

EXECUTIVE SUMMARY

Appreciable increase in tax collection	During 2010-11, tax collection increased by 23.97 <i>per cent</i> as against 12.25 <i>per cent</i> during the previous year. The State could achieve this due to increase in sales tax collection by 41.99 <i>per cent</i> caused by increase in the price of petroleum products.
Internal Audit was weak	Internal Audit Wing (IAW) was able to audit only 22 out of the 132 units planned for audit during the year. Further, none of the outstanding audit observations of IAW was cleared during 2009-10 and 2010-11.
Ineffective follow up of audit observations	The Department accepted ₹ 66.22 crore in 750 cases pointed out by us but only 23.70 <i>per cent</i> of the amount accepted was recovered.
Results of audit	In 2010-11 we test checked records of 205 units relating to KGST and VAT And pointed out 3,152 observations involving ₹ 944.66 crore, out of which 332 cases involving ₹ 50.94 crore were accepted. Apart from this we conducted two reviews also.
What we have highlighted in this Chapter	<p>In our review on Compounding Schemes in the Commercial Taxes Department we have pointed out cases involving money value of ₹ 38.35 crore. The review on Utilisation of declaration forms in inter-state trade contains cases of short/non-levy of tax of ₹ 326.27 crore.</p> <p>We have also presented 19 paragraphs involving money value of ₹ 85.03 crore in this Chapter.</p> <p>We are concerned that most of the omissions highlighted in this Chapter had been pointed out by us repeatedly in the past audit reports, but such irregularities still persist and remain undetected till they are pointed out by us.</p>
Our conclusion	<p>The Department needs to improve the internal control system including strengthening of internal audit so that weaknesses in the system are addressed and omissions pointed out by us are prevented or detected and remedied in a timely manner.</p> <p>We also urge the Department to initiate immediate action to recover the underassessment of tax and other irregularities pointed out by us, more so in those cases where it has accepted our observations.</p>

CHAPTER-II: TAX ON SALES, TRADE ETC.

2.1 Tax administration

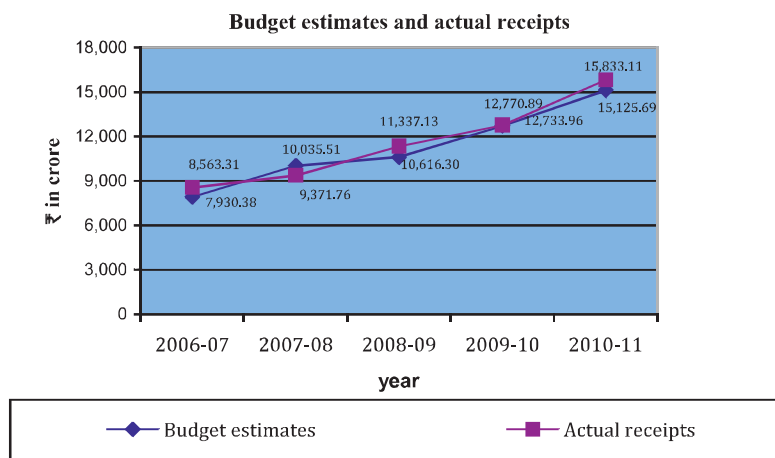
The Commercial Taxes Department contributes a major part of the revenue of the State. The revenue is derived from the assessment and collection of different taxes like sales tax, value added tax and central sales tax which are regulated by the Kerala General Sales Tax Act, 1963, the Kerala Value Added Tax Act, 2003, the Central Sales Tax Act, 1956 and notifications issued by the Department from time to time. The Department is under the administrative control of the Secretary to Government, Taxes. The Commissioner of Commercial Taxes administers the Acts and Rules. He is assisted by Joint Commissioners, Dy. Commissioners, Asst. Commissioners and Commercial Tax Officers. The assessment, levy and collection of tax is done by Assistant Commissioners and Commercial Tax Officers.

2.2 Trend of receipts

Actual receipts from VAT/tax on sales, trade etc. during the last five years (2006-07 to 2010-11) along with the budget estimates during the same period is exhibited in the following table and graph.

(₹ in crore)

Year	Budget estimates	Actual receipts	Variation	Percent age of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts	Percentage of growth rate
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
2010-11	15,125.69	15,833.11	(+) 707.42	(+) 4.67	21,721.69	72.89	23.97



We noticed that the Department was able to achieve a healthy growth rate of 23.97 *per cent*, the highest in the last five years, during 2010-11.

2.3 Assessee profile

The number of dealers registered at the end of 2008-09, 2009-10 and 2010-11 is shown below:

2008-09	1,59,207
2009-10	1,59,665
2010-11	1,69,298

We noticed significant increase (9,633) in the number of dealers during 2010-11. The VAT collection from the top 50 dealers in the State was ₹ 4,610.75 crore which was 29.12 *per cent* of the total collection. Out of the total dealers, 24,712 dealers constituting 14.60 *per cent* were paying tax at 0.5 *per cent* under the category of presumptive tax payers.

Tax collection from KGST during 2010-11 was ₹ 7,402.07 crore as per the Finance Accounts prepared by Accountant General(A&E). However, our analysis revealed that tax as per the returns filed by five major dealers alone was ₹ 7,368.45 crore and the month wise collection under the KGST recorded by the Department was ₹ 7,243.64 crore. Hence, the Department may reconcile the figures and rectify the difference.

2.4 Receipt of VAT per assessee

The receipt of VAT/sales tax per assessee during 2010-11 was ₹ 9.15 lakh, which was higher than the previous year's receipt of ₹ 7.79 lakh by ₹ 1.36 lakh.

2.5 Arrears in sales tax assessment

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

Opening balance	9,267
Addition during 2010-11 including remanded cases	3,826
Total	13,093
No. of assessments completed	6,947
Arrear cases – 6,155	
Current cases – 512	
Remanded cases – 280	
Closing balance	6,146

The Department completed 6,947 assessments under the KGST which was 53.05 *per cent* of the assessments due for finalisation.

We recommend the Government to complete assessments of the remaining cases in a time bound manner.

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 2006-07 to 2010-11 along with 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 over the previous year
	(₹ in crore)			
2006-07	8,563.31	78.21	0.91	0.91
2007-08	9,371.76	89.75	0.96	0.82
2008-09	11,377.13	102.59	0.90	0.83
2009-10	12,770.89	126.01	0.99	0.88
2010-11	15,833.11	115.61	0.73	0.96

Source: Finance Accounts and Departmental figures.

We are glad to note that the Department had reduced the cost of collection by 8.25 *per cent* during 2010-11.

2.7 Analysis of collection

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

(₹ in crore)			
Revenue head	2008-09	2009-10	2010-11
Sales Tax	5,881.97	5,212.92	7,402.07
VAT	5,035.19	7,235.26	8,097.15
CST	425.38	292.94	310.42

The above table indicates that during 2010-11 collection of sales tax increased by ₹ 2,189.15 crore and VAT collection by ₹ 861.89 crore. We observed that the significant increase of 41.99 *per cent* under Sales tax was due to steady increase in the price of petroleum products during 2010-11.

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 ₹ 2,520.43 crore in 8,692 paragraphs. Of these, the Department/Government accepted audit observations involving ₹ 1,200.30 crore and had since recovered ₹ 20.06 crore. The details are shown in the following table:

(₹ in crore)						
Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	No.	Amount	No.	Amount	No.	Amount
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	--	--
2009-10	4,451	1,122.54	657	558.60	588	5.02
Total	8,692	2,520.43	1,477	1200.30	1,080	20.06

The recovery position as compared to the accepted cases during the last four years was very low being only 1.67 *per cent*. The insignificant recovery of ₹ 20.06 crore against the money value of ₹ 1,200.30 crore relating to the accepted cases during the period 2006-07 to 2009-10 highlights the failure of the Department in recovering the Government dues promptly even in respect of cases accepted by them.

2.9 Working of internal audit wing

The internal audit wing (IAW) in the Commercial Taxes Department commenced functioning from 1 June 2009. The wing is headed by a Deputy Commissioner, three Assistant Commissioners and six Commercial Tax Officers. During the year 2010-11, against the target of 132 units 22 units were audited leaving 110 units in arrears. The Department attributed the arrears to the ceiling fixed on Travelling Allowance to Audit Officers. There were 53 IRs with 755 observations involving ₹ 80.94 crore outstanding (October 2011). Further, during 2009-10 and 2010-11, there was no clearance of observations by settlement which indicated poor response to the observations of IAW. The Department has not prepared a separate internal audit manual.

2.10 Results of audit

In 2010-11, we test checked the records of 205 units relating to KGST and VAT. We detected underassessment of tax and other irregularities involving ₹ 944.66 crore in 3,152 cases which fall under the following categories :

(₹ in crore)

Sl. No.	Categories	No. of cases	Amount
1.	Compounding Scheme in Commercial Taxes Department (A review)	1	38.35
2.	Utilisation of declaration forms in inter-state trade (A review)	1	326.27
Value Added Tax			
3	Turnover escaping assessment	878	156.51
4	Grant of irregular exemption	392	46.32
5	Application of incorrect rate of tax	258	71.44
6	Grant of excess input tax credit	550	20.74
7	Incorrect grant of concessional rate of tax	23	0.51
8	Non/short levy of Interest	16	0.20
9	Other lapses	1,033	284.32
Total		3,152	944.66

The Department accepted underassessment and other deficiencies of ₹ 66.22 crore in 750 cases, of which 332 cases involving ₹ 50.94 crore were pointed out in audit during the year 2010-11 and the rest in earlier years. An amount of ₹ 15.70 crore was realised in 522 cases of which 216 cases involving ₹ 2.44 crore were pointed out during the year 2010-11.

Two reviews on “**Compounding Scheme in Commercial Taxes Department**” and “**Utilisation of declaration forms in inter-state trade**” with financial impacts of ₹ 38.35 crore and ₹ 326.27 crore and a few illustrative audit observations involving ₹ 85.03 crore are mentioned in the following paragraphs.

2.11 Compounding Schemes in Commercial Taxes Department

2.11.1 Highlights

- Loss of revenue due to permission granted incorrectly to work contractors – ₹ 6.92 crore.

(Paragraph 2.11.7.1)

- Short levy due to application of incorrect rate of tax – ₹ 7.14 crore.

(Paragraph 2.11.7.2)

- Short levy due to short accountal of works contract turnover – ₹ 4.76 crore.

(Paragraph 2.11.7.4)

- Omission to forfeit illegal collection by works contractors by way of tax – ₹ 15.60 crore.

(Paragraph 2.11.7.5)

- Incorrect computation resulted in short levy of compounded tax of ₹ 2.37 crore realisable from dealers in IMFL.

(Paragraph 2.11.10.1)

2.11.1 Introduction

The Kerala Value Added Tax Act, 2003 (KVAT), Kerala General Sales Tax Act 1963 (KGST), Central Sales Tax Act, 1956 (CST) and the rules made thereunder govern the levy and collection of tax on sale or purchase of goods in the State.

During the KGST period, dealers in certain evasion prone commodities like jewellery, work contract, cooked food etc. were permitted to pay tax at compounded rates. This was a simplified procedure under which tax was not related to the turnover of the dealer for the assessment year. The tax payable under the compounding scheme was less than the tax payable under the regular scheme and was attractive to the dealers and hassle free. The Government's intention was to attract more dealers into the tax net.

While introducing the KVAT Act in 2005, a scheme was included under Section 8 for dealers in works contract, metal crusher units, cooked food, video cassette, medicine and jewellery. Similarly, dealers liable to pay turnover tax on sale of IMFL under Section 5(2C) of the KGST Act were given an option to pay tax at compounded rates based on the purchase value of liquor from 1 April 2005. This was called the Compounding Scheme.

2.11.2 Organisational setup

The Principal Secretary to Government (Taxes) heads the Department at the Government level and Commissioner is in charge of the Department at the Department level. The levy and collection of tax under the KVAT Act, 2003, the KGST Act 1963 and CST Act, 1956 is administered by the Commissioner of Commercial Taxes with the assistance of Joint Commissioners, Deputy Commissioners and Inspecting Assistant Commissioners. Assistant Commissioners (Assessment) and Commercial Tax Officers are delegated with powers for assessment, levy and collection.

2.11.3 Audit objectives

We conducted the review to:

- examine efficiency and effectiveness of the compounding scheme in achieving the intention of its introduction,
- see the extent of compliance with the prescribed rules and procedures, and
- identify potential risk areas leading to leakage of revenue.

2.11.4 Scope and methodology of audit

We conducted the review during the period from December 2010 to May 2011 and test checked the assessment records for the years 2005-06 to 2009-10 of dealers who had opted for compounding in 32 assessment circles out of 102

assessment circles spread over nine¹ revenue districts. We selected the samples by simple random number sampling method and collected details of import of gold from Customs house, Air cargo complex, Cochin International Airport at Nedumbassery and cross verified it with the assessment records of the respective importers.

We also test checked the registers and records maintained in Commissionerate of Commercial Taxes as well as in selected Commercial Taxes assessment circles in the selected districts pertaining to dealers paying tax under the compounding scheme and also cross checked the data gathered from other sources ie. Customs house, KVATIS and TINXYS.

