2005-06	8,200.01	7,037.97	(-) 1,162.04	(-) 14.17	9,778.62	71.97	-
2006-07	7,930.38	8,563.31	(+) 633.93	(+) 7.98	11,941.82	71.71	21.67
2007-08	10,035.51	9,371.76	(-) 663.75	(-) 6.61	13,668.95	68.56	9.44
2008-09	10,616.39	11,377.13	(+) 760.74	(+) 7.17	15,990.18	71.15	21.39
2009-10	12,733.94	12,770.89	(+) 36.95	(+) 0.29	17,625.02	72.46	12.25

Budget estimates and Actual receipts



We noticed that the growth rate of tax on sales, trade etc. declined during 2007-08 and 2009-10, compared to 2006-07 and 2008-09.

2.3 Assessee profile

The number of dealers registered as at the end of 2008-09 and 2009-10 are shown below:

2008-09	1,59,207
2009-10	1,59,665

The increase in the number of dealers during 2009-10 was marginal. The VAT collection from 50 top dealers in the State was ₹ 1,566 crore which is 21.50 per cent of the total collection. Out of the total dealers, 23,818 dealers constituting 14.92 per cent were paying tax at 0.5 per cent under the category of presumptive tax payers.

The assessment in respect of five major assesseees of KGST are pending from 2004-05 onwards and hence we could not audit these files and ensure the correctness of the returns filed. This implies that approximately 40 per cent of revenue generated from commercial taxes (KVAT + KGST) could not be audited by us every year due to delay in completion of assessment.

2.4 Receipt of VAT per assessee

The receipt of VAT and sales tax per assessee during 2009-10 was ₹ 7.79 lakh which was higher than the previous year's receipt of ₹ 7.15 lakh by ₹ 0.64 lakh.

2.5 Arrears in sales tax assessment

The department furnished the position of arrears under sales tax which is as shown below:

		(Number of cases)
Opening balance		14,254
Addition during 2009-10 including remanded cases		4,345
Total		18,599
No. of assessments completed		9,332
Arrear cases	8,048	
Current cases	1,095	
Remanded cases	189	
Closing balance		9,267

Department completed 9,332 assessments under the KGST. We noticed that there was practically no revenue collection due to completion of the above assessments.

We recommend the Government to undertake a detailed review of these completed assessments.

2.6 Cost of collection

The gross collection of revenue receipts under the head, tax on sales, trade etc., expenditure incurred on collection and the percentage of expenditure to gross collection during 2005-06 to 2009-10 alongwith the all India average percentage of expenditure on collection to gross collection for relevant years are mentioned below:

Year	Collection	Expenditure on collection of revenue	Percentage of expenditure to gross collection	All India average percentage
	(Rupees in crore)			
2005-06	7,037.97	60.96	0.87	0.91
2006-07	8,563.31	78.21	0.91	0.82
2007-08	9,371.76	89.75	0.96	0.83
2008-09	11,377.13	102.59	0.90	0.88
2009-10	12,770.89	126.01	0.99	Not available

We noticed that the expenditure on collection was higher than the all India average except in the year 2005-06.

We recommend the Government to examine the reasons for such high costs of collection and take corrective measures.

2.7 Analysis of collection

Tax revenue collected on tax on sales, trade etc. during last two years as recorded in the books of the Accountant General (A&E) Kerala is given below:

(Rupees in crore)		
Revenue head	2008-09	2009-10
Sales Tax	5,881.97	5,212.92
VAT	5,035.19	7,235.26
CST	425.38	292.94

The above table indicates that during 2009-10 collection of sales tax decreased by ₹ 669.05 crore and VAT collection increased by ₹ 2,200.07 crore. Tax collection from the KGST was ₹ 5,212.92 crore as per the finance account prepared by the Accountant General (A&E). However, our analysis of the details furnished by assessing authorities reveal that five major dealers alone had paid ₹ 5,249.61 crore during 2009-10. As per the data collected from the department, the collection of sales tax and VAT during 2009-10 are ₹ 6,249.59 crore and ₹ 6,950.60 crore respectively which implies misclassification of receipts. We recommend immediate action to reconcile the differences. The entire collection under sales tax and under VAT represents voluntary payments by dealers.

2.8 Impact of audit

Revenue impact

During the last four years, we pointed out non/short levy, underassessment/loss of revenue, incorrect exemption, application of incorrect rate of tax etc., with revenue implication of ₹ 1,448.26 crore in 5,195 paragraphs. Of these, the department/Government accepted audit observations involving ₹ 647.99 crore and had since recovered ₹ 15.46 crore. The details are shown in the following table:

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	No.	Amount	No.	Amount	No.	Amount
2005-06	954	50.37	558	6.29	48	0.42
2006-07	1,004	309.17	179	250.50	108	3.18
2007-08	1,055	334.37	299	241.50	181	2.46
2008-09 Vol. I	2,181	459.11	341	32.77	203	9.40
2008-09 Vol. II	1	295.24	1	116.93	--	--
Total	5,195	1,448.26	1,378	647.99	540	15.46

We noticed that the Government failed to recover even the amount it has accepted.

We recommend that the Government may revamp the recovery mechanism to ensure that at least the amount involved in accepted cases are promptly recovered.

2.9 Working of internal audit wing

The internal audit wing (IAW) in the Commercial Taxes department was constituted in May 2009. The wing is headed by a Deputy Commissioner, three Assistant Commissioners and four Commercial Tax Officers. The IAW commenced functioning from 1 June 2009. The department has not prepared a separate internal audit manual. IAW covered eight out of 14 districts during June 2009 to February 2010 and 262 audit paragraphs were raised by them. However, as the reports were not finalised, we are unable to make any comment about the effectiveness of their performance.

2.10 Results of audit

We test checked the records of 163 units relating to KGST and VAT. We detected underassessment of tax and other irregularities involving ₹ 1,122.54 crore in 4,451 cases which fall under the following categories:

Sl. No.	Categories	No. of cases	Amount (Rupees in crore)
A. Value Added Tax			
1.	Turnover escaping assessment	791	92.57
2.	Grant of irregular exemption	660	70.47
3.	Application of incorrect rate of tax	342	28.05
4.	Incorrect grant of concessional rate of tax	87	26.75
5.	Grant of excess input tax credit	599	10.35
6.	Non/short levy of interest	81	6.63
7.	Other lapses	1,491	327.05
8.	Works contract	13	517.00
B. Kerala General Sales Tax			
9.	Grant of irregular exemption	74	19.20
10.	Turnover escaping assessment	102	8.24
11.	Application of incorrect rate of tax	54	2.28
12.	Non/short levy of interest	22	0.60
13.	Other lapses	135	13.35
Total		4,451	1,122.54

The department accepted underassessment and other deficiencies of ₹ 281.51 crore in 642 cases, of which 251 cases involving ₹ 276.55 crore were pointed out in audit during the year 2009-10 and the rest in earlier years. An amount of ₹ 5.02 crore was realised in 588 cases during the year 2009-10.

A few illustrative audit observations involving ₹ 463.59 crore are mentioned in the following paragraphs.

2.11 Audit observations

We scrutinised assessment records of sales tax/value added tax (VAT) in Commercial Taxes department and found several cases of non-observance of provisions of the Acts/Rules, non/short levy of tax/penalty/interest, incorrect determination/classification of turnover and other cases as mentioned in the succeeding paragraphs in this chapter. These cases are illustrative and are based on a test check carried out in audit. Such omissions on the part of assessing authorities (AA) are pointed out in audit each year, but not only the irregularities persist; these remain undetected till an audit is conducted. There is need for the Government to improve the internal control system including strengthening of the internal audit to ensure that such omissions are detected and rectified.

2.12 Non-observance of provisions of Acts/Rules

The Kerala General Sales Tax/Kerala Value Added Tax/Central Sales Tax Acts and Rules made thereunder provide for:

- (i) levy of tax/interest/penalty at the prescribed rate;*
- (ii) allowing exemption of turnover subject to fulfilment of the prescribed conditions; and*
- (iii) allowance of input tax credit as admissible.*

We noticed that the AAs while finalising the assessment did not observe some of the provisions which resulted in non/short levy/non-realisation of tax/interest/penalty of ₹ 463.59 crore as mentioned in the paragraphs 2.12.1 to 2.12.20.

Works contract

2.12.1 Short levy due to turnover escaping assessment

2.12.1.1 (CTO, special circle, Thiruvananthapuram; February 2010).

Rule 9 of the KVAT Rules provides that where in a works contract, the awarder supplies a portion of the goods involved in the execution of the works contract and deducts the value of the material from the payment made to the contractor, the turnover of the goods so supplied shall form part of the total turnover of the awarder as well as the contractor.

An assessee who is the awarder of various work contracts, supplied materials to the contractors for execution in the works contract. The value of materials so supplied was deducted from the bill of the contractor. However, we found that the value of materials which was

recovered from the bill of the contractor amounting to ₹ 1,871.61 crore supplied by the assessee for the years 2005-06 to 2008-09 was not subjected to tax by the assessee. This defect was not detected by the assessing authority which resulted in short levy of tax and interest of ₹ 274.24 crore.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received any further information (December 2010). However, we noticed subsequently that the assessments were revised in May 2010 creating an additional demand of ₹ 284.53 crore.

2.12.1.2 (CTOs, Works Contract, Ernakulam and Thrissur; November 2009 to January 2010)

Section 22 of the KVAT Act provides that where the return submitted by a dealer is with incorrect particulars, the assessing authority shall, after recording its reasons, reject the return with due notice to the dealer. The Act also stipulates that if any dealer files incorrect return and fails to file a fresh return, the assessing authority shall estimate the turnover of the return period and complete the assessment to the best of its judgement.

We verified the annual return with the annual accounts of nine assesseees in CTOs Works Contract, Ernakulam and Thrissur and found that the assesseees had returned considerably lesser turnover in their annual return than that disclosed in annual accounts. Further, the assesseees did not limit

the exemption claimed to the eligible limits. These defects were not detected by the assessing authorities which resulted in short levy of tax and interest of ₹ 17.22 crore.

After we pointed out the defects, the assessing authority stated in one case⁶ that the difference in turnover was due to the land value. The reply is not acceptable as the assessee had opted for compounding and hence tax is to be paid on the whole contract amount.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received their replies (December 2010).

• (CTO, Works Contract, Ernakulam; January 2010)

An assessee executed works contract valued at ₹ 91.77 crore for the year 2006-07 on turnkey basis. However, the assessee disclosed a turnover of ₹ 10.93 crore as labour element in the annual return and claimed exemption on that turnover, resulting in underassessment of turnover of ₹ 80.84 crore. This mistake was not detected by the assessing authority which resulted in short levy of tax and interest of ₹ 13.34 crore.

We pointed out the matter to the department and the Government in May 2010. We have not received their replies (December 2010).

⁶ M/s. Yasoram Builders, Ernakulam.

2.12.1.3 (CTO, Works Contract, Ernakulam; November 2009)

The proviso to KVAT Rule 10 (2) (a) provides that when the turnover arrived at after deducting the eligible deduction, falls below the cost of goods transferred in the execution of works contract, an amount equal to the cost of goods transferred in the execution of works contract with profit, if any, shall be the taxable turnover in respect of such works contract. Further, Section 6(1) (f) of the KVAT Act prescribes that the liability to pay tax shall be, in the case of transfer of goods involved in the execution of works contract, where the transfer is not in the form of goods, but in some other form at the rate of 12.5 *per cent*. Subsequently, it has been provided in the Act from April 2008 that the tax payable in respect of transfer of declared goods not in the form of goods but in some other form shall be at the rate prescribed under the respective schedules.

An assessee, engaged in works contract, claimed exemption under Rule 10 (2) (a) of the KVAT Rules from the total turnover of contract receipts and paid tax on the balance taxable turnover for the years 2007-08 and 2008-09. We found that the cost of goods transferred in the execution of works contract alongwith the profit element is considerably higher than the turnover that the assessee returned. As such, the assessee is liable to pay tax on the cost of goods transferred in the works contract instead of on the

conceded taxable turnover. This defect was not detected by the assessing authorities which resulted in short levy of tax and interest of ₹ 16.91 crore.

After we pointed out the defect, the assessing authority stated (November 2009) that the cost of goods transferred to works contract includes goods purchased interstate which had already suffered tax and hence is eligible for exemption. The reply is not acceptable as the goods purchased interstate is used in the works contract at a different State and hence is exigible to tax. The High Court of Tamil Nadu had held⁷ that the materials brought from outside the State and used in the execution of works contract within the State is exigible to tax in the State. We found that the assessing authority issued notice to the assessee in December 2009.

We reported the matter to the department and to the Government in May 2010. We have not received their replies (December 2010).

⁷ JDP Associates Vs TNTST and others 2004-05 (10) TNCTJ-165 Mad as cited in the AR(RR) for Tamil Nadu for the year ended 31 March 2008 (Para 2.10.1.5).

2.12.1.4 (CTO, (WC<), Thrissur; September 2009)

As per Section 8(a) (ii) of the KVAT Act, any works contractor having CST registration, may opt to pay tax at four *per cent* of the whole contract amount. Rule 9(1) (c) of the KVAT rules further provides that the total turnover of a dealer shall be the aggregate of contract amount received or receivable.

The taxable turnover of a works contract dealer paying compounded tax at the rate of four *per cent* for the year 2006-07 was determined by audit assessment wing as ₹ 10.49 crore even though the assessee had a contract receipt of ₹ 13.38 crore as per the certified accounts. This

resulted in short levy of tax of ₹ 11.55 lakh.

We pointed out the case to the department in October 2009 and reported to the Government in April 2010. We have not received their replies (December 2010).

• (CTO, (WC<), Thrissur; September 2009)

An assessee engaged in works contract conceded a total turnover of ₹ 2.23 crore in the annual return even though he had a contract receipt of ₹ 4.55 crore as per the certified P&L account for the year 2007-08. This resulted in escape of turnover of ₹ 2.32 crore and consequent short levy of tax and interest of ₹ 10.78 lakh.

We pointed out this case to the department in October 2009 and reported to the Government in April 2010. We have not received their replies (December 2010).

2.12.1.5 (CTO, special circle, Thiruvananthapuram; January 2010)

The CCT had instructed that the assessing authorities should cross check the details available in the returns filed by the assessee to ensure that there was no evasion of tax by the dealer.

An assessee who is engaged in the execution of Japan Bank for International Co-operation (JBIC) assisted water supply

scheme for Kerala Water Authority (KWA) opted for compounding and paid tax on ₹ 15.33 crore for 2007-08. We cross verified the payments made to the assessee with the records of JBIC available with KWA and noticed that the assessee was paid ₹ 17.12 crore. The discrepancy in turnover was not detected by the assessing authority which resulted in short levy of tax and interest of ₹ 8.60 lakh.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.1.6 (CTO (Works Contract), Thiruvananthapuram; March 2009)

Where the return submitted under sub-section (1) of the Section 20 is not in the prescribed manner, the assessing authority shall reject the return as per the KVAT Act. The Act also stipulates that if any dealer fails to submit a fresh return, the assessing authority shall estimate the turnover of the return period and complete the assessment to the best of its judgment.

A dealer assessed tax for the year 2006-07 on a conceded turnover of ₹ 1.90 crore as per the annual return. However, we found on scrutiny of the assessment records that the audited accounts of the assessee revealed a turnover of ₹ 2.11 crore. This mistake was not detected by the AA which resulted in short levy of tax and

interest of ₹ 3.36 lakh.

We pointed out the case to the department in March 2009 and reported to the Government in July 2009. The Government stated in January 2010 that the assessment had been revised creating an additional demand of ₹ 2.42 lakh towards tax and ₹ 82,000 towards interest. We have not received further information from the Government (December 2010).

2.12.2 Short levy due to incorrect exemption

2.12.2.1

- (CTOs : Special circle II, Ernakulam and Works Contract Mattancherry; November 2009)

The taxable turnover in relation to works contract in which transfer of property takes place not in the form of goods but in some other form shall be arrived at after deducting the amount in respect of labour charges etc., as per Rule 10(2)(a) of the KVAT Rules. Further, where the actual turnover in relation to works contract is not ascertainable from the books of accounts, the turnover shall be computed after deducting labour and other charges as given in the table below Rule 10(2) (b).

We noticed in CTOs, special circle II, Ernakulam and works contract Mattancherry that four dealers had assessed turnover in respect of works contract after deducting expenses much higher than that referred in the Table, even though the actual expenses in respect of labour and other charges were not ascertainable from their accounts. This mistake was not detected by

the assessing authorities and rectified which resulted in short levy of tax and interest of ₹ 68.29 crore.

We reported the matter to the department and to the Government in May 2010. We have not received their replies (December 2010).

- (CTO (WC<), Thiruvananthapuram; March 2009)

An assessee, engaged in the business of interior decoration, incorrectly availed exemption of ₹ 3.13 crore and ₹ 3.82 crore from the total turnover for the years 2005-06 and 2006-07, instead of availing exemption in respect of labour and other charges at the specified rate of 25 *per cent*, as these items were not separately ascertainable from the accounts. This resulted in short levy of tax of ₹ 47.34 lakh.

We pointed out this defect to the department in April 2009 and reported to the Government in July 2009. We have not received their replies (December 2010).

2.12.2.2 (CTO, special circle II, Ernakulam; November 2009)

Section 5(1) of the CST Act stipulates that a sale or purchase of goods shall be deemed to take place in the course of the export of the goods out of the territory of India, only if the sale or purchase either occasions such export or is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India.