2.11.5 Acknowledgment

We acknowledge the co-operation extended by the Commercial Taxes Department, Customs house and Air Cargo complex. We conducted an entry meeting on 24 January 2011 with the Secretary to the Government and explained the modalities of audit. The views expressed by the Secretary and the Commissioner of Commercial Taxes were taken care of. We conducted an exit conference on 13 June 2011 with the Secretary (Taxes) and explained the important audit findings. The views of the Department at the time of exit conference and their responses to our queries/observations have been incorporated in the report.

Audit findings

2.11.6 Trend of revenue

The following are the details of budget estimate and actual receipt of the Commercial Taxes Department during the period 2005-06 to 2009-10.

(₹ in crore)

Year	Budget estimates	Actual receipt	Percentage of actual collection to budget estimates.
2005-06	8,200.01	7,037.97	85.83
2006-07	7,930.38	8,563.31	107.98
2007-08	10,035.51	9,371.76	93.39
2008-09	10,616.39	11,377.13	107.17
2009-10	12,733.96	12,770.89	100.29

The following are the details of revenue realised under the compounding scheme:

¹ Ernakulam, Kollam, Kottayam, Kozhikode, Malappuram, Palakkad, Pathanamthitta, Thiruvananthapuram and Thrissur.

(₹ in crore)

Commodity	2005-06	2006-07	2007-08	2008-09	2009-10
Gold	NA	47.24	60.83	83.94	112.21
Metal Crusher	#	#	13.45	20.19	21.98
IMFL	#	48.26	66.03	96.44	120.51

details, though called for, were not furnished by the Department.

The Commissioner of Commercial Taxes stated that details of works contract, medicine, video cassette and cooked food are not readily available.

The intention behind the introduction of Compounding Scheme was to bring more dealers under the tax net and thereby enhance revenue collection. But we found that the Department did not maintain a data base of dealers who had opted for compounding. Hence, the Department was unable to evaluate whether they were able to attract more dealers into the tax net. Further, targets were not fixed for enlisting dealers and collection of tax. Due to these reasons the Department was unable to clearly assess the impact of the scheme and modify it for further improvement.

We recommend that the Government may develop a database of dealers who opt for compounding, to fix a target for collection of tax under the scheme and analyse the data in a scientific manner to refine the scheme.

2.11.7 Works Contract

2.11.7.1 Incorrect grant of permission to pay compounded tax

- Section 8(a) of the KVAT Act, 2003, gives an option to a works contractor to pay tax at the rate prescribed thereunder on the whole contract receipt instead of paying tax in accordance with the provisions of section 6 of the Act. Under Rule 11 of the KVAT Rule 2005, the contractor is required to file an application in Form I DA along with a copy of the agreement executed with the awarder of the contract and the work schedule for availing the benefit of the scheme. Further, Rule 24B stipulates that contractors who undertake construction or development of flats etc. should file a declaration in Form 49 containing the details of ongoing projects, transfer of apartment etc.

We test checked the assessment records of 51 contractors in three² assessment circles, and noticed that in 16 cases the applications filed were not accompanied by the documents required under Rule 11. However, the AA accepted the applications and accorded permission for payment of compounded tax instead of rejecting the same and levying tax under section 6 of the Act. This resulted in short collection of tax of ₹ 6.80 crore.

We pointed out the matter and the Commissioner opined that permission granted was conditional and the copies of agreements would be insisted upon at the time of submission of final return. The reply is not acceptable as Rule 11(1) read with

² CTO(WC) Kottayam, Mattancherry and Thrissur

(1A) stipulates that application for exercising option for compounded tax under Section 8 shall be filed within 30 days from the date on which the contract in respect of which such option filed is concluded. Along with the application the dealer shall furnish a copy of the agreement executed by the contractor with the awarder and work schedule.

- Section 8(a) of the KVAT Act 2003, envisages that the benefit of payment of tax under the said section should not be applied to any work contract where the transfer is in the form of goods. The Supreme Court of India had ruled³ that the work of supply and installation of elevator is not a work contract and hence not entitled for compounding.

We noticed that M/s Infosoft Digital Designing Services (P) Ltd., an assessee on the rolls of CTO, third circle, Thiruvananthapuram undertook a contract work which was in the nature of transfer of goods i.e “Supply and installation of flight information display system” and received ₹ 1.17 crore during the year 2008-09. The AA, however, permitted the contractor to pay compounded tax of ₹ 3.51 lakh.

Since the contractor transferred materials in the form of goods and the instant case is similar to the Supreme Court judgment cited above, he was not eligible to opt for the compounding scheme. The incorrect grant of permission resulted in short levy of tax of ₹ 12.27 lakh (including interest).

We pointed out the matter and the AA stated that the work forms a part of a composite contract which includes floor/ceiling/wall mounts as per site requirement and hence that will not fall under the category of transfer in the form of goods. The reply is not acceptable since out of the total contract amount of ₹ 1.76 crore, ₹ 1.63 crore (nearly 90 *per cent*) related to cost of equipment and only the balance of ₹ 0.13 crore related to installation charges, which was incidental to the main contract.

2.11.7.2 Application of incorrect rate of compounded tax

Section 8(a) of the KVAT Act 2003, as amended by the Kerala Finance Act 2008, specifies the rate of compounded tax payable by contractors having registration under the CST Act, 1956 as eight *per cent* of the whole contract receipt. It has further been provided under the said Section that in the case of any work covered under the above provisos which remains unexecuted fully or partly at the end of the year, the contractor shall continue to pay tax in respect of such works in accordance with the provisions of this clause.

By the Kerala Finance Act 2009, further provision has been inserted under Section 8(a) of the Act to the effect that in respect of works which commenced prior to 1 April 2008 and which remains partly unexecuted as on 1 April 2008, the contractor shall pay tax at the rates as it existed prior to 1 April 2008 till the completion of work, or upto 31 March 2009, whichever is earlier.

³ Kone Elevator (India) Ltd. V/s State of Andhra Pradesh [140 STC 22(SC)]

This provision came into effect from 1 April 2009 and is not applicable for 2008-09.

- We found from the assessment records of four assesseees in four works contract circles that the amount of compounded tax remitted for the year 2008-09 by these four works contractors was not at the rate prescribed, resulting in short remittance of tax and interest amounting to ₹ 6.64 crore as detailed below:

Name of Office	Name of Assessee	Amount of contract receipt	Tax remitted	Tax due @8%	Short remittance (including cess)	Interest due
₹ in lakh						
CTO (WC), Palakkad	Oceanus Dwelling (P) Ltd.	1,786.53	71.46	142.92	72.18	14.44
CTO (WC), Mattancherry	Sargam Builders	139.73	4.19	11.18	7.06	1.48
CTO (WC), Ernakulam	Asset Homes (P) Ltd.	8,125.50	194.99	650.04	459.61	96.52
CTO (WC) Pathanamthitta	BTech Builders	199.02	5.97	16.08	10.21	2.53
Total					549.06	114.97

- M/s Vellappally Construction, an assessee on the rolls of CTO(WC), Kottayam having registration under the CST Act, opted for payment of tax under the compounded scheme and the AA permitted to pay compounded tax vide orders issued during October 2009. The assessee filed annual return for the year 2008-09 in form 10B disclosing a total contract receipt of ₹ 5.02 crore. Out of the total contract receipt, ₹ 4.96 crore was taxed at the rate of four *per cent* on the ground that it related to ongoing projects and the balance of ₹ 5.53 lakh at the rate of eight *per cent*. Our scrutiny of the accounts of the dealer filed with the Department revealed that during the year the assessee received ₹ 7.58 crore which related to new contract entered during the year 2008-09 attracting tax at the rate of eight *per cent*. Thus the AA did not notice the turnover that escaped assessment as well as application of incorrect rate of tax, which resulted in short remittance of tax of ₹ 50.15 lakh (including cess and interest).

2.11.7.3 Irregular grant of exemption

- Section 8(a)(ii) of the KVAT Act inserted by Finance Act 2009, provides that any works contractor having registration under the CST Act or an importer as defined under the Act, opting for payment of tax under the compounding scheme should pay tax at the rate of three *per cent* of the contract receipt after deducting the purchase value of goods effected by way of interstate purchase and for the purchase value of goods so deducted should pay tax at the schedule rate applicable to such goods.

We noticed that M/s KMC Construction Ltd. an assessee on the rolls of CTO (WC), Mattanchery who opted for payment of tax under the compounding scheme

did not remit the tax due on goods valued ₹ 6.41 crore purchased interstate and transferred through works contract during the year 2009-10. This resulted in non remittance of tax of ₹ 60.57 lakh (including interest). However, we noticed that the assessee had disclosed ₹ 31.58 lakh as output tax due on “others” details of which are not ascertainable.

- We observed that in the following cases, tax was computed on the contract receipt after deducting labour charges thereon instead of on the whole contract receipt. This resulted in short computation of tax of ₹ 25.99 lakh (including interest) as detailed below:

Name of office	Name of assessee/ Year	Contract receipt	Amount deducted towards labour	Tax due (including Cess@ one per cent for 08-09 and 09-10)/ Interest	Total
		(₹ in lakh)			
CTO, WC, Thrissur	Swaraj Builders				
	2006-07	110.49	102.65	2.05 0.92	2.97
	2007-08	119.54	96.65	1.93 0.64	2.57
	2008-09	124.39	37.75	1.14 0.24	1.38
	2009-10	84.95	73.18	2.22 0.20	2.42
CTO, WC, Palakkad	Geogy George 2008-09	531.71	54.47	1.63 0.33	1.96
CTO, WC, Kottayam	SOJ Associates 2008-09	76.66	69.77	2.11 0.36	2.47
	Sanoj Mathew 2008-09	770.89	101.50	3.08 0.49	3.57
	South India Foundation 2008-09	192.32	111.86	3.39 0.54	3.93
Works Contract, Ernakulam	RDS Project Ltd 2007-08	6,158.60	97.50	3.90 0.82	4.72
Total					25.99

We verified the cases locally and found that exemption claimed as labour in these cases were not for separate labour contract, but were part of composite contract under compounding scheme. The exemption allowed from the turnover was not correct.

Since the Department is fully computerised and returns are filed online, Government may consider building a validation in the software to ensure that the works contractors opting for compounding are not permitted to claim any deduction other than for payment to sub contractors.

2.11.7.4 Turnover escaped assessment

- From the annual returns filed we noticed in the case of twelve contractors opting for payment of tax under the compounding scheme that the contract receipts returned was much lesser than that accounted for resulting in short remittance of tax of ₹ 4.65 crore (including interest) as detailed in the following table:

Name of Office	Name of Contractor	Year/ Contract receipt returned	Contract receipt as per A/cs	Turnover escaped	Tax due/ Interest due	Total
(₹ in lakh)						
CTO, Works Contract, Ernakulam	M/s Jayakrishnan & Co	2005-06 161.12	184.65	23.53	0.47 0.26	0.73
		2006-07 190.94	260.17	69.23	1.38 0.61	1.99
		2008-09 475.68	604.08	128.40	3.89 0.78	4.67
	NJK Builders (P) Ltd	2006-07 471.31	621.21	149.87	3.00 1.32	4.32
		2007-08 397.80	682.59	284.79	5.70 1.82	7.52
	Asset Homes (P) Ltd.	2006-07 68.14	1,443.88	1,375.74	27.51 12.66	40.17
CTO, Works Contract, Malappuram	K Mosakutty	2007-08 140.53	210.36	69.83	2.10 0.31	2.41
CTO, Works Contract, Kottayam	Thalapala Engineering company	2008-09 72.61	644.64	572.03	23.11 0.39	23.50
	Wexco Homes (P) Ltd.	2008-09 987.06	1,837.39	850.33	68.71 11.68	80.39
		2007-08 1,113.77	1,849.33	735.57	29.42 8.53	37.95
	Home Basics	2008-09 117.06	344.57	227.51	6.89 1.17	8.06
	Shaji Mathew	2007-08 1,117.55	1,232.15	114.60	2.29 0.73	3.02
CTO, Works Contract, Kozhikode	Hilite builders	2008-09 2,458.13	4,912.15	2,454.02	198.28 25.78	224.06
CTO, Works Contract, Mattanchery	JVN Properites	2008-09 96.87	158.42	61.55	1.86 0.37	2.23
CTO, Works Contract, Thrissur	Pentark Builders and developers	2008-09 388.36	576.49	188.13	15.20 2.89	18.09
	Trichur builders	2008-09 1,853.09	2,014.48	161.39	4.81 1.00	5.81
Total						464.92

- Shri. Mohan Mathew, Neelettu construction, a works contractor on the rolls of CTO(WC), Kottayam opted for payment of tax under the compounding

scheme for the year 2009-10 and filed return in form 10B disclosing contract receipt of ₹ 4.05 crore. Scrutiny of the assessment records revealed that the contractor was issued certificate in form 20E for receiving contract amount of ₹ 4.24 crore without TDS from three awarders. However, contract amount returned as received from the said three awarders was ₹ 47.90 lakh only. Thereby contract amount of ₹ 3.76 crore had escaped assessment. This resulted in short remittance of tax of ₹ 11.38 lakh (at the rate three *per cent* + cess).

The Government may consider prescribing minimum percentage of the certificates filed by works contractors along with returns to be checked/cross verified by AA for exemption from TDS etc.

2.11.7.5 Omission to forfeit the illegal tax collection

Section 30(2) of KVAT Act 2003 restricts works contractors paying tax under Section 8(a) of the Act from collecting tax up to 31 March 2008. Section 72(1) of the Act provides to forfeit to Government any sum collected by dealers by way of tax in contravention of section 30(2).