An assessee claimed sale of ships as export sales. As per the terms and conditions, the ships/vessels are delivered at the Shipyard at Cochin and the title, risk, ownership etc over the vessel were transferred to the buyer and the buyer takes possession of the vessel immediately upon delivery. Hence, the sale falls within the definition of sale under KVAT Act. Since none of the conditions

stipulated in the CST Act is fulfilled in this transaction, the exemption amounting to ₹ 1,148.09 crore for the period from 2005-06 to 2008-09 given is not in order resulting in short levy of tax and interest of ₹ 54.70 crore.

We reported the matter to the department and to the Government in May 2010. We have not received their replies (December 2010).

2.12.2.3 (CTOs: Special Circle II, Ernakulam and Works Contract, Ernakulam; November and December 2009)

Section 10 of the KVAT Act provides for deduction of tax from every payment, including advance payment to any works contractor in relation to any works contract awarded. The Act also stipulates that for the above purpose, the contractor may produce a liability certificate in relation to such works contract from the assessing authorities showing the tax liability or tax remittance, as the case may be, of the contractor in relation to the work and the amount to be deducted from the contract amount is 10 *per cent* in the case of unregistered contractor.

We observed in CTOs Special Circle II, Ernakulam and Works Contract, Ernakulam that four assesseees awarded sub-contracts valued at ₹ 267.22 crore and claimed exemption for the same. The exemption claimed is not allowable as the condition that liability certificate in relation to such works contract from the assessing authorities showing the tax liability or tax remittance has

not been fulfilled. The assessing authorities did not detect this mistake, which resulted in short levy of tax and interest of ₹ 32.74 crore.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.2.4 (CTO, Works Contract, Ernakulam; January 2010)

Section 22 of the KVAT Act stipulates that, where the return submitted is with incorrect particulars, the assessing authorities shall, after recording its reasons, reject the return with due notice to the dealer. The Act also provides that if any dealer files incorrect return and fails to file a fresh return, the assessing authority shall estimate the turnover of the return period and complete the assessment to the best of its judgement.

An assessee who is engaged in works contract disclosed for the year 2008-09, a total turnover of works contract of ₹ 87.16 crore. However, the assessee returned a taxable turnover of ₹ 2.45 crore after claiming exemption for ₹ 84.71 crore (i.e. 97.19 per cent) on the contention that he received payment of ₹ 2.45 crore only for that year. We found that the assessee had received payment amounting to ₹ 60.70

crore from the awarders of contract. As such the assessee is liable to pay tax at least on the contract amount received of ₹ 60.70 crore after allowing deductions as per Rule 10(2) (b) of the KVAT Rules, as the element of labour and other charges are not separately ascertainable from the records. This defect was not detected by the assessing authority which resulted in short levy of tax and interest of ₹ 6.70 crore.

We reported the matter to the department and to the Government in May 2010. We have not received their replies (December 2010).

2.12.2.5 (CTO, Works Contract, Mattancherry; November 2009)

The whole of the contract amount in respect of works contract referred in Section 8 shall not include amount paid to sub-contractors for the execution of the portion of works contract if the sub-contractor is a registered dealer liable to tax under sub-section (1) or (1A) of Section 6 and the contractor claiming deduction in respect of such amount furnishes a certificate in the prescribed manner.

A dealer who had opted to pay tax at the compounded rates claimed deduction in respect of sub-contract awarded for the years 2006-07 to 2008-09. We found that the sub-contract was purely labour contract and hence the sub-

contractors were not liable to tax. Further we found that the materials for the works were issued by the awarder and hence the liability rests with the awarder itself. The incorrect claim of exemption had resulted in short levy of tax and interest of ₹ 1.56 crore.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.2.6 (CTO, Works Contract, Thiruvananthapuram; March 2009)

Rule 9 of the KVAT Rules provides that in a works contract in which the transfer of property takes place not as goods but in some other form, the taxable amount shall be the whole amount payable to the dealer for carrying out such contract less the labour charges not incurred in relation to the goods involved in the works contract and other charges. Further, interest at 12 *per cent per annum* is leviable for default in payment of tax within the due date.

An assessee engaged in works contract for the year 2006-07, availed exemption of ₹ 1.52 crore towards labour and other charges as per the annual return against an eligible exemption of ₹ 1.25 crore on the total turnover of ₹ 2.68 crore as disclosed in the P&L Accounts. This resulted in short levy of tax and interest of ₹ 4.20 lakh.

We pointed out the matter to the department in April 2009 and reported to the Government in July 2009. The Government stated in November 2009 that the assessment was revised and an additional demand of ₹ 4.88 lakh was created. We have not received a report on recovery (December 2010).

2.12.3 Application of incorrect rate of tax

2.12.3.1 (CTOs, Works Contract, Ernakulam and Mattancherry; November 2009)

Section 6(1) (f) of KVAT Act as amended from 1 July 2006, stipulates that in the case of transfer of goods involved in execution of works contract, where the transfer is not in the form of goods, but in some other form, tax is leviable at the rate of 12.5 *per cent* and when transfer is in the form of goods, tax is leviable at the rates prescribed under the respective schedule. Further, Rule 10(2) (a) of KVAT Rules prescribes that in relation to works contract in which transfer of property takes place not in the form of goods but in some other form, the taxable turnover in respect of the transfer of property involved in the execution of works contract shall be arrived at after deducting labour and other charges from the total amount received or receivable by the dealer for the execution of the works contract.

In case of two contractors who were engaged in works contract for the years 2006-07 and 2007-08, where transfer of property took place not in the form of goods but in some other form, the taxable turnover was arrived at after deducting expenses much higher than that allowable under the Rule. Further, tax was assessed at various rates ranging from four to 20 *per cent*, instead of at the correct rate of 12.5 *per cent*. The assessing authorities did not detect these mistakes which resulted in short levy of tax and interest of ₹ 9.21 crore.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.3.2 (Three CTOs⁸ : April 2008)

Section 7(5) of the CST Act stipulates that a registered dealer may apply in the prescribed manner not later than six months before the end of a year to the authority which granted his certificate for cancellation of such registration, and the authority shall unless the dealer is liable to pay tax under this Act, cancel the registration accordingly and where he does so, the cancellation shall take effect from the end of the year. The rate of tax for the year 2008-09 as per Section 8(a) (i) of the KVAT Act for a dealer without CST registration was at the rate of three *per cent* and as per Section 8(a) (ii) of the KVAT Act, for a dealer with CST registration, was eight *per cent*.

We observed in CTOs works contract, Ernakulam, Kozhikode and Thiruvananthapuram, that 18 dealers had applied for cancellation of CST registration in April 2008 and the assessing authorities granted permission to cancel the CST registration in April 2008 itself. This allowed the dealers to pay tax at reduced rate for the year 2008-09 in violation of the provisions of the Act, resulting in short levy of tax of ₹ 4.66 crore.

After we pointed out the matter, the assessing authority stated that the provisions contained in Section 6(5) of the KVAT Act enables the dealer to cancel the registration and opt to pay tax under Section 6(5) in that year itself. The reply is not tenable as Section 6(5) relates to presumptive tax and is not relevant to the case. Further, explanation 2 under Section 8 enables dealers who had opted for cancellation of CST registration prior to 31 March 2008 for payment of tax under Section 8.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.3.3 (Three⁹ CTOs (WC & LT); July 2009 to September 2009)

Any works contractor not registered under the CST Act may opt to pay tax at two *per cent* of the whole contract amount as per Section 8(a) of the KVAT Act. The works contractor, not falling under the above clause may pay tax at four *per cent*.

Three assesseees in works contract having CST registration opted to pay compounded tax for the years 2005-06 and 2007-08 on the contract receipt of ₹ 6.63 crore at the rate of two *per cent*

instead of at four *per cent*. This resulted in short levy of tax and interest of ₹ 13.31 lakh.

⁸ CTOs: Works Contract, Ernakulam, Kozhikode and Thiruvananthapuram.

⁹ Alappuzha, Kottayam and Malappuram.

After we pointed out the cases in August 2009 and October 2009, the department stated in December 2009 and January 2010 that in one¹⁰ case action was initiated to realise the short levy and in another¹¹ case assessment had been completed in November 2009 creating an additional demand of ₹ 2.35 lakh. Reports on recovery have not been received (December 2010).

We reported the cases to the Government between December 2009 and February 2010. We have not received their replies (December 2010).

2.12.3.4 (CTO Works Contract, Thiruvananthapuram; March 2009)

Section 8(a) of the KVAT Act prescribes that any works contractor, other than those engaged in the installation of plant and machinery may, opt to pay tax at four *per cent* of the whole contract amount. The Act further stipulates that in the case of transfer of goods involved in execution of works contract, where the transfer is not in the form of goods, but in some other form, the rate of tax applicable is 12.5 *per cent*. Further, under Rule 9 of the KVAT Rules, deduction admissible towards labour and other charges in respect of contract receipts for installation of plant and machinery is at the rate of 15 *per cent*. Interest is also leviable at the prescribed rates as specified under the Act for default in payment of tax within the due dates.