We noticed that the following works contractors, who opted for payment of tax under the scheme, collected tax as evidenced from accounts as well as from the agreement entered into with the awarders. The AA did not forfeit the amount collected by way of tax of ₹ 15.60 crore to the Government as detailed below:

(₹ in lakh)						
Name of Office	Name of assessee	Year	Contract receipt	Tax collected	Interest	Total
CTO (WC), Ernakulam	Mather Projects	2005-06	2,687.50	94.91	56.00	150.91
		2006-07	5,359.99	182.83	85.93	268.76
		2007-08	8,469.67	338.79	118.58	457.37
	Novel Villas	2005-06	839.51	16.79	9.91	26.70
		2006-07	1,497.97	29.96	14.08	44.04
		2007-08	1,721.64	34.43	12.05	46.48
	Korath Gulf Links	2006-07		3.04	1.43	4.47
		2007-08		14.51	5.08	19.59
	Kent Construction	2006-07	285.58	6.57	3.09	9.66
		2007-08	845.68	33.83	11.84	45.67
	Desai Homes	2005-06	4,421.77	88.44	52.18	140.62
		2006-07	5,747.48	114.95	54.03	168.98
		2007-08	5,893.76	117.88	41.26	159.14
CTO (WC), Pathanamthitta	Tropicana Reality Developers	2007-08	380.03	7.61	2.82	10.43
	B Tech Builders	2007-08	262.94	5.28	1.95	7.23
Total						1,560.05

We pointed out the matter and the AA replied that agreement contains a clause for payment of tax including sales tax, but the clause by itself is not the basis to conclude that the dealer has collected tax from the customers. The reply is not acceptable as the contract agreement clearly specifies the payment of tax to be paid along with each installment. Further, while applying for compounding the dealer had filed the copy of the agreements which clearly indicated the element of tax payable to the dealer by the purchasers.

2.11.8 Mechanised metal crusher units [Sn 8(b)]



2.11.8.1 Incorrect computation of compounded tax

The KVAT Act allows dealers producing granite metal with the aid of mechanised crushing unit to pay tax at the rates specified under Section 8(b) on the basis of the jaw size of the crushers used by them. The Act, as it stood up to 31 March 2008, provided for levy of tax on primary crushers⁴ at the rate of 50 *per cent* of the rates specified in accordance with jaw size, thereby assessing each and every primary crushing unit. The Act was amended with effect from April 2009. The Minister for Finance in the budget speech clarified: “the amendment was made to clear doubt regarding tax on primary crushers and made primary crushers as a whole for the purpose of computation of compounded tax, at the rate of 50 *per cent* of the aggregate of the tax payable on secondary crushers⁵”.

- M/s KK Rocks and Granites India, Pvt. Limited, a mechanised metal crusher unit on the rolls of CTO, third circle, Thiruvananthapuram had opted for payment of tax under section 8(b) of the Act for the year 2007-08. The unit possessed a cone crusher of jaw size 36” x 8” which is classified separately from 2007-08 onwards as it is neither a primary nor a secondary crusher on which tax

⁴ Primary crushers are crushers in which rocks upto 5 ft by 4 ft by 4 ft in size were crushed to size of 12 inches or smaller.

⁵ At secondary crusher, the crushed stone passes over a screen and the metal is again crushed into smaller size.

was paid at the rate of ₹ 3.60 lakh (secondary crusher) instead of at the correct rate of ₹ 7.50 lakh resulting in short remittance of tax of ₹ 3.90 lakh.

- We found from the inspection report dated 4 July 2008 available in the records of CTO, Thiruvalla that M/s Panachayil Industries was in possession of 14 metal crusher units, which they opted for compounding in 2008-09. However, in 2009-10, they opted for compounding of nine crusher units only. The AA had no details regarding disposal of plant and machinery by the dealer and hence the matter needs to be investigated as to whether there was short levy of compounding tax during 2009-10.

2.11.8.2 Non-consideration of addition made in fixed assets (Plant and machinery)

We test checked the accounts of metal crusher units, and noticed that in the following cases, considerable addition to fixed asset (Plant and machinery) was accounted for during the years. The assessing authorities did not ascertain whether the addition was due to purchase of crusher units. Considering the huge amount of addition made in the fixed asset, the possibility of undisclosed crusher unit in these cases cannot be ruled out. This requires detailed enquiry by the AA.

Sl No	Name of office	Name of the assessee	Year	Addition made to fixed asset during the year (₹ in lakh)
1.	CTO, 3 rd Circle, Thiruvananthapuram	KK Rocks and Granites India (P) Ltd.	2007-08	41.50
			2008-09	174.02
2.	Special Circle, Thrissur	M/s Thomson Granite (P) Ltd.	2009-10	23.46
3.	CTO, Angamaly	M/s Poabs Granite Products (P) Ltd.	2008-09	1,466.59
4.	CTO, Tiruvalla	M/s Panachayil Industries	2006-07	135.43
			2007-08	300.54
			2008-09	309.84

We recommend that the Government may consider issuing instructions for periodical inspection of metal crusher units so as to ascertain the number of units in the possession of the assessee.

2.11.9 Dealers in ornaments of gold etc.



2.11.9.1 Loss of revenue due to the introduction of compounding scheme

The Hon'ble Minister for Finance in his revised budget speech for the year 2006-07, observed that the rate of tax on jewellery was four *per cent* under the KGST Act, 1963 and on introduction of KVAT Act, 2003 with effect from April 2005, the rate of tax was reduced to one *per cent*. Further, the Minister noticed that the trade did not reciprocate the reduction in tax rate by showing sufficient growth in turnover which resulted in shortfall in revenue during 2005-06 compared with that of 2004-05. Considering the fact that the jewellery market is a vibrant sector in Kerala with gold prices reaching record highs and in order to share the prosperity of the dealers, the Minister proposed to introduce a compounding scheme for jewellers. The proposal so made was implemented by the Kerala Finance Act 2006, whereby the normal rate of tax was increased to four *per cent* with effect from July 2006. According to the new scheme, dealers in jewellery were permitted to pay tax at the rate of 200 *per cent* of the maximum amount of tax paid for any of the previous consecutive three years. It was further provided that where a dealer had paid tax under the scheme during a year, compounded tax payable for the succeeding year should be 115 *per cent* of the tax paid under the scheme during the previous year. Thus by availing the proviso, if a dealer had paid tax under the compounding scheme for a year, for the subsequent year, additional tax burden would only be 15 *per cent* more than that during the previous year. Again, by the Finance Act 2008, the rate of compounded tax was reduced to 150 *per cent* from 200 *per cent* with effect from April 2008. The price of gold had substantially appreciated during the period from 2005-06 to 2009-10 at the compounded rate of 21.97 *per cent*.

From the above details, it could be seen that the additional tax burden of 15 *per cent* for the succeeding year was not even capable of covering the tax due to the increase in price.

Further, trade in gold jewellery increased substantially during the period. However, we noticed that the dealers limited their additional tax burden to 15 *per cent* by availing the scheme which could cover turnover much less than the actual, defeating the spirit behind implementation of the scheme, i.e. sharing the

prosperity of the dealers. Rather, the scheme became a tax saving one to the assesseees, as detailed below:

(₹ in lakh)

Sl. No	Name of Assessee	Year	Sales t/o as returned (percentage of increase)	115 per cent of the previous year t/o actually covered under the scheme	Turnover escaped due to the compounding scheme [(4)-(5)]
(1)	(2)	(3)	(4)	(5)	(6)
1	Malabar business centre (P) Ltd., Palakkad	2006-07	1,645.32		
		2007-08	4,184.22 (154)	1,892.12	2,292.10
		2008-09	13,972.22 (234)	2,175.92	11,796.30
		2009-10	18,981.82 (36)	2,502.31	16,479.51
2	Al Ahali business trade links, Thrissur	2006-07	1,539.32		
		2007-08	3,008.85 (96)	1,770.22	1,238.63
		2008-09	6,641.13 (121)	2,035.75	4,605.38
		2009-10	8,794.57 (32)	2,341.11	6,453.46
3	Bhima Jewellery, Thiruvananthapuram	2007-08	21,485.26		
		2008-09	24,605.66 (14.52)	24,708.04	(-) 102.39
		2009-10	50,507.15 (105.27)	28,414.25	22,092.90
4	Sunny Diamonds Thiruvananthapuram	2008-09	113.60		
		2009-10	786.70 (592.51)	130.64	656.06
5	Bhima Jewels, Ernakulam	2007-08	12,756.65		
		2008-09	20,805.56 (63)	14,670.15	6,135.41
		2009-10	30,361.21 (46)	16,870.67	13,490.54
6	Malabar Kochi Arcade (P) Ltd Ernakulam	2007-08	1,567.36		
		2008-09	8,108.88 (417.90)	1,802.46	6,306.42
		2009-10	22,307.29 (175.90)	2,072.83	20,234.46
7	Malabar Dazzle India (P) Ltd. Malappuram	2007-08	410.48		
		2008-09	1,707.32 (316)	472.05	1,235.27
		2009-10	11,365.65 (565.56)	542.86	10,822.79

Thus, it is clear from the above table that the scheme did not cover the actual turnover of the dealers who opted for the same.

We recommend that the Government may adopt a pragmatic basis for fixing the rate of compounding tax so as to absorb price escalation as well as the growth in the trade.

2.11.9.2 Omission to reverse the input tax credit availed

Section 11(7) of KVAT Act, 2003, provides that goods in respect of which input tax credit (ITC) was availed and which are subsequently used for purposes for

which ITC is not allowable should be reversed. Section 11(4) of the Act restricts the dealers opting for compounding scheme from availing input tax credit.

We observed that in two cases, ITC availed by dealers who opted for payment of tax under the scheme, on the purchases effected during the previous years and held in stock and used for sale in subsequent years on which tax was paid under section 8(f), was omitted to be reversed. This resulted in revenue loss of ₹ 54.03 lakh as detailed in the following table:

Sl. No.	Name of office	Name of dealer	Year	ITC availed during previous years on opening stock
				(₹ in lakh)
1.	Special circle I, Ernakulam	A Geeri Pai Gold and Diamond	2008-09	37.06
2.	Special circle II, Ernakulam	Malabar Arcade Cochin	2008-09	16.97
Total				54.03

The Commissioner, however, was of the view that this aspect was factored in while fixing the initial rate of 200 *per cent* and as such there is no loss. The reply is not acceptable as the initial rate had been reduced to 150 *per cent* from April 2008, applicable in the cases pointed out above.

The CCT may issue instructions for levy and collection of reverse tax on account of ITC availed on closing stock held in the preceding year before granting permission for compounding for the next year.

2.11.9.3 Incorrect compounding

- M/s Bhima Jewels, a dealer in gold and diamond jewellery and an assessee on the rolls of CTO, Special circle II Ernakulam, opted for payment of tax under section 8(f) of the Act for the year 2009-10. It filed annual return disclosing total turnover of ₹ 392.90 crore and remitted tax of ₹ 7.57 crore stated to be due under section 8 (f). The sales turnover returned included bullion also, which would not fall under the purview of Section 8(f). However, the AA did not initiate action to assess the turnover of bullion under Section 6(1) of the Act resulting in short levy of ₹ 76.50 lakh (including interest).

After we pointed out (January 2011) the matter, the AA replied (February 2011) that bullion was also covered under compounding scheme under the circular of CCT. During the exit conference, the CCT upheld the view stating that the intention of the Government was explained in his clarification. However, we found that the CCT had exceeded the powers while issuing the circular as the powers are limited only for issuing clarifications where there is ambiguity regarding classification of goods or rate of tax. By this clarification, the Commissioner brought bullion also under the compounding scheme which was beyond the scope of compounding and was against the provisions of the Act which allowed only dealers in ornaments or wares of gold to opt for it. If the

intention of the Government was to include bullion also under the compounding scheme, the Act should have been amended as was done in 2011. Moreover, the Act when amended during 2011 did not give retrospective effect and we noticed that dealers who opted for compounding scheme for jewellery were paying tax under Section 6(1) for semi finished gold bar as could be seen from the point discussed in the last bullet. Hence the case requires further examination.

- M/s Edimannikal Fashion Jewellery, an assessee on the rolls of CTO, Pathanamthitta had opted for payment of tax at the compounded rate for the year 2008-09. The AA fixed the compounded tax for the year as ₹ 8.97 lakh including cess. Against this, the assessee remitted ₹ 6.87 lakh only. However, the AA did not initiate action to collect the balance unpaid tax due of ₹ 2.10 lakh.

Further, for the year 2009-10, the AA erroneously fixed the compounded tax due as ₹ 7.90 lakh being 115 *per cent* of tax paid for 2008-09 instead of ₹ 10.31 lakh being tax payable for the year 2008-09 resulting in short levy of ₹ 2.41 lakh. Total short remittance for the two years comes to ₹ 4.51 lakh.