An assessee who executed the works contract of supply and installation of medical gas system, with vacuum plant and suction unit with regulator, in various hospitals, incorrectly assessed tax at the compounded rate of four *per cent* on the gross contract receipts of ₹ 39.92 lakh for the year 2006-07 instead of assessing the contract receipts at the rate of 12.5 *per cent* after deducting 15 *per cent* towards labour and other charges. This resulted in short levy of tax and interest of ₹ 3.25 lakh.

We pointed out the matter to the department in April 2009 and reported to the Government in July 2009. The Government stated in November 2009 that the assessment was revised with an additional demand of ₹ 3.32 lakh. We have not received further report on the recovery (December 2010).

¹⁰ CTO (WC<), Kottayam.

¹¹ CTO (WC<), Malappuram.

2.12.4 Short levy due to incorrect classification

(Three CTOs¹²: November 2009 to January 2010)

The Supreme Court had held {M/s. Kone Elevator (India) Ltd. Vs State of Andhra Pradesh in 140 STC 22 (SC)} that sale, erection and commissioning of a lift is sale and not works contract. In addition to output tax leviable at appropriate rates, cess at the rate of one *per cent* is leviable on the output tax payable from 2008-09.

We noticed that five assesseees in CTOs Special Circle II, Ernakulam, Works Contract, Ernakulam and Works Contract, Thiruvananthapuram incorrectly assessed the turnover for sale, erection and commissioning of lifts for the years 2005-06 to 2008-09 as works contract and claimed exemption in relation to the turnover on labour charges incurred. We noticed that the assessing authorities did not detect this mistake which resulted in short levy of tax and interest of ₹ 11.24 crore.

After we pointed out these mistakes the assessing authorities stated that the Supreme Court decision pointed out in audit had been challenged by the dealer and had been referred to the constitution bench of the Supreme Court. The reply is not acceptable as the decision of the Supreme Court is still valid as it has not been stayed by the Court. Moreover, the court order produced by the assessee does not prevent the assessing authorities from making any assessments in this regard but only restricts them from taking any coercive steps to recover tax.

We pointed out the matter to the department and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.5 Short levy due to incorrect computation of tax

(CTO (WC<), Kozhikode; May 2010)

Section 8(a) (ii) of the KVAT Act prescribes that, any works contractor having CST registration may opt to pay tax at four *per cent* on the whole contract amount.

An assessee who had opted to pay compounded tax was having total contract receipt of ₹ 20.58 crore. He paid tax of ₹ 73.50 lakh instead of ₹ 82.31 lakh. This

resulted in short levy of tax of ₹ 8.81 lakh.

After we pointed out the case to the department in June 2009, the department stated in November 2009 that notice had been issued to the dealer. We have not received further report on the recovery (December 2010).

We reported the matter to the Government in January 2010. We have not received their reply (December 2010).

¹² CTOs: Special Circle II, Ernakulam, Works Contract, Ernakulam and Works Contract, Thiruvananthapuram.

Value Added Tax

2.12.6 Short levy due to excess availing of input tax credit

2.12.6.1 (CTO, special circle II, Ernakulam; November 2009)

Where any goods purchased in the State are subsequently sent outside the State or used in the manufacture of goods and the same are sent outside the State otherwise than by way of sale in the course of interstate trade or export or where the sale in the course of interstate trade is exempted from tax, input tax credit shall be limited to the amount of input tax paid in excess of the rate specified under the CST Act on the purchase turnover of such goods sent outside the State as per the proviso to section 11(3) of KVAT Act. The rate of tax applicable under the CST Act was three *per cent* during 2007-08. Section 11 (7) of the Act further stipulates that, if goods in respect of which input tax credit has been availed are subsequently used, fully or partly, for purposes in relation to which no input tax credit is allowable under the section, the input tax credit availed of in respect of such goods shall be reversed.

An assessee stock transferred raw materials valued at ₹ 3.44 crore and 90.30 *per cent* of their finished products for the year 2007-08. However, while limiting input tax credit to that extent by assessing reverse tax, it was assessed as ₹ 24.05 crore instead of ₹ 27.32 crore. This resulted in short levy of tax and interest of ₹ 3.85 crore.

We pointed out the mistake to the department in December 2009 and reported to the Government in June 2010. We have not received their replies (December 2010).

2.12.6.2 (CTO, special circle II, Ernakulam; November 2009)

Input tax credit (ITC) shall not be allowed to any amount illegally collected by way of tax as per proviso to Section 11(3) of the KVAT Act.

A dealer availed ITC of ₹ 35.75 crore on local purchases of goods valued at ₹ 828.35 crore as against the eligible claim of ₹ 33.13 crore for the year 2007-08 which was

not detected by the assessing officer. This resulted in short levy of tax and interest of ₹ 3.11 crore.

We pointed out the mistake to the department in December 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

- (IAC, Kattappana; November 2009)

A dealer availed input tax credit of ₹ 2.60 crore for the years 2005-06 to 2007-08 against the eligible credit of ₹ 2.57 crore due to mistake in computation

which was not detected by the assessing officer. This resulted in short levy of tax and interest of ₹ 4.53 lakh.

We pointed out the mistake to the department in January 2010 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.6.3 (CTO, special circle, Malappuram; March 2009)

During 2005-06 and 2006-07, the rate of tax under the CST Act was four *per cent*.

A dealer who effected interstate stock transfer of ayurvedic products for ₹ 16.38 crore and ₹ 19.02 crore during 2005-06

and 2006-07 respectively, claimed the entire input tax credit without limiting it to tax paid in excess of four *per cent* on stock transfer outside the State which was not detected by the assessing officer. This resulted in short levy of tax and interest of ₹ 41.69 lakh.

We pointed out the mistake to the department in April 2009 and reported to the Government in December 2009. We have not received their replies (December 2010).

2.12.6.4 (CTO, special circle, Mattancherry at Aluva; September 2009)

Input tax credit shall not be allowed as per Section 11(5) of the KVAT Act for the purchase of goods which are used in the manufacture, processing or packing of goods specified in the first schedule to the Act. Coconut oil and coconut oil cake are included in first schedule with effect from 1 May 2007.

A dealer who used copra purchased by him for manufacture of coconut oil and coconut oil cake for the year 2007-08 availed input tax credit of ₹ 8.41 lakh for the month of May and June 2007 on the purchase turnover of copra. This resulted in excess availing of ITC of ₹ 8.41 lakh and consequent short levy of tax and interest of

₹ 9.92 lakh.

We pointed out the mistake to the department in October 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

• (CTO, special circle, Kasaragod; August 2009)

A dealer claimed input tax credit for the entire purchase turnover of cashew nut for the year 2007-08. Even though 35.15 *per cent* of the total sales turnover relates to consignment and stock transfer, the input tax credit availed corresponding to this turnover was not deducted and the assessing officer had not detected this mistake. This resulted in short levy of tax of ₹ 6.69 lakh.

After we pointed out the mistake to the department in September 2009; the department stated in December 2009 that notice had been issued to the assessee. We have not received further reply from the department (December 2010).

We reported the defect to the Government in May 2010. We have not received their reply (December 2010).

2.12.7 Application of incorrect rate of tax

2.12.7.1 (19¹³ CTOs; August 2008 to November 2009)

The KVAT Act provides that batteries and parts thereof, petroleum bitumen (upto 30 June 2006), lead oxide, mansion polish, harpic, lizol, biscuits of all varieties and pickles sold under a brand name, speakers etc., handloom cotton tapes, medicated toothpowder and toothpaste, epoxy powder, *supari*, black and red oxide, dettol, detergents, doors, windows and their frames and thresholds for doors of aluminium and plastic, prickly heat powder and similar medicated body powder, adhesive tape and cosmetics are taxable at the rate of 12.5 *per cent* and branded soft drinks excluding soda and refrigerators and their spare parts are taxable at the rate of 20 *per cent* from July 2006 to March 2007. The Act also stipulates that expeller variety of sesame oil cake and frozen marine products are taxable at the rate of four *per cent*. The Act further prescribes that where sale is to or by military, air force or NCC canteen and canteen stores department, the tax payable shall be at half the rate applicable to such goods as per proviso to Section 6(1) of the KVAT Act. The High Court of Kerala had held that Nycil prickly heat powder is medicated talcum powder and not a drug or medicine and that, purchase of vehicles through CSD is not eligible for the concessional rate of tax as motor vehicles are sold not to CSD but to defence personnel. Further, interest at 12 *per cent per annum* is leviable for default in payment of taxes within the due dates.

We found during scrutiny of the records of 19 offices that 24 dealers had applied incorrect rate of tax on various commodities having a total taxable turnover of ₹ 23.66 crore. In spite of the specific provisions in the Act, these mistakes were not detected by the AAs which resulted in short levy of tax and interest of ₹ 2.40 crore as detailed below:

¹³ AIT & CTO Alappuzha, Special circles: I Ernakulam, II Ernakulam, Kasaragod and Palakkad CTOs: Chalakudy, First circle Changanacherry, Chittur, First circle Kannur, Third circle Kannur, Koothuparamba, First circle Kozhikode, Second circle Kozhikode, Fourth circle Kozhikode, Manjeri, Neyyattinkara, Payyannur, First circle Thiruvananthapuram and Second circle Thiruvananthapuram.

Audit Report (Revenue Receipts) for the year ended 31 March 2010

Sl. No.	Assessment circles Month of audit	Commodity Assessment year	Rate applicable Rate applied	Turnover (₹)	Short levy (₹)
1.	CTO, Special circle, Palakkad March 2009	Battery 2005-06 and 2006-07	12.5 4	6.69 crore	72.34 lakh
	After we pointed out the case to the department in May 2009, the department stated in June 2009 that notice under Section 25 (1) had been issued in June 2009. We reported the defect to the Government in February 2010. We have not received their reply (December 2010).				
2.	CTO, Special circle, Kasaragod August 2009	Petroleum bitumen 2005-06 and 2006-07	12.5 4	2.69 crore	31.45 lakh
	After we pointed out the case in September 2009, the department stated in December 2009 that the assessment had been revised based on audit observation. We reported the matter to the Government in March 2010. We have not received their reply (December 2010).				
3.	CTO, Special circle II, Ernakulam March 2009	Motor Vehicles 2005-06 and 2006-07	12.5 6.25	1.61 crore	12.89 lakh
	We pointed out the mistake to the department in April 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).				
4.	CTO, First circle, Changanacherry December 2008	Lead Oxide 2005-06 and 2006-07	12.5 4	1.21 crore	12.87 lakh
	We pointed out the case to the department in January 2009 and reported to the Government in February 2010. We have not received their replies (December 2010).				
5.	CTO, Special circle I, Ernakulam April 2009	Nycil prickly heat powder 2005-06	12.5 4	1.07 crore	12.42 lakh
	We pointed out the mistake to the department in May 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).				
6.	AIT & CTO, Alappuzha June 2009	Cotton tape 2005-06 and 2006-07	12.5 0	97.87 lakh	12.23 lakh
	After we pointed out the case in July 2009, the department stated in September 2009 that the assessments were revised. Report on recovery has not been received. We reported the case to the Government in January 2010. We have not received their reply (December 2010).				
7.	CTO, Chittur August 2009	Medicated tooth powder and tooth paste 2005-06 to 2007-08	12.5 4	78.06 lakh	8.90 lakh
	We pointed out the case to the department in September 2009 and reported to the Government in March 2010. We have not received their replies (December 2010).				
8.	CTO, Second circle, Thiruvananthapuram February 2009	Branded Soft drinks 2006-07	20 12.5	75.10 lakh	6.87 lakh

Sl. No.	Assessment circles Month of audit	Commodity Assessment year	Rate applicable Rate applied	Turnover (₹)	Short levy (₹)
	After we pointed out the case, the department stated in October 2009 that the assessment had been revised in September 2009. We reported the matter to the Government in March 2010. We have not received their reply (December 2010).				
9.	CTO, First circle, Kannur August 2009	Epoxy powder 2005-06 to 2007-08	12.5 4	76.67 lakh	6.52 lakh
	After we pointed out the case in September 2009, the department stated in November 2009 that notice had been issued to the assessee. We reported the matter to the Government in February 2010. We have not received their reply (December 2010).				
10.	CTO, Fourth circle, Kozhikode November 2009	Doors, windows and their frames and thresholds for doors of aluminium, plastics etc. 2007-08	12.5 4	57.76 lakh	5.89 lakh
	We pointed out the case to the department in December 2009 and reported to the Government in February 2010. We have not received their replies (December 2010).				
11.	CTO, First circle, Changanacherry December 2008	Mansion polish, <i>harpic, lizol,</i> shoe polish & <i>brasso</i> 2005-06 and 2006-07	12.5 4	51.97 lakh	5.81 lakh
	We pointed out the case to the department in January 2009 and reported to the Government in February 2010. We have not received their replies (December 2010).				
12.	CTO, Second circle, Kozhikode June 2009	Adhesive Tape 2005-06 to 2007-08	12.5 4	56.27 lakh	5.55 lakh
	We pointed out the mistake to the department in July 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).				
13.	CTO, Second circle, Thiruvananthapuram February 2009	Biscuits sold under brand name 2005-06 and 2006-07	12.5 4	53.91 lakh	5.34 lakh
	After we pointed out the case in March 2009, the department stated in October 2009 that the assessments for the years have been revised. We reported the matter to the Government in March 2010. We have not received their reply (December 2010).				
14.	CTO, Neyyattinkara December 2008	Expeller variety of sesame oil cake 2005-06 to 2006-07	4 0	97.43 lakh	4.85 lakh
	We pointed out the mistake to the department in January 2009 and reported to the Government in November 2009. We have not received their replies (December 2010).				

Audit Report (Revenue Receipts) for the year ended 31 March 2010

Sl. No.	Assessment circles Month of audit	Commodity Assessment year	Rate applicable Rate applied	Turnover (₹)	Short levy (₹)
15.	CTO, Koothuparamba June 2009	<i>Supari</i> (Betel nut) 2005-06	12.5 4	40.88 lakh	4.83 lakh
After we pointed out the case in July 2009, the department stated in September 2009 that notice had been issued to the assessee. We have not received further information. We reported the matter to the Government in January 2010. We have not received their reply (December 2010).					
16.	CTO, third circle, Kannur June 2009	Oxides 2005-06	12.5 4	33.98 lakh	3.98 lakh
After we pointed out the case in July 2009, the department stated in August 2009 that notice had been issued to the assessee. After we reported the case to the Government, we have not received their reply (December 2010).					
17.	CTO, First circle, Kozhikode August 2009	<i>Dettol</i> 2007-08	12.5 4	50.92 lakh	3.82 lakh
After we pointed out the defect to the department in September 2009 and reported to the Government in February 2010, we have not received their replies (December 2010).					
18.	CTO, Payyannur, August 2009	Cosmetics 2005-06	12.5 0	21.31 lakh	3.73 lakh
After we pointed out the mistake to the department in October 2009, the department stated in February 2010 that assessment was revised u/s. 25(1) and tax determined as Rs. 2.72 lakh. We have not received further report on recovery from the department (December 2010). We reported the mistake to the Government in May 2010. We have not received their replies (December 2010).					
19.	CTO, Manjeri August 2008	Pickles sold under a brand name 2005-06 and 2006-07	12.5 4	43.61 lakh	3.71 lakh
After we pointed out the case to the department in October 2008 and reported to the Government in December 2008, the Government stated in November 2009 that the assessments were revised in May 2009 and an additional demand of ₹ 3.71 lakh created. We have not received further report on recovery (December 2010).					
20.	CTO, First circle, Thiruvananthapuram January 2009	Speakers 2005-06	12.5 4	29.31 lakh	3.31 lakh
After we pointed out the case to the department in March 2009 and reported to the Government in July 2009, the Government stated in October 2009 that assessment had been reopened under Section 25 of the Act and additional demand created was demanded from the dealer. We have not received further report on recovery (December 2010).					
21.	CTO, Special circle II, Ernakulam October 2009	Frozen Marine products 2007-08	4 0	67.19 lakh	3.17 lakh

Sl. No.	Assessment circles Month of audit	Commodity Assessment year	Rate applicable Rate applied	Turnover (₹)	Short levy (₹)
	We pointed out the mistake to the department in December 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).				
22.	CTO, First circle, Thiruvananthapuram January 2009	Refrigerator and spares 2006-07	20 12.5	32.29 lakh	2.93 lakh
	We pointed out the mistake to the department in March 2009 and reported to the Government in July 2009. The Government stated in October 2009 that the assessment had been revised in May 2009 and balance tax and interest of ₹ 4.72 lakh demanded out of which the assessee had remitted an amount of ₹ 80,000. We have not received further report on recovery of balance amount (December 2010).				
23.	CTO, Chalakudy March 2009	Batteries and detergents 2006-07	12.5 4	28.07 lakh	2.93 lakh
	We pointed out the case to the department in March 2009 and reported to the Government in December 2009. We have not received their replies (December 2010).				
24.	CTO, Special circle I, Ernakulam March 2009	Motor Vehicles 2005-06 and 2006-07	12.5 6.25	46.89 lakh	2.93 lakh
	After we pointed out the mistake in March 2009, the assessing authority stated that the assessee had sold the goods to CSD and all the sale bills were raised in the name of CSD. The reply is not correct in view of the judicial pronouncement as vehicles are sold in the names of personnel and not in the name of CSDs as CSDs cannot take registration in their name. We pointed out the mistake to the department in May 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).				