- M/s Alukkas Jewellery, Thrissur and M/s Peeyar Exporters are dealers in jewellery on the rolls of CTO, Special Circle, Thrissur. They opted for payment of tax under the compounded scheme for the year 2008-09 and paid tax at the rate prescribed under Section 8(f) of the KVAT Act for the turnover of jewellery. The dealers were also dealing in semi manufactured gold bar with HSN code 7108.13.00 falling under entry 4(4) of the Third schedule to the KVAT Act. The turnover of semi manufactured gold bar was assessed to tax at the rate of one *per cent* instead of at the rate of four *per cent* resulting in short levy of tax (including cess and interest) of ₹ 17.46 lakh as detailed below:

Name of assessee	Turnover of semi finished gold bar	Short levy at the differential rate of 3 <i>per cent</i> + cess	Interest	Total
(₹ in lakh)				
Alukkas Jewellery	425.47	12.89	2.71	15.60
Peeyar Exporters	50.68	1.54	0.32	1.86
Total				17.46

2.11.10 Foreign liquor

2.11.10.1 Incorrect computation of tax

Section 7 of the KGST Act, 1963, as substituted by the Kerala Finance Act 2006, provides that any bar attached hotel, not being a star hotel of and above three star hotel/heritage hotel etc., may at its option, instead of paying turnover tax on foreign liquor in accordance with the provisions of section 5(2), pay turnover tax calculated:

- at 10 per cent of 140 per cent of the purchase value of such liquor in the case of those hotels situated in municipality, corporation etc. and 135 per cent of the purchase value in other places; or
- 115 per cent of the highest turnover tax payable by it as conceded in the return or accounts or the turnover tax paid for any of the consecutive three years, whichever is higher.

We test checked the assessment records of dealers in foreign liquor who opted for payment of tax under Section 7 for the years between 2006-07 and 2009-10 and noticed that the amount of compounded tax worked out and remitted was not in accordance with the provision of the Act. The incorrect computation resulted in short levy of turnover tax of ₹ 2.37 crore in 44 cases in 10 CTOs⁶.

We observed that the short remittance was due to the omission on the part of the assessing authorities in computing the amount of tax due.

The Government may amend the KVATIS software so that IMFL dealers file the returns along with purchase statements electronically and the Department may issue necessary instructions to the AAs to complete the assessments promptly at the end of each year.

2.11.11 Internal control

Internal control is an integral process by which an organization governs its activities effectively to achieve its objectives. Internal control is effected mainly through internal audit and proper maintenance of registers. Previously, there was a separate audit wing in the Department. But, consequent to the introduction of KVAT Act 2003 with effect from 1 April 2005, the internal audit wing was not functioning. Maintenance of registers is an essential factor to have an internal control on the functioning of an office. However, no separate registers were prescribed/maintained to watch the details of dealers who had opted for payment of tax under the compounding scheme.

2.11.12 Conclusion

- The omission/defects pointed out were mainly due to the non-adherence of the provisions of the Act and Rules.
- As far as jewellery is concerned, the loss sustained was due to the lack of scientific norm in fixing the compounded rate that factors hike in gold price and increase in volume.

2.11.13 General Recommendations

We recommend that the Government may consider implementing the following recommendation for rectifying the system and compliance deficiencies:

- review of works contract compounding by a senior/supervisory officer;

⁶ Special circle I & III Ernakulam, Special circles Kollam, Kottayam, Malappuram, CTOs Angamaly, Chalakuddy, Changanassery, Nedumangad and CTO II circle Mattancherry.

- prescribe proper registers or implement IT systems to watch the details of dealers who have opted for payment of tax under the compounding scheme to have an effective internal control; and
- conduct periodic inspection of metal crusher units to ascertain the number of units in the possession of the assessee from time to time.

2.12 “Utilisation of declaration forms in inter-state trade”

The Central Sales Tax Act (CST Act), 1956 and the rules framed thereunder provide for concessional rate of tax in respect of inter-state sales of goods and exemption from tax in respect of branch transfers and export sales. These concessions/exemptions are subject to furnishing of declarations in the prescribed forms viz. ‘C’, ‘F’ and ‘E-I/II’ etc. Failure to furnish the declarations or submission of defective or incomplete declaration forms will make the transactions liable to tax as applicable to sale in the appropriate State.

We conducted a review on Utilisation of declaration forms in inter-state trade to check the genuineness of the claims for exemptions/concessions based on these forms. We found various irregularities as mentioned below:

2.12.1 Highlights

- Cross verification of C Form declarations revealed purchase effected through bogus forms, understatement of purchase etc. amounting to ₹ 1.25 crore with a tax effect of ₹ 43.41 lakh.

(Paragraph 2.12.10)

- Concessional rate was allowed for Inter State sale without production of C forms, tax effect of which worked out to ₹ 92.91 crore.

(Paragraph 2.12.11)

- Exemption was allowed for Inter State transfer without production of F forms which resulted in short levy of tax of ₹ 123.38 crore.

(Paragraph 2.12.12)

- Concession was allowed on defective C forms which resulted in short levy of tax of ₹ 109.55 crore.

(Paragraph 2.12.13)

- Exemption was allowed on defective F forms involving tax effect of ₹ 15.13 crore.

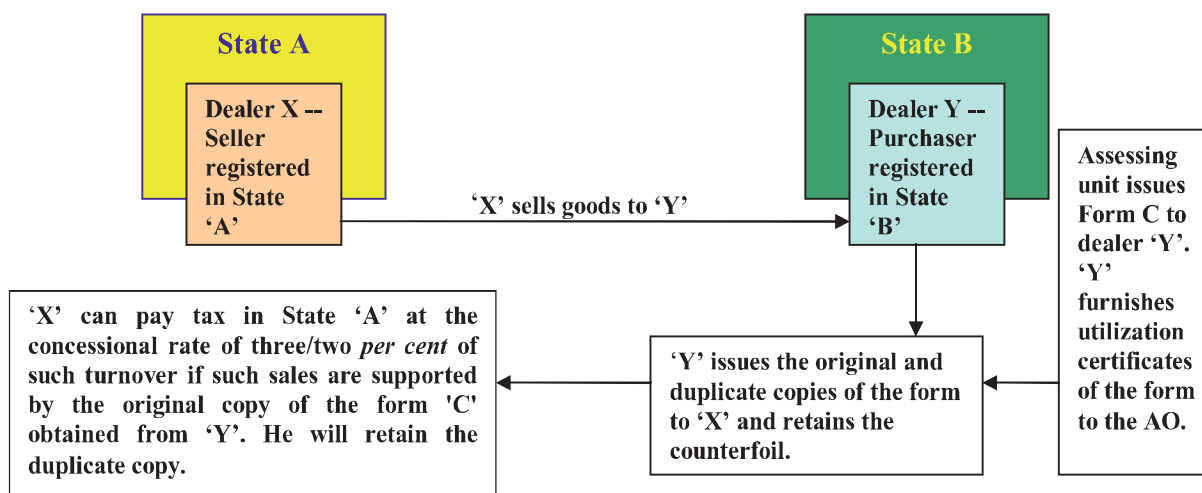
(Paragraph 2.12.14)

2.12.2 Introduction

The Central Sales Tax Act, 1956, (CST Act) governs the levy and collection of tax on inter-state transactions. Section 8 and Section 6A of the Act provide for certain concessions/exemptions to promote trade through registered dealers and to avoid cost escalation of goods to the ultimate purchaser. It is the responsibility of the Commercial Tax Department to ensure that the concession/exemption is not misutilised by fraudulent transactions.

Under the provisions of the CST Act, every dealer, who in the course of inter State trade or commerce, sells to a registered dealer, goods of the classes, specified in the certificate of registration of the purchasing dealer, shall be liable to pay tax at the concessional rate of three *per cent* from 1 April 2007 and two *per cent* with effect from 1 June 2008 of such turnover provided such sales are supported by declarations in form 'C'.

The steps involved in the process are illustrated below:



Under Section 6A of CST (Amendment) Act 1972, transfer of goods not by reason of sales by a registered dealer to any other place of his business outside the State or to his agent or principal in other States is exempt from tax on production of declaration in form 'F', duly filled in and signed by the principal officer of the other place of business or his agent or principal as the case may be, along with evidence of despatch of such goods.

The Empowered Committee of State Finance Ministers (EC) has introduced a web site called Tax Information Exchange System (TINXSYS) which acts as a repository of interstate transactions taking place between various States and Union Territories. TINXSYS is a centralised exchange of data related to transactions in respect of all interstate dealers spread across the various States and Union territories of India. The website was designed to help the Commercial Tax Departments of various States and Union Territories to effectively monitor the interstate trade.

The State of Kerala had evolved a new system, Kerala Value Added Tax Information System (KVATIS) which is a full fledged information system software that enables the automation of various functions of the Department. KVATIS has introduced downloading of statutory forms including C/F forms from January 2010 and dealers are not permitted to use manual declaration forms from that date. The introduction of e-forms has practically eliminated all the drawbacks in the manual system where the dealers had to obtain blank forms in advance from the Department and furnish utilisation certificate for the used form.

We appreciate the introduction of e-form which is simple, transparent and managed without human intervention. Further the downloaded declarations are uploaded automatically to TINXSYS on a daily basis. The genuineness of the e-forms can be checked through the commercial taxes website and TINXSYS.

2.12.3 Organisational setup

The Department of Commercial Taxes which administers the levy and collection of tax under the KVAT Act 2003, the KGST Act 1963 and CST Act, 1956 is headed by the Commissioner of Commercial Taxes who functions with the assistance of Joint Commissioners, Deputy Commissioners and Inspecting Assistant Commissioners. Assessment, levy and collection of tax is done by Assistant Commissioners (Assessment) and Commercial Tax Officers.

2.12.4 Audit objectives

The review aims to ascertain whether:

- There exists a fool proof system for custody and issue of the declaration forms;
- Exemption/concession of tax granted by the assessing authorities was supported by the original declaration forms;
- There is a system for ascertaining genuineness of the forms for preventing evasion of tax;
- There is a system of uploading the particulars in the TINXSYS website and the data available there is utilised for verifying the correctness of the forms;
- Appropriate steps are taken on receipt and detection of fake, invalid and defective (without proper or insufficient details) forms; and
- There exists an effective and adequate internal control mechanism.

2.12.5 Scope and methodology of audit

- The review covered all the commercial tax units audited between November 2010 and January 2011, covering assessments completed during the period from 2007-08 to 2009-10, where exemptions/concessions were granted under the CST Act. Cases noticed during regular audit of other units during the current audit cycle were also included.
- The details of C/F forms issued by the dealers in the State in favour of dealers outside the State for effecting inter-state purchases were collected from the selling State by the concerned Accountant General's office and those details were cross verified by us with respect to the counter foils and utilisation registers of the respective assesseees in the State.

2.12.6 Acknowledgment

We acknowledge the co-operation extended by the Commercial Taxes Department for providing necessary information and records for review. We held an entry conference on 24 January 2011 with the Secretary to the Government and Commissioner of Commercial Taxes where in the scope and methodology of audit was explained. We held an exit conference on 31 October 2011 with the Additional Secretary to the Government and have included their responses given during the Conference and on other occasions.

2.12.7 Trend of revenue under CST

The budget estimates and actual realisation of revenue under Central Sales Tax for the period from 2006-07 to 2007-11 are mentioned below:

(₹ in crore)

Year	Budget estimates	Actual receipts	Variation excess (+)/shortfall (-)	Percentage of variation
2006-07	443.00	339.66	(-) 103.34	(-) 23.33
2007-08	569.25	1016.21	(+) 446.96	(+) 78.52
2008-09	353.22	425.38	(+) 72.16	(+) 20.43
2009-10	174.60	292.94	(+) 118.34	(+) 67.78
2010-11	164.00	310.42	(+) 146.42	(+) 89.28

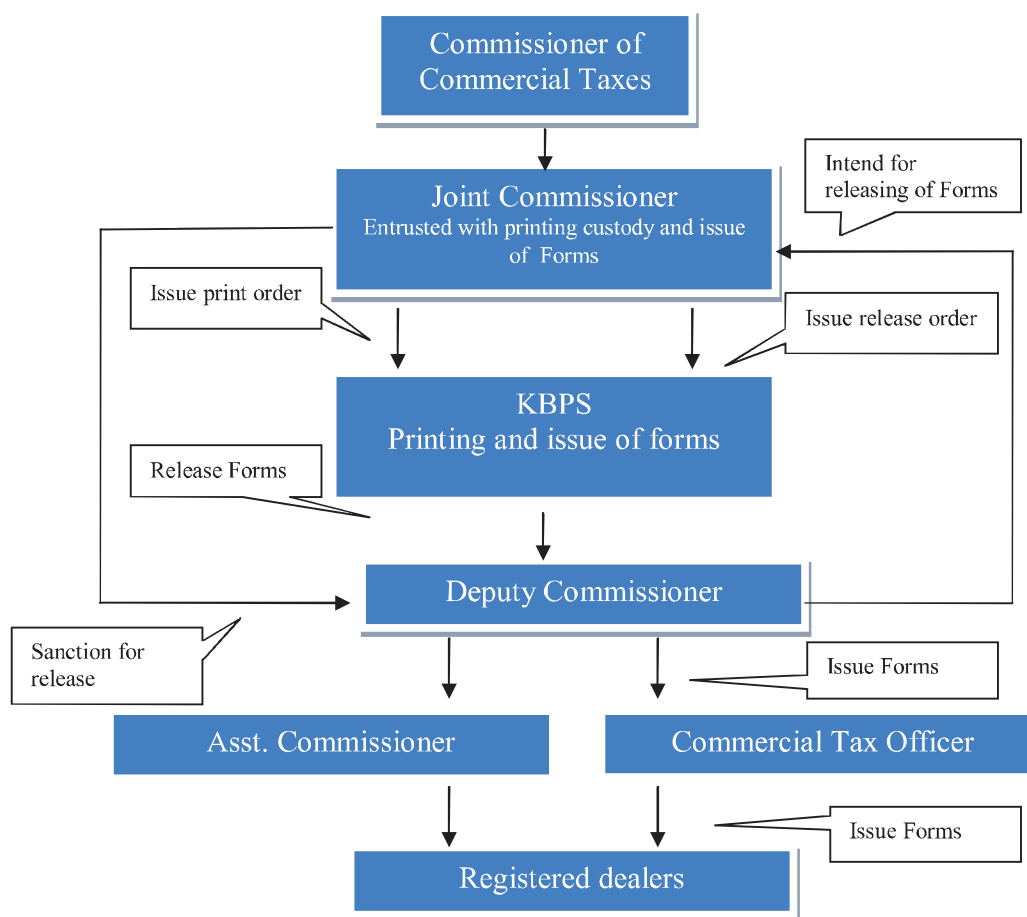
It may be seen from the above table that the actual realisation of revenue was more than the budget estimates except in 2006-07. Further, the percentage of excess was more than two-thirds (67 per cent) of the budget estimates in three out of the five years, the reasons for which were not furnished by the Department.