2.12.7.2 (CTO, special circle, Mattancherry at Aluva; September 2009)

High Court of Kerala had held (MP Agencies Vs State of Kerala reported in 18 KTR 82) that *ujala* supreme and *ujala* stiff and shine are not industrial raw materials coming under list A of third schedule to the KVAT Act but are commodities taxable at 12.5 per cent under the Act. Further, sales to canteen stores department are taxable at half the rate applicable under proviso to Section 6(1) of the KVAT Act.

A dealer assessed tax for the year 2007-08 on the sales turnover of *ujala* supreme valued at ₹ 2.36 crore at the rate of four per cent and the sales turnover of *ujala* stiff and shine valued at ₹ 9.43 lakh to canteen stores department at two per cent instead of at the correct rate of 12.5 per cent and 6.25 per cent respectively. This resulted in short levy of tax and interest of ₹ 23.94 lakh.

We pointed out the mistake to the department in October 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.8 Short levy due to excess availing of special rebate

2.12.8.1 (CTO, Special circle, Ernakulam; March 2009)

Where the goods in respect of which tax under Section 6(2) of the Act has been paid, are sent outside the State or used in the manufacture of goods and the same are sent outside the State, otherwise than by way of sale in the course of interstate trade or export or where the sale in the course of interstate trade is exempted from tax, the special rebate under this section shall be limited to the amount of such tax paid in excess of four *per cent* as per proviso to Section 12 of KVAT Act.

An assessee who effected interstate stock transfer of gold ornaments valued at ₹ 151.04 crore for the year 2006-07 availed special rebate for the entire purchase instead of limiting it to the eligible limit. This resulted in short levy of tax and interest of ₹ 1.67 crore.

We pointed out the mistake to the department in May 2009 and reported to the Government in June 2010. We have not received their replies

(December 2010).

- (CTO, Special circle (produce), Mattanchery; July 2009)

An assessee effected interstate stock transfer of tea manufactured by him valued at ₹ 29.88 crore during 2006-07. However, the assessee did not limit special rebate to that extent. This resulted in short levy of tax and interest of ₹ 5.96 lakh.

We pointed out the mistake to the department in August 2009 and reported to the Government in June 2010. We have not received their replies (December 2010).

2.12.8.2 (CTO, Special circle II, Ernakulam; November 2009)

As per Section 12 (1) (a) of the KVAT Act, in calculating the net tax payable, special rebate equal to the tax paid under Section 6(2) of the KVAT Act shall be deducted.

An assessee who had not disclosed purchases from unregistered dealers, availed special rebate of ₹ 7.46 lakh for the year 2007-08. This resulted in short levy of tax

and interest of ₹ 8.87 lakh.

We pointed out the mistake to the department in December 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

- (CTO, Special circle, Kasaragod; August 2009)

A dealer claimed special rebate relating to the purchase tax paid during the year 2006-07 valued at ₹ 6.49 lakh for the year 2007-08. However, the assessee had already claimed the entire special rebate for the year 2006-07 in that year itself which was not detected by the assessing officer. This resulted in short levy of tax of ₹ 6.49 lakh.

After we pointed out the defect to the department in September 2009, the department stated in December 2009 that notice had been issued to the assessee. We have not received further report on recovery (December 2010).

We reported the mistake to the Government in May 2010. We have not received their reply (December 2010).

2.12.9 Short levy of output tax

2.12.9.1 (CTO, Special circle I, Ernakulam; May 2009)

Where any dealer detects any omission or mistake in the annual return submitted by him with reference to the audited figure, he shall file revised annual return rectifying the mistake or omission alongwith the audit certificate as per Section 42(2) of the KVAT Act. Where, as a result of such revision, the tax liability increases, the revised return shall be accompanied by proof of payment of tax, interest due thereon and penal interest, calculated at twice the rate of interest.

A dealer availed input tax credit of ₹ 32.97 lakh on purchase for the year 2006-07 valued at ₹ 3.97 crore. However, as per the certified accounts, the purchases from the VAT dealers were valued at ₹ 15.06 lakh. In spite of this, no action was taken by the assessing officer to get the return revised or to disallow the excess input tax

credit and realise the differential tax. This resulted in short levy of tax, interest and penal interest of ₹ 53.61 lakh.

We pointed out the mistake to the department in May 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.9.2 (CTO, Special circle I, Ernakulam; April 2009)

A dealer assessed output tax on sales turnover of ₹ 112.37 crore as conceded in the return for the year 2006-07, even though local sale as per the certified accounts for that year was ₹ 113.37 crore. However, no action was taken to revise the return and pay differential tax. This resulted in short levy of tax, interest and penal interest of ₹ 24.05 lakh.

We pointed out the mistake to the department in May 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.9.3 (CTO, special circle, Mattancherry at Aluva; September 2009)

A dealer in steel availed input tax credit of ₹ 57.06 lakh for the year 2007-08 on the purchase turnover of ₹ 14.19 crore as conceded in the annual return. However, as per the certified accounts, the assessee was eligible for an input tax credit of ₹ 49.30 lakh only on the purchase turnover of ₹ 12.26 crore. This resulted in short levy of tax, interest and penal interest of ₹ 11.73 lakh.

We pointed out the mistake to the department in October 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.9.4 (CTO, special circle (produce), Mattancherry; June 2009)

A dealer failed to assess tax on DEPB licence for the years 2005-06 to 2007-08, valued at ₹ 1.57 crore. Even though this fact was available in the audited accounts, the AA failed to detect it and levy tax during scrutiny of the return. This resulted in short levy of tax, interest and penal interest of ₹ 10.55 lakh.

After we pointed out the mistake the assessing officer stated in July 2009 that the assessee remitted ₹ 6.30 lakh in July 2009 of which ₹ 1.42 lakh was adjusted against interest and the balance against tax (December 2010).

We reported the mistake to the Government in May 2010. We have not received their reply (December 2010).

2.12.9.5 (CTO, Special circle II, Ernakulam; March 2009)

A dealer availed input tax credit of ₹ 51.55 lakh for the year 2006-07 on the local purchases valued at ₹ 7.23 crore. However, the certified accounts revealed a local purchase turnover of ₹ 6.04 crore only which was not detected by the assessing officer and the excess claim disallowed. This resulted in short levy of tax, interest and penal interest of ₹ 8.03 lakh.

We pointed out the mistake to the department in April 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.10 Short levy due to incorrect allowance of discount

2.12.10.1 (CTO, Special circle, Mattancherry; January 2009)

Explanation III (ii) under Section 2(lii) of the KVAT Act stipulates that any discount on the price allowed in respect of any sale where such discount is shown separately in the tax invoice and the buyer pays only the amount reduced by such discount; or any amount refunded in respect of goods returned by customers shall not be included in the turnover.

An assessee incorrectly excluded from the turnover, discount amounting to ₹ 12.37 crore and ₹ 1.17 crore for the years 2005-06 and 2006-07 respectively which were not shown in the invoices raised by the

dealer. This resulted in short levy of tax of ₹ 54.18 lakh.

We pointed out the matter to the department in February 2009 and reported to the Government in April 2010. We have not received their replies (December 2010).

• (CTO, Special circle I, Ernakulam; November 2009)

A dealer collected tax on the entire invoice price for the years 2005-06 and 2006-07 and subsequently allowed discount through credit notes and excluded the discount from taxable turnover which was not detected by the assessing officer and the discount thus claimed was not disallowed. This resulted in short levy of tax of ₹ 39.66 lakh.

We pointed out the mistake to the department in March 2010 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.10.2 (CTO, Nedumkandam; May 2009)

Input tax credit shall not be available in respect of the tax paid on the turnover subsequently allowed as discount as per proviso to Section 11(3) of the KVAT Act.

A dealer in cement and Asbestos Cement sheet received an amount of ₹ 24.83 lakh for the years 2006-07 and 2007-08 as discount subsequent to sale, but availed

input tax credit on the entire purchase turnover instead of limiting it to that extent. This resulted in excess availing of input tax credit of ₹ 3.10 lakh.

After we pointed out the mistake to the department in June 2009 and reported it to the Government in January 2010, the Government stated in March 2010 that notice had been issued to the dealer to revise the assessment. We have not received their further reply (December 2010).

2.12.11 Short levy due to incorrect computation

2.12.11.1 (CTO, special circle II, Ernakulam; November 2009)

Where the return submitted is with incorrect particulars, the assessing officer shall, after recording reasons, reject the return with due notice to the dealer, as per Section 22 of the KVAT Act. The AA shall estimate the turnover of return period and complete the assessment to the best of its judgement.

A dealer incorrectly computed the tax eligible for set off for the year 2007-08 as ₹ 43.33 crore instead of as ₹ 42.98 crore. However, the return was not rejected by the assessing authority. This resulted in short levy of tax and interest of ₹ 41.65 lakh.