Audit findings

System deficiencies

2.12.8 Printing and issue of declaration forms

For interstate transactions up to December 2009 printed declaration forms were issued to dealers and for transactions thereafter electronic forms are issued. Even after December 2009, printed forms were issued for transactions pertaining to earlier periods. The Joint Commissioner, under the supervision of the Commissioner of Commercial Taxes, was responsible for distribution of manual forms which was printed at the Kerala Books and Publication Society (KBPS) (A Government Autonomous Body) as per order and kept at their custody. The required number of forms were allotted to the Deputy Commissioners at the district level based on their requisition who in turn were required to collect it from KBPS and distribute them to the Assistant Commissioners as per their indent.



Cross check of records relating to printing and issue of declaration forms available at the Commissionerate and KBPS for the period from April 2005 to June 2011 revealed the following discrepancies which proves that the printing and issue of declaration forms was not properly monitored at the Commissionerate level.

- The closing balance of C Form books available as per the stock register maintained in KBPS as on 18 June 2011 was 6,870. The balance as per the register maintained in the Commissionerate on the above date was 13,950. The excess of 7,080 books at the Commissionerate occurred due to the following reasons.
- Issue of 11,130 C form books as per 21 sanctions granted between August 2007 and June 2011 were not entered in the stock register maintained at Commissionerate. On two occasions, the entry in the registers at the Commissionerate and KBPS differed by 200 and 100 books. Between October 2008 and February 2011 three DCs did not lift the allotted C form books aggregating 2,100 from KBPS and four DCs lifted lesser number of books (aggregate 2,250) than that allotted. No reconciliation/physical verification was seen to have been conducted. If (proper) reconciliation/

physical verification was conducted, the above defects could have been detected.

2.12.9 Utilisation of declaration forms

Consequent to introduction of VAT, the Central Sales Tax (Registration and Turnover) Rules, 1957 was amended to fix a time limit of three months (after the end of the period to which the declaration or the certificate relates) for furnishing the declarations in Forms C and F along with the returns. Under the KVAT Rules, as amended from 24 April 2007, dealers are required to furnish along with the annual return, a statement on details of statutory forms issued during the return period.

We observed the following deficiencies in enforcing the above provisions and in confirming the genuineness of the transactions covered by these forms:

- Though assessing authorities have been directed to assess the turnover in cases of non-submission of declaration forms, cases of non submission of forms even after one to three years and allowing of exemptions/concessions without their production was noticed in most cases. Some high value cases noticed are featured in the compliance deficiencies portion of the review.
- Utilisation statements of the declaration forms were not found in the files produced to us, though audit was conducted one to two years, after the end of the assessment year. This indicated that there was no system to promptly verify utilisation certificate at the time of scrutiny of returns/conducting tax audits
- The Department has not issued guidelines prescribing a check list of points to be scrutinised (such as whether the date from which the registration entered is valid, date of issue, name and address of the seller with the name of State, purchase order number and date, purpose of goods purchased etc are mentioned) prior to acceptance of the declaration forms;
- Grant of exemption based on incomplete forms was noticed and a few high value cases are incorporated in the review.
- The Department has not implemented a system to verify declaration forms submitted by the dealers with the database available in the TINXSYS website before allowing exemption/concession of tax;
- The Department has not installed a regular system of picking up a sample of declaration forms and taking them up for further verification with the concerned states; and
- No regular mechanism has been prescribed for monitoring forms sent to other states and forms received from other states for verification.

2.12.9.1 Enforcement measures

Branch of the Enforcement Wing of the Department deals with investigation of interstate transactions.

We noticed the following deficiencies in the enforcement mechanism:-

- There was no mechanism to report to the concerned authority, details of declaration in forms 'C' and 'F' found lost, destroyed, stolen etc. or defective forms noticed and to take necessary action to declare such forms as invalid by giving wide publicity through issue of notification or circulars to all divisions etc.
- There was no mechanism to notify cases of bogus or non-existent dealers detected by the Department and to intimate it to other State Governments for publication in their gazettes.
- There was no system of blacklisting dealers who have been found utilising invalid/fake declaration forms in the past and to circulate their names among various units and to alert other States. There was no system to monitor such dealers regularly to watch further mischief and to levy maximum penalty in case of repeated default.
- The Department did not maintain a data bank on forms declared invalid or dealers found to be fictitious or whose registration certificates were cancelled within and outside the State.
- The Department did not maintain a sample of the colour, design and format of the forms prevailing in different States for comparison in order to identify the fake or forged declaration forms.

Compliance deficiencies

2.12.10 Results of cross verification of declaration forms

Results of verification received from other states

We collected and forwarded details of 436 C forms and 229 F forms and we received result of verification of 264 C forms from 13 states and 111 F forms from five states. From cross verification results we received confirmation that three C forms issued from Maharashtra were fake. The turnover covered by the above forms was ₹ 32.57 lakh. Similarly inter state sale value of two C form received from two states⁷ were understated by ₹ 92.58 lakh. When we pointed out this, ₹ 13.14 lakh was realised at Special Circle, Trivandrum in respect of an assessee. We also observed that sales effected under the cover of three C forms from a dealer from Tamilnadu amounting to ₹ 53.64 lakh was not accounted by the purchasing dealer. Short levy of tax on the above account worked out to ₹ 43.41 lakh including interest and penalty.

⁷ Gujarat and Jammu Kashmir

2.12.11 Concession allowed without production of C forms

The CST Act stipulates that every dealer, who in the course of inter State trade or commerce, sells to a registered dealer, goods of the classes, specified in the certificate of registration of the purchasing dealer, shall be liable to pay tax at the concessional rate of three *per cent* for the period 2007-08 and two *per cent* for the period 2008-09 onwards of such turnover provided such sales are supported by declarations in form 'C'. As per Rule 12(7) of CST (R&T) Rules (Amended), C/F forms shall be produced before the AA in the quarter following the quarter in which the transaction has occurred.

We verified CST assessment files in the State, and observed that concessional rate for inter state sale was allowed without production of C Forms. In respect of 17 offices⁸ inspected, we observed that in case of 80 assesseees, interstate sales turnover amounting to ₹ 545.82 crore was assessed at concessional rate of tax without production of C forms. Short levy of tax in this regard worked out to ₹ 92.91 crore including interest and penalty.

When we pointed this out, the assessment in respect of 18 assesseees in seven⁹ assessment circles were revised and an additional demand of ₹ 13.69 crore created. Reply in balance cases has not been received.

2.12.12 Exemption allowed without production of F forms

Section 6A of the CST (Amendment) Act, 1972, provides that transfer of goods not by reason of sales by a registered dealer to any other place of his business outside the State or to his agent or principal in other States is exempt from tax on production of declaration in form 'F', duly filled in and signed by the principal officer of the other place of business or his agent or principal as the case may be, along with evidence of despatch of such goods which shall be produced before the AA.

We verified CST assessment files in respect of 15 offices¹⁰ in the State, and observed that in case of 53 assesseees, interstate transfer of goods amounting to ₹ 799 crore was exempted without production of F forms. Short levy in this regard worked out to ₹ 123.38 crore including interest and penalty.

⁸ Special Circles Alappuzha, Aluva, Ernakulam I, Kasargod, Kollam, Kottayam, Kozhikode II, Mattanchery, Thrissur, CTO I Circle Palakkad, Perumbavoor, CTO II Circles, Palakkad, Kalamassery, Kottayam, CTO IV Circle Ernakulam, CTO V Circle Kozhikode, CTO Attingal

⁹ Special Circle Ernakulam III, Kollam, Kottayam, Palakkad, Thrissur, CTO II Circle Palakkad, Kottayam

¹⁰ Special Circle Aluva, Ernakulam I & III, Mattanchery, Kottayam, Kollam, Thrissur, CTO II Circles, Ernakulam, Kalamassery, Palakkad, Kottayam, CTO III Circle Ernakulam, Thrissur, Kollam, CTO IV Circle Ernakulam.

When we pointed this out, the assessments in respect of three assesseees in three¹¹ assessment circles were revised and an additional demand of ₹ 10.56 lakh created. Reply in balance cases has not been received.

2.12.13 Concession allowed on defective C forms

Section 8(1) (b) of the CST Act, 1956 as it stood during the relevant period stipulates that turnover of interstate sale of goods to registered dealers other than Government where the rate of which under the State Act is more than four *per cent* would attract tax at the rate of four *per cent* only. Section 8(4) (a) of the Act read with Rule 12(1) of the CST (R&T) Rules 1957 states that in order to prove that the transaction would fall under Section 8(1) (b) the dealer is required to file declarations in Form C duly filled and signed by the authorised officer of the Government/ registered dealer. Declarations not duly filled and signed and not containing the particulars are required to be treated as defective. The Hon'ble High Court of Kerala¹² had ruled that in order to avail the reduced rate of tax under Section (8) (1) (a)/(b) the declaration produced should be in original.

We verified the CST assessments completed between February and December 2010 in respect of three assesseees in Special Circle II Ernakulam and observed that the AA accepted C Forms in which figures were erased and rewritten without authorisation; bills covered were not authenticated, and purchases effected before the date of registration etc. were covered. Total interstate sale of goods amounting to ₹ 160.62 crore was allowed concession on such defective declaration. The short levy of tax in this regard worked out to ₹ 109.55 crore including interest and penalty.

¹¹ Special Circle Kollam, Palakkad, Thrissur.

¹² 18 KTR 138

2.12.14 Exemption allowed on defective F forms

Section 6A of CST (Amendment) Act 1972, provides that transfer of goods not by reason of sales by a registered dealer to any other place of his business outside the State or to his agent or principal in other States is exempt from tax on production of declaration in Form 'F', duly filled in and signed by the principal officer of the other place of business or his agent or principal as the case may be, along with evidence of dispatch of such goods. Declarations not duly filled and signed and not containing the particulars are required to be treated as defective.

We verified the CST assessment files of three offices¹³ and observed that in case of three assessees, interstate transfer of goods was exempted on defective F forms in which transfer relating to more than one month was covered; corrections were made on invoices without authentication; transactions covering period beyond the validity of declaration etc. Total interstate transfer amounting to ₹ 107.19 crore was exempted on such defective forms. The short levy

of tax in this regard worked out to ₹ 15.13 crore including interest and penalty.

2.12.15 Absence of systems to verify resale

Section 8(3) read with Section 8(1) (b) of the CST Act 1956, provides that a Registered dealer is entitled to effect interstate purchase of goods of the class or classes specified on the Certificate of Registration which are intended for resale by him by paying tax at four *per cent* subject to submission of declaration in Form C. Section 10A read with Section 10 of the Act stipulated that if any persons after purchasing any goods for any of the purpose specified in Section 8(3) fails to make use of the goods for any such purpose, such persons were liable to pay a sum not exceeding one and half times of the tax which would have been levied under Section 8(2) of the Act by way of penalty

We observed in Special Circle II, Ernakulam that an assessee, had effected inter-state stock transfer of HSD valued ₹ 58.48 crore and ₹ 18.96 crore respectively for the years 2004-05 and 2005-06 out of the interstate purchase made by issuing declarations in Form C.

As per the Act, goods purchased against 'C' forms are meant for resale. In this case however, the goods were stock transferred to other States and the AA did not have systems in place to verify that the goods were resold.

We recommend that the Department may put in place

¹³ Special Circles Aluva, Ernakulam I and Kollam

a system to verify that resale had taken place where goods purchased against Form C are disposed outside the State.

2.12.16 Internal Control Mechanism

Due to the changed procedure in assessment as a result of switchover from KGST to KVAT Rules the system of filing details of utilisation in form No.VI under CST assessment was dispensed with during the KVAT period. Though a provision to file the utilisation certificate along with annual return in KVAT Rules has been restored with effect from April 2007, the assesseees are not submitting the same and there was no system in the Department to ensure that the copy of Form No.VI was filed along with the annual return.

Even though instructions were issued by the Department to allow concessions/exemptions only on production of valid declarations in form C/F, the assessing officers were allowing concessions/exemptions without production of C/F forms.

The Department has not issued any instructions regarding the checks to be carried out to spot bogus/obsolete/invalid declarations before accepting declarations for allowing concession/exemption.

2.12.17 Conclusion

We found that

- The system of e-issue of declaration forms has been introduced which is a welcome step.
- Departmental instructions were not complied with by the assessment circles.

2.12.18 Recommendations

We recommend that the Government may consider implementing the following steps for rectifying the defects pointed out in the review.

- Issue instructions regarding the checks to be carried out before accepting declarations for allowing concession/exemption.
- Strengthen the internal control mechanism for the strict compliance of Departmental instructions.

2.13 Other 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.

2.14 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 ₹85.03 crore as mentioned in the paragraphs 2.14.1 to 2.14.25.

Value Added Tax

2.14.1 Allowance of incorrect concession

(CTO, special circle II, Ernakulam; November 2010)

Serial No. 98 of Schedule III to the KVAT Act provides for levy of tax at four *per cent* on sale of petroleum products covered under the Act to KSEB, NTPC and other power generating undertakings in the joint sector. The Government of India issued Guidelines (February 1973) stipulating conditions to be fulfilled to qualify as a joint sector undertaking. These included minimum 26 *per cent* equity ownership by the State Industrial Development Corporation (SIDC) and holding of not more than 25 *per cent* share by private partner without prior approval of the Central Government. Further, naptha, a petroleum product, was taxable at 12.5 *per cent* till June 2006.

We noticed from the assessment records that Indian Oil Corporation assessed tax on sale of naptha for ₹ 18.84 crore during 2005-06 and ₹ 43.64 crore during 2006-07 (upto June) to BSES Kerala Power Ltd. at concessional rate of four *per cent* applicable to undertakings in joint sector. However, in the case of BSES Kerala Power Ltd. SIDC was holding 13.68 *per cent* equity shares and hence does not qualify as a Joint Sector undertaking as it did

not meet the criteria specified by the Government of India. The application of incorrect rate of tax resulted in short remittance of tax and interest of ₹ 7.78 crore (at differential rate of 8.5 *per cent* on ₹ 18.84 crore + ₹ 43.64 crore).

When we pointed out the case to the Department (November 2010) and to the Government (April 2011), the Government replied (September 2011) that assessment under section 25(1) of the Act has been completed (April 2011) and short levy pointed out by the audit made good. We have not received further information regarding collection (December 2011).

2.14.2 Short levy due to non disallowance of IPT/Special rebate on stock transfer

2.14.2.1 (CTO, special circles, Mattancherry, Malappuram and Special circle I Ernakulam; September 2010)

Proviso (3) to Section 11(3) of KVAT Act provides that if goods purchased in the State are used in the manufacture of goods and the same are sent outside the State otherwise than by way of sale, input tax credit shall be limited to tax paid in excess of four *per cent*. Further Rule 12 A of the KVAT Rules 2005 provides that where taxable goods are used during a return period partly in relation to taxable transaction and partly in relation to exempted or non-taxable transaction, the input tax paid or special rebate to which the dealer has become entitled shall be apportioned between the taxable and exempted or non-taxable transaction on the basis of the ratio of taxable and exempted turnover and input tax credit allocable to exempted transaction shall be disallowed. Section 6(1) of the Kerala Finance Act 2008 provides that there shall be levied and collected from dealers a cess at the rate of 1 *per cent* on the tax payable by them under Section 6 and 8 of the KVAT, Act 2003. Section 31(5) of KVAT Act provides that if tax or any other amount due under the Act is not paid by any dealer, such dealer shall pay simple interest at the rate of 12 *per cent* per annum on such amount defaulted.

We noticed from the assessment records that the AA either assessed reverse tax less than that required as per statute or not assessed such tax resulting in short levy of tax of ₹ 6.52 crore as detailed below:

(₹ in lakh)

Sl. No.	Assessment Circle	Commodity Assessment year	IPT to be disallowed on various grounds	IPT disallowed/ tax assessed by AA	Excess IPT/short levy of tax, cess and interest
1.	CTO, Spl.Circle I, Ernakulam	<u>Gold Jewellery</u> 2008-09	439.02	Nil	540.96
2.	CTO,Spl.Circle, Mattancherry	<u>Zinc Ingots</u> 2007-08	113.79	37.94	97.85
3.	CTO,Spl.Circle, Malappuram	<u>Ayurvedic Medicine</u> 2007-08	18.19	14.51	4.57
4.	CTO,Spl.Circle, Malappuram	<u>Ayurvedic Medicine</u> 2008-09	24.62	21.79	3.17
5.	CTO,Spl.Circle, Mattancherry	<u>Pipes and fittings</u> 2008-09	5.67	Nil	5.67
Total					652.22

We pointed out the cases to the Department between April and September 2010 and to the Government between April and May 2011. We have not received further information (December 2011).

2.14.2.2 (CTO, special circle, Kottarakkara; August 2010)

Government by a notification¹⁴ had exempted tax on interstate sale of rubber with effect from August 2008 on the condition that the rubber involved, had suffered tax under the KVAT Act 2003. When sale in the course of interstate trade is exempted from tax, ITC should be limited to tax paid in excess of four *per cent*.

We observed from the assessment records that a dealer purchasing rubber latex from unregistered dealers sold 29.46 *per cent* of his turnover interstate during 2008-09. However, the AA did not limit input tax credit availed in excess of four *per cent* on

purchases corresponding to such sales. This resulted in short levy of tax and interest of ₹ 6.24 lakh.

We pointed out the matter to the Department in August 2010 and to the Government (April 2011). We have not received further information (December 2011).

- (CTO, Manjeri; August 2010)

We noticed from the assessment records that a dealer in tread rubber sold 57.64 *per cent* of his total turnover interstate during 2008-09 but input tax credit was not limited to tax paid in excess of four *per cent* on such sales. This resulted in excess availment of input tax and interest of ₹ 3.11 lakh.

We pointed out the matter to the Department (October 2010) and to the Government (May 2011). The Government replied (September 2011) that the assessment was completed (November 2010) with an additional demand of ₹ 2.65 lakh. We have not received further information (December 2011).

2.14.2.3 (CTO, special circle, Malappuram; April 2010)

Section 31(6) of the KVAT Act provides that if the tax due is not paid by the assessee within the prescribed time, interest will become due with effect from the date on which the tax would have fallen due for payment. Further, Section 91 of the Act stipulates that where any tax due or demanded under the Act is paid by any dealer, the payments so made shall be appropriated first towards interest accrued on such tax or other amount under Section 31(5) and the balance shall be appropriated towards principal outstanding.

We noticed from the assessment records that an assessee remitted (March 2010) input tax credit of ₹ 14.51 lakh and ₹ 21.79 lakh availed in excess during 2007-08 and 2008-09 respectively, without remitting the interest due. Further, the

¹⁴ SRO 804/2008 dated 31.07.2008

Department did not assess interest and appropriate the remittances first towards interest, which resulted in short levy of tax of ₹ 5.73 lakh.

We pointed out the matter to the Department (April 2010) and to the Government (March 2011). The Government stated (July 2011) that the AA issued notice to the dealer to remit the amount. We have not received further information (December 2011).

2.14.3 Application of incorrect rate of tax

2.14.3.1 (CTO, Special circle II & III, Ernakulam; January 2011)

Under the KVAT Act 2003, gold coins attract tax at the rate of four *per cent* as per entry 4(4) of IIIrd Schedule. The Commissioner of Commercial Taxes had clarified¹⁵ that gold rectangular bars being semi-manufactured will fall under HSN Code 7108.13.00 and will be taxable at the rate of four *per cent*.

We cross verified the import details in respect of a Bank and a public limited company gathered from Customs House, Air Cargo Complex, Nedumbasserry, with their assessment records and noticed that the assessee imported semi finished gold bar with HSN Code 7108.13.00 during 2008-09. The sale value of import worked out to

₹ 175.40 crore and the same was assessed to tax at the rate of one *per cent* instead of at the correct rate of four *per cent* resulting in short levy of tax, cess and interest of ₹ 6.48 crore.

The Bank and the public limited company conceded sales turnover of bullion of ₹ 683.16 crore & ₹ 677.77 crore respectively for the year. As gold imported by them was semi finished, the entire turnover was likely to be related to such semi-finished gold, liable to tax at the rate of four *per cent*.

We pointed this out to the Department (January 2011) and to the Government (June 2011). We have not received further information (December 2011)

- (CTO, special circle I, Ernakulam; January 2011)

We noticed from the assessment records that a bank assessed tax on sales turnover of gold bar with HSN code 7108.13.00 amounting to ₹ 35.64 crore and ₹ 72.95 crore for the years 2007-08 and 2008-09 respectively at one *per cent* instead of at the correct rate of four *per cent*. Application of incorrect rate of tax resulted in short levy of tax, cess and interest of ₹ 4.10 crore.

We pointed out the matter to the Department in March 2011 and to the Government (May 2011). The Department stated that they cannot complete an assessment under VAT simply on the basis of HSN code. Mere change of HSN code from 7108.12.00 cannot change the nature of bullion. The reply is not accepted as HSN recorded by Customs Authorities after inspection of goods was 7108.13 and under Rules for interpretation of Schedules, it is the basis for

¹⁵ No.C3.23036/08/CT dated 29.09.08

determination of rate of tax. Further, the CCT relied on HSN code while issuing the clarification and hence the Department is bound to assess the goods based on HSN code. We reported the case to the Government (May 2011). We have not received further information (December 2011).

- (CTO, second circle, Ernakulam; November 2010)

We noticed from the assessment records that a bank had effected sale of gold bars in small quantities of 20/50 gms for ₹ 1.86 crore during 2008-09 and paid tax at the rate of one *per cent* applicable to bullion. This resulted in short levy of tax of ₹ 6.71 lakh.

When we pointed this out [to] the Department (December 2010), the AA replied that notice has been issued under Section 25(1). We reported the case to the Government (April 2011). Further report has not been received (December 2011).

2.14.3.2 (IAC, Kattappana; December 2009)

Notification¹⁶ issued by the Government under the KVAT Act provides that confectionery including toffee, chocolates and sweets of all kinds sold under brand name registered under the Trade Mark Act 1999 are taxable at the rate of 12.5 *per cent*.

We noticed from the assessment records that a manufacturer of confectionery sweets under brand name 'Cryptms' self assessed output tax on sales turnover of confectionery of ₹ 8.23 crore during the years 2005-06, 2006-07 and 2007-08 at the rate

of four *per cent* instead of at the correct rate of 12.5 *per cent*. This resulted in short levy of tax and interest of ₹ 84.50 lakh .

We pointed out (January 2010) the matter to the Department and to the Government in March 2011. The Government stated (October 2011) that the assessments for the years 2005-06, 2006-07 and 2007-08 were revised creating an additional demand of tax and interest of ₹ 1.01 crore. We have not received further information (December 2011).

2.14.3.3 (CTO, special circle, Mattancherry; August 2010)

The KVAT Act provides that bakery products including biscuits of all varieties, cakes, pastries, pizza and bread sold under brand name registered under Trade Marks Act, 1999 are liable to be assessed at the rate of 12.5 *per cent*.

We noticed from the assessment records that an assessee manufacturing and selling cakes and bakery products under registered brand name assessed tax on sales

turnover of such products for ₹ 1.08 crore at four *per cent* instead of at the correct rate of 12.5 *per cent* during 2008-09. This resulted in short levy of tax and interest of ₹ 10.73 lakh.

¹⁶ SRO 82/2006, Entry 24(1) (c) and (d).

We pointed out the matter to the Department in October 2010 and [to] the Government in January 2011. We have not received further information (December 2011).

2.14.3.4 (CTO, special circle, Mattancherry; July 2010)

The High Court of Kerala had held¹⁷ that Ujala Supreme and Ujala Stiff and Shine are not industrial raw materials coming under list A of the Third schedule to the KVAT Act but are commodities taxable at 12.5 *per cent* under the Act. The KVAT Act provides that where the sale is to or by Canteen Stores Department, the tax payable shall be at half the rate applicable to such goods.

We noticed from the assessment records that a dealer assessed tax for the year 2008-09 on sales turnover of 'Ujala Supreme' and 'Ujala Stiff and Shine' valued at ₹ 4.93 crore at the rate of four *per cent* and sales turnover valued at ₹ 7.14 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 ₹ 49.02 lakh.

We pointed out the matter to the Department (July 2010) and to the Government (March 2011), the Government replied (October 2011) that the assessment has been revised (June 2011) applying the correct rate. We have not received further information (December 2011).

- (CTO, Ettumanoor; December 2009).

We noticed from the assessment records that a dealer assessed tax on the sales turnover of Ujala Supreme and Ujala Stiff and Shine for ₹ 1.03 crore during the period 2007-08 at the rate of four *per cent* instead of at the correct rate of 12.5 *per cent*. This resulted in short levy of tax and interest of ₹ 10.62 lakh.

We pointed out the matter to the Department in December 2009 and to the Government (February 2011). The Government stated (July 2011) that the assessment was completed under Section 25(1) of the Act creating additional demand of ₹ 14.14 lakh against which the assessee remitted ₹ 4.71 lakh in June 2010. We have not received further information (December 2011).

2.14.3.5 (CTO(WC & LT), Alappuzha; August 2010)

Section 6(1) (f) of the KVAT Act provides 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 tax liability is at the rate of 12.5 *per cent*.