We pointed out the mistake to the department in December 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.11.2 (CTO, Special circle I, Ernakulam; March 2009)

Gold, silver and platinum ornaments are taxable at the rate of one *per cent* upto 30 June 2006 and thereafter at the rate of four *per cent* as per schedules II and III to the KVAT Act.

A dealer assessed output tax on the sales turnover of gold ornaments valued at ₹ 343.63 crore for the year 2006-07 as ₹ 10.50 crore instead of ₹ 10.64 crore which was not detected by the assessing officer. This resulted in short levy of tax and

interest of ₹ 17.18 lakh.

We pointed out the mistake to the department in May 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.11.3 (CTO, Tirur; April 2009)

Section 8(f) of the KVAT Act stipulates that a dealer in ornaments of gold, who has commenced business during the period from 1 October 2006 to 28 February 2007, may opt to pay tax for that year at one hundred and fifty *per cent* of average monthly tax. Further, the compounded tax payable for the year 2007-08 by a dealer who exercised option for compounding under this clause between 1 December 2006 and 15 March 2007 shall be one hundred and fifteen *per cent* of the compounded tax fixed for the year 2006-07 or tax collected as per accounts, whichever is higher. Section 22(2) of the Act further stipulates that a dealer whose return is rejected may file a fresh return curing the defects together with proof of payment of tax and interest on the tax payable at the rate of 12 *per cent per annum* for the period from the due date of filing of return till the date of filing of fresh return.

The compounded tax for the year 2006-07 of a dealer in gold ornaments who commenced business on 18 February 2007, was fixed incorrectly by the AA due to reckoning of turnover from the period 18 February 2007 to 28 February 2007 as the turnover for one month instead of taking this turnover as that for 11 days and accordingly arriving at the turnover for one month. This resulted in short assessment of tax and interest of ₹ 10.12 lakh for the year 2006-07 and 2007-08.

We pointed out the case to the department in June 2009 and reported to the

Government in November 2009. The Government stated in February 2010 that the self assessment returns filed by the dealer had been revised based on the audit objection creating an additional demand of ₹ 8.91 lakh towards tax and ₹ 1.47 lakh towards interest and advised for revenue recovery. We have not received further report on recovery (December 2010).

2.12.11.4 (CTO, special circle I, Ernakulam; April 2009)

Interstate sales turnover not covered by declaration in Form C is taxable at the rate of 10 *per cent* or at the rate applicable to the sale or purchase of such goods inside the State, whichever is higher as per Section 8(2) (b) of the CST Act.

A dealer self assessed tax on the interstate sales turnover of ₹ 1 crore as disclosed in the annual return, even though the certified accounts reflected an interstate sales turnover of ₹ 2 crore. This resulted in short levy of tax of ₹ 10.07 lakh.

We pointed out the mistake to the department in April 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.12 Short levy due to turnover escaping assessment

2.12.12.1 (CTO, special circle, Palakkad; February 2010)

Sale price includes excise duty also as per Section 2 (xliv) of the KVAT Act.

A manufacturer and dealer in tread rubber, did not assess the turnover relating to excise duty and cess amounting to ₹ 12.08

crore collected for the year 2006-07. This resulted in short levy of tax and interest of ₹ 64.76 lakh.

We pointed out the mistake to the department in April 2010 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.12.2 (IAC, Kattappana; November 2009)

Transfer of right to use any goods for any purpose, whether or not for a specified period, is liable to tax at four *per cent* at all points of such transfer as per Section 6(1) (c) of the KVAT Act. High Court of Kerala had held (M/s. Kreem Foods Private Limited Vs State of Kerala reported in [2009] 24 VST 333) that royalty received in transfer of right to use trade mark is liable to tax at the rate of four *per cent*.

A dealer in *hawai chappals*, umbrella and school bags received royalty valued at ₹ 1.36 crore for the years 2005-06 to 2007-08 in respect of transfer of right to use their trade mark, which was not assessed to tax. This resulted in short levy of tax and interest of ₹ 7.27 lakh.

We pointed out the mistake to the department in January 2010 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.13 Short levy due to application of incorrect rate of input tax credit

Collection of tax at a rate higher than that applicable to such goods is illegal and no input tax credit shall be allowed to any amount illegally collected by way of tax as per proviso to sub Section 3 of Section 11 read with Section 30(3) (a) (ii) of the KVAT Act.

We found in the scrutiny of records in six offices¹⁴ that six assesseees availed input tax credit for the year 2005-06 to 2007-08 at incorrect rates of tax on

the purchase turnover of various commodities valued at ₹ 4.41 crore. This resulted in short levy of tax and interest of ₹ 44.61 lakh as detailed below.

¹⁴ CTOs: Special Circle I and Special Circle II, Kozhikode, Special Circle Malappuram, Special Circle Mattancherry, Second circle Kottayam and Attingal.

Audit Report (Revenue Receipts) for the year ended 31 March 2010

Sl. No.	Assessment circles Month of audit	Commodity Assessment year	Rate of tax claimed Rate of tax eligible	Turnover (₹)	Short levy (₹)
1.	CTO, Spl Circle I, Kozhikode; September 2009	Pacemaker, stents 2005-06 and 2006-07	12.5 4	1.33 crore	14.79 lakh
<p>After we pointed out the case in September 2009, the assessing authority stated in October 2009 that notice had been issued to the assessee. We have not received further report on recovery (December 2010).</p> <p>We pointed out the case to the department in December 2009 and to the Government in April 2010. We have not received their replies (December 2010).</p>					
2.	CTO Spl. Circle II, Kozhikode; January 2009	Plastic compound 2006-07	12.5 4	1.07 crore	11 lakh
<p>We pointed out the case to the department in March 2009 and reported to the Government in January 2010. We have not received their replies (December 2010).</p>					
3.	CTO, Spl. Circle, Malappuram; February 2009	<i>Eva</i> compound (Plastic compound) 2006-07	12.5 4	94.92 lakh	9.84 lakh
<p>We pointed out the matter to the department in April 2009 and reported to the Government in December 2009. We have not received their replies (December 2010).</p>					
4.	CTO, Second circle, Kottayam; May 2009	Rubber wood 2006-07 and 2007-08	12.5 4	52.40 lakh	4.45 lakh
<p>We pointed out the matter to the department in June 2009 and reported to the Government in November 2009. We have not received their replies (December 2010).</p>					
5.	CTO, Special circle, Mattancherry; January 2009	Flax seed oil/linseed oil 2005-06 and 2006-07	12.5 4	26.87 lakh	2.28 lakh
<p>We pointed out the matter to the department in February 2009 and reported to the Government in April 2010. We have not received their replies (December 2010).</p>					
6.	CTO, Attingal; September 2008	Sodium silicate 2005-06	12.5 4	26.50 lakh	2.25 lakh
<p>After we pointed out the matter in October 2008, the department stated in November 2009 that the excess input tax claim was demanded in February 2009. We have not received further report on recovery (December 2010).</p> <p>We pointed out the matter to the Government in April 2010. We have not received their reply (December 2010).</p>					

2.12.14 Non-levy of reverse tax

- (CTO, special circle, Malappuram; March 2009)

If goods in respect of which input tax credit has been availed are subsequently used, fully or partly, for purposes in relation to which no input tax credit is allowable under the section, the input tax credit availed of in respect of such goods shall be reversed and reverse tax shall be deemed to be an amount due under Section 11(7) of the KVAT Act.

A dealer had effected free sale of medicine for ₹ 3.51 crore and ₹ 4.05 crore during 2005-06 and 2006-07 respectively and exempted sale to special economic zone for ₹ 62.04 lakh in 2006-07. However, proportionate input tax and special rebate in respect to the above has not been assessed as reverse tax.

This resulted in short levy of tax and interest of ₹ 15.06 lakh.

We pointed out the mistake to the department in April 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

- (CTO, Tirurangadi; October 2009)

An assessee who had shown a purchase of ₹ 20.65 lakh as per the certified accounts of 2006-07, conceded a reverse tax of ₹ 17,743 only instead of ₹ 2.35 lakh. This resulted in short levy of tax, interest and penal interest of ₹ 4.14 lakh.

We pointed out the matter to the department in November 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.15 Short levy due to excess grant of input tax credit

- (CTO, second circle, Kottayam; May 2009)

As per Section 11 (3) of the KVAT Act where any goods purchased in the State are subsequently sent outside the State or used in the manufacture of goods and the same are sent outside the State otherwise than by way of sale in the course of interstate trade or export or where the sale in the course of interstate trade is exempted from tax, input tax credit shall be limited to the amount of input tax paid in excess of the rate specified under the CST Act. The rate of tax applicable under the CST Act was four *per cent* during 2006-07 and three *per cent* during 2007-08.