We noticed from the assessment records that a works contractor assessed tax at four *per cent* instead of at the correct rate of 12.5 *per cent* on transfer value of materials amounting to ₹ 4.25 crore for 2008-09. As the

¹⁷ MP Agencies Vs State of Kerala reported in 18 KTR 82

contract was executed for Cochin International Airport Ltd., the assessee was not eligible for concessional rate of four *per cent* allowable to Government Departments etc. This resulted in short levy of tax and interest of ₹ 41.87 lakh.

We pointed out the matter to the Department in September 2010 and to the Government in February 2011. We have not received further information (December 2011).

- (CTO(WC<), Kollam; January 2010)

We noticed from the assessment records that an assessee engaged in tyre retreading returned tax at the rate of four *per cent* instead of at the correct rate of 12.5 *per cent* for the contract receipts of ₹ 23.97 lakh and ₹ 33.47 lakh during the periods 2006-07 and 2007-08 respectively. This resulted in short levy of tax and interest of ₹ 6.15 lakh.

We pointed out the matter to the Department in February 2010 and reported to the Government in December 2010. The Government replied (September 2011) that the assessments were completed in January 2011 and demand raised. We have not received further information (December 2011).

2.14.3.6 (CTO, special circle, Thrissur; May 2009)

Entry No.64 (8) of the notified list of goods provides that margarine is taxable at the rate of 12.5 *per cent*.

We noticed from the assessment records that a dealer assessed output tax on sales turnover of margarine for ₹ 1.53 crore at the rate of four *per cent* instead of at

the correct rate of 12.5 *per cent* during the year 2005-06, 2006-07 and 2007-08. This resulted in short levy of tax and interest of ₹ 15.75 lakh.

We pointed out the matter to the Department (June 2009) and the Government (April 2011). The Government stated (September 2011) that the assessments were completed based on the audit observation and revenue recovery action is pending. We have not received further information (December 2011).

2.14.3.7 (CTO, first circle, Kottayam; June 2009 and June 2010)

Entry 30 of the notified list of 12.5 *per cent* taxable goods of the KVAT Act provides that digital photocopiers are taxable at the rate of 12.5 *per cent*.

We noticed from the assessment records that a dealer in digital photo copier computed tax on the sales turnover of ₹ 39.45 lakh, ₹ 31.84 lakh, ₹ 9.20 lakh and ₹ 56.98 lakh for the years 2005-06, 2006-07, 2007-08 and 2008-09

respectively at the rate of four *per cent* instead of at the correct rate of 12.5 *per cent*. This resulted in short levy of tax and interest of ₹ 14.51 lakh.

We pointed out (July 2009) short levy relating to the years 2005-06 to 2007-08, based on which the Department revised the assessments and created additional

demand of ₹ 15.42 lakh. However, we noticed (June 2010) that the same defect persisted in 2008-09. The Department stated (June 2010) that the commodity dealt with by the assessee is not digital copier but laser printer cum copier which comes under IT products chargeable at four *per cent* tax. The reply is not acceptable as the product is sold as digital copier as per the sales statement and further the Department had revised the assessment for the years 2005-06 to 2007-08. We reported the case to the Government (May 2011) and have not received any further information (December 2011).

2.14.3.8 (CTO (WC & LT), Kannur; June 2010)

Section 7(5) of the CST Act 1956 stipulates that a registered dealer may apply not later than six months before the end of a year for cancellation of registration, and the authority shall, unless the dealer is liable to pay tax under this Act, cancel the registration accordingly. The cancellation shall take effect from the end of the year.

We noticed from the assessment records that during the year 2007-08 the AA accepted the application dated 19.07.2007 for cancellation of registration of a works contractor with immediate effect and allowed him to pay compounded tax at three *per cent* instead of four *per cent* payable. Cancellation of registration in violation of the CST Act resulted in short levy of

tax and interest of ₹ 4.16 lakh.

We pointed out the matter to the Department (July 2010) and the Government (March 2011). The Government stated (May 2011) that the assessment under Section 25 of the Act had been completed (January 2011) creating a demand of ₹ 4.52 lakh, including interest. We have not received further information (December 2011).

- (CTO(WC & LT), Kasaragod; May 2010)

We noticed from the assessment records that an AA accepted the application for cancellation of CST registration filed by a dealer in June 2006. The dealer assessed his works contract turnover of ₹ 2.21 crore relating to Government work at three *per cent* under Section 8(a) (i) of the Act instead of four *per cent* under Section 8 (a) (ii) of the Act for the year 2006-07, though the cancellation should have come into effect from the end of the year. This resulted in short payment of tax and interest to the tune of ₹ 3.30 lakh.

We pointed out the matter to the Department in June 2010 and to the Government in February 2011. The Department stated in July 2010 that notice was issued to the assessee. We have not received further information (December 2011).

2.14.3.9 (CTO, (WC<), Mattancherry; May 2010)

The KVAT Act, 2003, as it stood prior to April 2008 provides that a dealer registered under the Central Sales Tax Act can opt to pay compounded tax at four *per cent*. Though dealers were liable to pay tax at eight *per cent* from April 2008, they were permitted to pay tax at pre-revised rate in respect of work remaining partly unexecuted as on 1 April 2008.

We noticed from the assessment records of 2008-09 that a works contractor paid compounded tax at the rate of 2.3 *per cent* for the works remaining partly unexecuted as on 1 April 2008. As the dealer had CST registration during

2007-08, he was eligible to opt for compounding at the rate of four *per cent* under Section 8(a) (ii) of KVAT Act, 2003. Application of incorrect rate of compounding resulted in short levy of ₹ 3.76 lakh.

When we pointed out this (June 2010) the Department stated that as per the Finance Act 2009, works which commenced prior to 1 April 2008 and remaining partly executed on that date are liable to be taxed at the rate that existed prior to April 2008 and hence there was no short levy. The reply is not tenable as the compounded rate of 2.3 *per cent* related to civil work contracts of pre-VAT period which was valid only upto March 2007. We reported it to the Government (April 2011). Further report had not been received (December 2011).

2.14.4 Excess claim of input tax credit

2.14.4.1 (CTO, special circle(produce), Mattancherry; July 2010)

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

We noticed from the assessment records that an assessee in his annual return for 2008-09 brought forward a tax credit of ₹ 51.46 lakh depicting it as excess input tax credit of the previous year.

However, input tax credit carried forward to the year as per the annual return of 2007-08 was nil. Besides computational mistakes resulted in further excess credit of ₹ 8.76 lakh as total of input tax was shown as ₹ 2,65,08,883 instead of ₹ 2,56,32,956. These resulted in short assessment of tax and interest of ₹ 69.25 lakh.

We pointed out (July 2010) the issue to the Department and to the Government (May 2011). We have not received further information (December 2011).

2.14.4.2 (CTO, Manjeri; October 2008)

Section 22(3) of the KVAT Act provides that if any dealer files an 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 judgment. The Act also provides for levy of penalty, not exceeding twice the amount of tax or other amount evaded or sought to be evaded, where the assessee has made bogus claim of input tax.

We noticed from the assessment records of 2005-06 that a dealer in timber claimed input tax credit twice on three purchases effected during December 2005 and March 2006 and availed excess input tax credit of ₹ 2.53 lakh. We consider that besides recovering excess credit of ₹ 2.53 lakh, the Department should levy penalty of ₹ 5.06 lakh for this offence.

We pointed out the matter to the Department in October 2008 and to the Government (February 2011). The Government stated (July 2011) that on the basis of audit observation tax, interest and penalty totalling to ₹ 8.62 lakh was demanded. The assessee paid ₹ 2.72 lakh and the balance was advised under Revenue Recovery. We have not received further information (December 2011).

2.14.5 Non-levy of reverse tax

(CTO, Special Circle, Kannur; August 2010)

Section 2 (xlii) of the KVAT Act specifies 'reverse tax' as that portion of input tax of the goods for which credit has been availed but such goods remain unsold at the closure of business or are subsequently used for any purpose other than resale or manufacture of taxable goods. Further Section 11(4) and 12(2) of the Act stipulates that a dealer paying compounded tax shall not be eligible for input tax credit / special rebate.

We observed from the assessment records that a dealer in jewellery had a closing stock of ₹ 16.89 crore during 2007-08 for which he had taken input tax credit. During 2008-09 he switched over to the compounding scheme for which no input tax credit is allowable. The tax payable under the compounded scheme is worked out on the basis of sales effected during the previous years. The huge closing stock at

the end of 2007-08, on which the dealer had taken input tax credit, was sold during the subsequent year (2008-09), though the dealer was not eligible to avail input tax credit under the compounding scheme. This resulted in leakage of revenue of ₹ 67.54 lakh.

We pointed out the matter to the Department in October 2010 and to the Government (March 2011). The Department stated in December 2010 that the assessee availed input tax credit prior to the switching over to the compounding

scheme and it need not be reversed. The reply is not acceptable as no ITC is to be allowed on goods sold under compounding scheme and as such on the stock sold under compounding, reverse tax is leviable.

2.14.6 Non-levy of interest/non-appropriation of payment to interest

(CTO, special circle II, Ernakulam; February 2009)

Section 42(2) of the KVAT Act, 2003 provides that where any dealer detect any omission or mistake in the annual return submitted by him with reference to the audited figures, he shall file a revised annual return rectifying the mistake or omission along with the audit certificate. Where, as a result of such revision, the tax liability increases, the revised return shall be accompanied by proof of payment of such tax, interest due thereon under sub-section (5) of Section 31 and penal interest, calculated at twice the rate. Further, Section 91 of the Act stipulates that where any tax due or demanded under the Act is paid by the dealer, the payments so made shall be appropriated first towards interest accrued on such tax or other amount under Section 31 (5) and the balance shall be appropriated towards principal outstanding.

We noticed from the assessment records that an assessee filed revised return and differential tax of ₹ 1.61 crore during 2005-06 without remitting interest and penal interest due. Further the Department did not assess interest and appropriate the remittance first towards interest which resulted in short levy of tax and interest of ₹ 41.98 lakh.

We pointed out the matter to the Department in April 2009. The Department stated that the case would be examined. The case was reported to the Government in

December 2010. We have not received further information (December 2011).

2.14.7 Short levy due to turnover escaping assessment

2.14.7.1 (CTO, (WC<), Mattancherry; May 2010)

Section 6(1)(f) of the KVAT Act, provides 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 at the rate of 12.5 *per cent* shall be levied. Further proviso to rule 10(2) (a) of KVAT Rules 2005 provides that when taxable turnover in respect of works contract not in the form of goods falls below the cost of goods transferred in the execution of works contract, an amount equal to the cost of goods transferred together with profit, if any, shall be the taxable turnover.

We noticed from the assessment records of 2008-09 that a works contractor conceded taxable turnover of ₹ 4.13 crore. Out of the taxable turnover, ₹ 2.58 crore was assessed at four *per cent* instead of

at 12.5 *per cent*. Further, the taxable turnover of ₹ 4.13 crore was less than the cost of goods consumed in the works contract which amounted to ₹ 4.87 crore. Escapement of turnover from assessment coupled with application of incorrect rate resulted in short levy of tax and interest of ₹ 35.52 lakh.

We pointed out the case to the Department (May 2010) and the Government (April 2011). We have not received further information (December 2011).

- (CTO(WC & LT), Alappuzha; August 2010)

We noticed from the assessment records of 2008-09 that a works contractor who had contract receipts of ₹ 13.30 crore assessed tax on turnover of ₹ 4.92 crore only. The turnover was less than the cost of goods transferred to works contract of ₹ 6.33 crore. Hence, the taxable turnover including profit should be ₹ 6.38 crore and turnover of ₹ 1.46 crore that escaped assessment resulted in short levy of tax and interest of ₹ 21.10 lakh.

We pointed out the matter to the Department in September 2010 and to the Government in February 2011. We have not received further information (December 2011).

2.14.7.2 (CTO(WC), Malappuram; July 2009)

Under Section 42(2) of the KVAT Act, 2003 if there is omission or mistake in annual return with reference to audited figures he shall file revised annual return along with audit certificate rectifying the defect. If tax liability increases he shall file proof of payment of balance tax, interest and twice the amount of interest as penal interest.

We noticed from the assessment records that a dealer returned total and taxable turnover of ₹ 1.84 crore and ₹ 3.73 crore for the years 2006-07 and 2007-08 respectively as against ₹ 2.34 crore and ₹ 4.37 crore shown in the profit and loss accounts for the respective years. This resulted in short levy of tax, interest and penal interest of ₹ 32.08 lakh.

We pointed out the matter to the Department in July 2009 and to the Government in December 2009. The Government stated (July 2011) that the loss of revenue as pointed out by audit was assessed and is being collected. We have not received further reply (December 2011).

- (CTO, special circle, Mattancherry; September 2010)

We noticed from the assessment records that the sales turnover of minerals depicted in the annual return for 2008-09 and assessed to tax by an assessee was less than the certified accounts figure by ₹ 4.14 crore. This resulted in non-levy of tax of ₹ 19.75 lakh at the rate of four *per cent*.

We pointed out the matter to the Department in October 2010 and to the Government in January 2011. We have not received further information (December 2011).