An assessee claimed input tax credit for the entire purchases for the years 2006-07 and 2007-08, even though 53 *per cent* of the goods manufactured were sent outside the State otherwise than by way of sale. The input tax credit availed corresponding to the stock transfer was not disallowed. This resulted in short levy of tax of ₹ 11.88 lakh.

We pointed out the matter to the department in June 2009 and reported to the Government in November 2009. We have not received their replies (December 2010).

2.12.15.2 (CTO, special circle I, Kozhikode; September 2009)

A dealer claimed input tax credit for the entire purchases for the year 2007-08, even though 8.40 *per cent* of the total sales turnover relates to consignment sale. The input tax credit availed corresponding to this turnover was not disallowed. This resulted in short levy of tax and interest of ₹ 3.82 lakh.

After we pointed out the case in September 2009, the assessing authority stated that notice was issued to the dealer. We have not received a report on recovery (December 2010).

We reported the matter to the department in October 2009 and to the Government in April 2010. We have not received their replies (December 2010).

2.12.16 Incorrect computation of presumptive tax

(CTO, second circle, Thiruvananthapuram; February 2009)

As per Section 6(5) of the KVAT Act, a dealer whose total turnover for a year is below ₹ 50 lakh, may pay presumptive tax at the rate of half *per cent* of the turnover of taxable goods instead of paying tax under sub-section(1) of Section 6. However, as per Rule 17(31) of the KVAT Rules, where a dealer who has opted for payment of presumptive tax is likely to become ineligible for the payment of such tax, such dealer shall intimate the facts to the registering authority and he shall be liable for payment of tax in accordance with the provisions of sub-section (1) and (2) of Section 6 from the day following the day on which he has become ineligible.

A dealer irregularly paid presumptive tax for the entire sales turnover of ₹ 77.20 lakh for the year 2006-07 instead of paying presumptive tax for the turnover upto ₹ 50 lakh and at the specified rate for the balance turnover of ₹ 27.20 lakh. This resulted in short levy of tax of ₹ 4.45 lakh.

After we pointed out the matter in March 2009, the department stated in October 2009 that the assessment was revised

with an additional demand of ₹ 4.45 lakh and the assessee had paid an amount of ₹ 94,976.

After we reported the matter to the Government in March 2010, we have not received their replies (December 2010).

Sales Tax

2.12.17 Short levy of tax due to incorrect exemption

2.12.17.1 (CTO, special circle II, Ernakulam; November 2009)

Tea sold under brand name registered under the Trade and Merchandise Marks Act, 1958 is liable to be taxed at the rate of eight *per cent* as per Section 5 (1) of the KGST Act. However, the tax payable on branded tea under this item shall be reduced by the amount of tax paid on unbranded tea in the State.

An assessing officer finalised the assessments of a dealer engaged in public distribution of provision, consumables etc., for the years 2001-02 to 2004-05 in December 2008, exempting the sales turnover of tea sold under the brand name 'Sabari' valued at ₹ 72.92 crore. This mistake resulted in short levy of tax of ₹ 2.39 crore.

After we pointed out the mistake in November 2009, the assessing officer stated that Section 5 (2) of the Act specifically excludes manufactured tea from requirement of treating sale by brand name holder, as first sale in the State. The reply is not tenable as tea manufactured and sold under brand name is specifically excluded from Section 5(2) and hence is governed by Section 5(1) of the Act.

We pointed out the matter to the department in December 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.17.2 (CTO, Haripad; March 2009)

Where a sale of any goods in the course of interstate trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods to the Government/registered dealer shall be exempted from tax under Section 6(2) of the CST Act.

The AA finalised the assessment of a dealer in paper for the year 2004-05, exempting the sales turnover of paper to Government departments for an amount of ₹ 2.94 crore treating it as sale in transit. However, we found that the sales to the Government department were not effected during the

movement of goods from one State to another. This resulted in short levy of tax of ₹ 13.39 lakh.

After we pointed out the matter to the department in April 2009, the department stated in January 2010 that permission of the CCT to reopen the assessment had been requested. We have not received further reply (December 2010).

After we reported the matter to the Government in November 2009, we have not received their reply (December 2010).

2.12.18 Application of incorrect rate of tax

2.12.18.1 (CTO, special circle, Palakkad; February 2009)

Tax payable by a dealer on the interstate sales turnover of declared goods, not supported by declaration in Form C shall be calculated at twice the rate applicable to the sale or purchase of such goods inside the State as per Section 8(2) (a) of the CST Act. The rate of tax applicable on the sale of cotton yarn was two *per cent* plus AST at 15 *per cent* as per the KGST Act.

A dealer in cotton yarn disclosed the interstate sales turnover of cotton yarn not covered by Form 'C' valued at ₹ 6.32 crore and ₹ 1.36 crore for the years 2002-03 and 2003-04 respectively in his annual returns. However, the AA finalised the assessments applying the incorrect rate of tax at two *per cent* and one *per cent* respectively instead of four *per cent* plus AST. This mistake resulted in short levy of tax of ₹ 21.33 lakh.

After we pointed out the mistake in May 2009, the department stated in August 2009 that the assessment would be re-opened after obtaining permission from the Commissioner of Commercial Taxes. We reported the case to the Government in February 2010. We have not received their replies (December 2010).

2.12.18.2 (CTO, special circle, Kannur; September 2009)

Umbrella and parts thereof, oil palm kernels and water are taxable at the rate of eight *per cent* as per Schedule I to the KGST Act.

An assessing officer finalised the assessment in January 2009, of a dealer in umbrella etc. for the years 2003-04 and 2004-05 assessing the sales turnover of umbrella valued at ₹ 1.37 crore at the rate of four *per cent*

instead of at the correct rate of eight *per cent*. This resulted in short levy of tax and interest of ₹ 7.35 lakh.

We pointed out the matter to the department in October 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

- **(CTO, special circle, Kottayam; November 2008)**

An assessing officer finalised the assessment of a dealer for the year 2002-03 assessing the sales turnover of oil palm kernels for ₹ 59.28 lakh at the rate of four *per cent* instead of at the correct rate of eight *per cent*. This resulted in short levy of tax of ₹ 2.73 lakh.

We pointed out the matter to the department in February 2009 and reported to the Government in September 2009. We have not received their replies (December 2010).

- (CTO, special circle, Mattancherry; December 2008)

The assessing officer finalised the assessments of a manufacturer for the years 2003-04 and 2004-05, levying tax on the turnover of water purchased from unregistered dealers at the rate of five *per cent* instead of at the correct rate of eight *per cent*. This mistake resulted in short levy of tax of ₹ 2.30 lakh.

We pointed out the mistake to the department in February 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.18.3 (CTO, special circle, Mattancherry at Aluva; December 2008)

Interstate sales turnover not covered by declaration in Form C is taxable at the rate of 10 *per cent* or at the rate applicable to the sale or purchase of such goods inside the State, whichever is higher as per Section 8 (2) (b) of the CST Act. Spices oil and essences are liable to be taxed at 12 *per cent* plus AST as per Schedule I to the KGST Act.

The fast track team¹⁵ finalised the CST assessment of a dealer for the year 2004-05 in November 2007, incorrectly assessing the interstate sales turnover of spices oil and essence not covered by declaration in Form C at the rate of 10 *per cent* instead of at the correct rate of 12 *per cent* plus AST. This resulted in short levy of tax of ₹ 2.68 lakh.

We pointed out the mistake to the department in February 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

2.12.19 Short levy due to incorrect computation

(CTO, special circle, Kannur; September 2009)

The assessing officer shall check all calculations and credits given in an assessment as per the instruction issued by the erstwhile Board of Revenue.

An assessing officer finalised the assessment of a dealer in rubber for the years 2002-03 to 2004-05 in September and October 2008 and incorrectly computed the purchase turnover of latex used in the conversion of field latex to centrifuged latex, valued as ₹ 2.71 crore instead of ₹ 4.02 crore. This resulted in short levy of tax and interest of ₹ 28.16 lakh.

We pointed out the mistake to the department in October 2009 and reported to the Government in May 2010. We have not received their replies (December 2010).

¹⁵ A team of assessing officers constituted by the CCT under Section 17 (D) of the KGST Act.

2.12.20 Turnover escaping assessment

(CTO, special circle, Kottayam; November 2008)

Scrap rubber is taxable at 12 *per cent* as per Schedule I to the KGST Act. However, tax at six *per cent* is leviable on rubber purchased by rubber based industrial units in the State.

The fast track authorities finalised the assessments of two dealers engaged in the manufacture and sale of rubber products for the years 2003-04 and 2004-05 in May 2007. We noticed that they did not levy tax

on the intrastate purchase turnover of scrap rubber valued at ₹ 97.13 lakh. This resulted in short levy of tax of ₹ 6.70 lakh.

We pointed out the matter to the department in February 2009 and reported to the Government in July 2009. The Government stated in November 2009 that the assessments were revised in October 2009.