2.14.7.3 (CTO, special circle I, Ernakulam; January 2011)

According to Entry 67 of notified list of 12.5 *per cent* taxable goods under KVAT Act, spare parts of motor vehicle are liable to be taxed at 12.5 *per cent*. Further, the Supreme Court held¹⁸ that warranty charges received from the manufacturers by the agents for replacing defective parts of vehicles are sale of goods and hence liable to tax.

We noticed from the assessment records that the AA did not assessed warranty claim of ₹ 1.80 crore received by a dealer in 2008-09 resulting in short levy of tax and interest of ₹ 27.58 lakh.

We pointed out the matter to the Department (March 2011) and to the Government (May 2011). We have not received replies (December 2011).

- (CTO, special circle III, Ernakulam; July 2010)

We noticed from the assessment records that an assessee did not pay tax on goods involved in warranty replacement amounting to ₹ 78.67 lakh on the ground that a review petition on the issue is pending with the Supreme Court of India. As the Supreme Court decision has not been stayed the assessee is liable to comply with the existing decision and pay tax. Failure to do so resulted in short levy of tax, interest and cess of ₹ 11.50 lakh.

We pointed out the matter to the Department (July 2010) and to the Government (May 2011). The Government stated (September 2011) that the assessment was revised (October 2010) and the assessee paid the additional demand in full in February 2011. Collection particulars are awaited (December 2011).

2.14.7.4 (CTO (WC & LT), Kannur; June 2010)

The KVAT Rule provide that the taxable turnover in relation to a works contract, where transfer of property takes place not in the form of goods but in some other form, shall be arrived at after deducting labour and other specified charges from the contract receipt. If the turnover so arrived at 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 together with profit shall be the taxable turnover in respect of such works contract.

We noticed from the assessment records that the AA did not assess the turnover that escaped assessment due to excessive exemption claimed by a dealer during 2008-09 resulting in short levy of tax of ₹ 17.39 lakh.

We pointed out the matter to the Department (June 2010) and to the Government (February 2011).

¹⁸ Mohd Ekram Khan & Sons Vs Commissioner of trade tax (2004) 12 KTR 572.

The Government stated (May 2011) that the assessment under Section 25 was completed creating a demand of ₹ 31.50 lakh including interest. We have not received further information (December 2011).

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

Entry 30(2) (c) (1) of the Notified list of the KVAT Act provides that tax at the rate of 12.5 *per cent* shall be levied on photo copier spares. Materials involved in Full Service Maintenance Agreement (FSMA) and warrantee charges are taxable at the appropriate rate. Rule 9(2) C of the Act provides that if goods transferred in the execution of Annual Maintenance Contract (warrantee charges) is not ascertainable, 50 *per cent* of such contract amount is assessable to tax. Further Section 25(1) of the Act, provides that where for any reason the whole or any part of the turnover of business of a dealer has escaped assessment to tax in any year, the assessing authority may proceed to determine, to the best of its judgement the turnover which has escaped assessment to tax.

We noticed from the assessment records that a dealer in photocopiers, tax machines and consumables did not include in the return an amount of ₹ 1.01 crore being recovery of FSMA material cost and copier warrantee charges during the year 2007-08. This was not detected by the AA which resulted in short levy of tax and

interest of ₹ 15.11 lakh.

We pointed out the matter to the Department in January 2010 and the Government in August 2010. We have not received further information (December 2011).

2.14.7.6 (CTO, third circle, Thiruvananthapuram; February 2010)

Explanation VII under Section 2(liii) of the KVAT Act 2003, stipulates that where a dealer sells any goods purchased by him at a price lower than that at which it was purchased and subsequently receives any amount from any person towards reimbursement of the balance price, the amount so received shall be deemed to be turnover in respect of such goods.

We noticed from the assessment records that a dealer in home appliances who sold goods at a price lower than purchase price did not assess to tax, the incentive of ₹ 75.89 lakh received as incentives during the period 2007-08. This resulted in short levy of tax and interest to the tune of ₹ 11.67 lakh.

We pointed out the matter to the Department (April 2010) and to the Government (December 2011). The Government stated (September 2011) that the assessment was revised (June 2011) with additional demand of ₹ 12.72 lakh including interest. We have not received further information (December 2011).

2.14.7.7 (CTO, Tirurangadi; October 2009)

Sale of IT software attracts tax at the rate of four *per cent* under the Third schedule to the KVAT Act 2003. Further, the Act stipulates that the assessing authority can proceed to determine to the best of his judgement, the turnover which has escaped assessment to tax and assess the tax thereon.

We noticed from the assessment records that a dealer in software did not assess the sales turnover of software amounting to ₹ 34.40 lakh and ₹ 2.07 crore for the years 2006-07 and 2007-08 respectively. This resulted in short levy of tax and interest of

₹ 11.56 lakh.

We pointed (November 2009) out the matter to the Department and to the Government (December 2010). The Government stated (April 2011) that the assessments were revised creating an additional demand of ₹ 12.94 lakh. We have not received any further information (December 2011).

2.14.7.8 (CTO, special circle, Palakkad; January 2011)

Sale of Duty Entitlement Pass Book (DEPB) licence attracts tax at the rate of four *per cent* under the Third schedule to the KVAT Act 2003.

We noticed from the assessment records that an assessee did not pay tax on the sales turnover of DEPB license

amounting to ₹ 2.17 crore during 2008-09. This resulted in short levy of tax of ₹ 8.78 lakh.

We pointed out the matter to the Department (January 2011) and the Government (May 2011). The Government replied (October 2011) that the assessee followed accrual basis of accounting and based on Accounting Standard (AS) 9, revenue should be recognized to the extent expected to be realised. It was also stated that the amount of ₹ 2.17 crore represents a prudent estimate arising out of DEPB which was treated as income recognized, as required by AS 12 and corresponding debit has been made in 'miscellaneous receivable' account. The reply is not acceptable as the 'other income' as furnished in the accounts at the time of audit by the assessee specifically includes income out of sale of DEPB licenses. We have not received further information (December 2011).

- (CTO, special circle, Thiruvananthapuram; November 2009)

We noticed from the assessment records that a dealer in software did not assess the sales turnover of licences amounting to ₹ 15.60 lakh for 2006-07 and ₹ 46.15 lakh for 2007-08. This resulted in short levy of tax and interest of ₹ 2.99 lakh.

We pointed out the matter to the Department (November 2009) and reported it to the Government (February 2011). The Government replied (September 2011) that the assessments were completed based on audit observation. We have not received further information (December 2011).

2.14.7.9 (CTO(WC<), Kottayam; September 2010)

Section 2(xliv) of KVAT Act, 2003 provides that “sale price” means the amount of valuable consideration received or receivable by a dealer for the sale of any goods inclusive of any sum charged for anything done by the dealer in respect of the goods or service at the time of or before delivery thereof. The Hon’ble Supreme Court held¹⁹ that expenditure incurred by the seller on freight would become part of the amount for which the goods are sold to the buyer and would fall within the scope of “turnover”. Sale of manufactured goods to Kerala State Electricity Board (KSEB) is taxable at four *per cent* from April 2008.

We noticed from the assessment records that a works contractor supplying poles to KSEB at specified locations did not assess tax on transportation charges amounting to ₹ 19.72 lakh, ₹ 25.20 lakh and ₹ 10.14 lakh received during 2006-07, 2007-08 and 2008-09 respectively. This resulted in short levy of tax, cess and interest of ₹ 7.96 lakh.

We pointed out the matter to the Department (September 2010) and to the Government (April 2011). The Government stated (August 2011) that the audit objection is sustainable and the AA created additional demand as per order dated March 2011. We have not

received further information (December 2011)

2.14.7.10 (CTO, special circle, Malappuram; February 2009)

The KVAT Act stipulates that motor vehicles used for a minimum period of fifteen months subsequent to registration under Motor Vehicles Act, 1988 are used vehicles and are taxable at four *per cent*. All other motor vehicles are taxable at the rate of 12.5 *per cent*.

We noticed from the assessment records that a dealer in motor vehicles did not assess tax on the sales turnover of demo vehicles of ₹ 7.99 lakh and ₹ 34.98 lakh for the year 2005-06 and 2006-07 respectively. This resulted in short levy of tax and interest

of ₹ 7.09 lakh.

We pointed out the matter to the Department in February 2009. The Department stated that the demo vehicles were purchased within the State and sold as used vehicles and as the sale price was less than the purchase price no tax was levied. The reply is not tenable as the vehicles sold were not registered under the Motor Vehicles Act and setting off purchase price from sale price is against the provisions of the KVAT Act. The case was reported to the Government in December 2010. We have not received further information (December 2011).

¹⁹ 34 VST 273(SC)

2.14.7.11 (CTO, Vadakara; August 2010).

The Departmental procedures prescribe, *inter alia*, internal and external surveys on a regular basis for collecting necessary data for enabling the assessing authorities to make proper assessments. Internal survey consists of gathering useful information from records of the assessing officers, whereas external survey consists of collection of necessary details from publications, reports, registers of other Departments. Every dealer who import goods shall be liable to pay tax on his sales irrespective of the turnover.

We noticed from the assessment records that an assessee included in his accounts import purchase of flooring material for ₹ 1.36 crore and ₹ 62.78 lakh during 2008-09 and 2007-08 respectively. We found that as per customs records his import purchase during these years were ₹ 1.56 crore and ₹ 74.08 lakh respectively. Failure to assess sales turnover corresponding to understated purchase turnover

resulted in short levy of tax and interest of ₹ 5.07 lakh.

We pointed out the matter to the Department in September 2010 and reported to the Government in January 2011. The Department stated that the details of import was not available and the matter would be examined. We have not received further information (December 2011).

- (CTO, Kodungallur; December 2010)

We noticed from the assessment records that an assessee included in his accounts import purchase of flooring materials for ₹ 90.67 lakh during the year 2008-09. We found that as per customs records his import purchase during the year was ₹ 1.05 crore. Failure to conduct external surveys to verify purchase turnover resulted in short levy of tax, interest and penal interest of ₹ 2.91 lakh.

We pointed out the matter to the Department in January 2011 and reported to the Government (May 2011). We have not received further information (December 2011).

2.14.7.12 (CTO, second circle, Thiruvananthapuram; March 2010)

Section 6(1) (f) of the KVAT Act 2003 provides 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 liability to pay tax shall be 12.5 *per cent*.

We noticed from the monthly returns that an assessee engaged in fabrication and installation of machinery had a turnover of ₹ 70.10 lakh for the year

2007-08. We however, noticed that the assessee disclosed a turnover of ₹ 38.90 lakh only in his annual return, resulting in escapement of turnover. Further, the taxable turnover was assessed at four *per cent*. This was not correct as the turnover relates to works contract not in the form of goods, and hence the transfer

value of material amounting to ₹ 49.07 lakh is liable to be assessed at 12.5 *per cent*. These defects resulted in short levy of tax, interest and penalty of ₹ 4.58 lakh.

We pointed out the matter to the Department (March 2010) and the Government (February 2011). The Government stated (September 2011) that the assessment was revised and demand of ₹ 4.58 lakh created. We have not received further information (December 2011).

2.14.8 Irregular claim of input tax credit

2.14.8.1 (CTO, special circle (Produce), Mattancherry; July 2010)

Section 6 of the Kerala Finance Act 2008 provided for levy of one *per cent* social security cess from 1 April 2008, on tax payable under the KVAT Act on commodities other than declared goods. Section 6(5) of the Act stipulates that the provisions regarding assessment, input tax credit, special rebate and recovery in the KVAT Act 2003 shall *mutatis mutandis* apply to the cess also. Therefore goods not eligible for ITC, are not eligible for credit of cess also.

We noticed from the assessment records that an assessee did not avail ITC of ₹ 20.53 crore on purchase of rubber valued at ₹ 513.13 crore during 2008-09, as the goods were transferred to other States. However, the assessee availed credit of corresponding cess amounting to ₹ 20.53 lakh. Besides, the

assessee availed credit of

₹ 12.09 lakh as excess cess brought forward from the previous return period. As cess was introduced from April 2008, there could not be any carry forward of cess from 2007-08. These mistakes resulted in short levy of cess of ₹ 32.62 lakh.

We pointed out this issue to the Department in July 2010 and the Government (May 2011). The government stated (October 2011) that the AA issued notice and the dealer paid an amount of ₹ 9.76 lakh being cess, interest and penal interest. We have not received further information (December 2011)

2.14.8.2 (CTO, special circle, Mattancherry; September 2010)

Notification issued in March 2005 under the KVAT Act provides that building materials and fixtures used in construction activities are outside the purview of capital goods and are not eligible for input tax credit.

We noticed from the assessment records that the AA did not disallow the input tax credit availed by an assessee during 2008-09 which related to purchase of building material used for construction purpose,

resulting in short remittance of tax and interest of ₹ 12.10 lakh.

We pointed out the matter to the Department in October 2010 and the Government (May 2011). We have not received further information (December 2011).

2.14.8.3 (CTO, special circle (Produce), Mattancherry; June 2010)

The KVAT Act provides that the input tax credit availed in respect of tax paid on purchase of goods which are used subsequently for any purpose other than resale or manufacture of taxable goods or execution of works contract or use as container or packing materials of taxable goods within the State shall be assessed as reverse tax. The reverse tax so determined shall be deemed to be an amount due under the Act.

We noticed from the assessment records that the AA did not reverse the input tax credit of ₹ 8.23 lakh claimed by a dealer during 2008-09, being the tax paid on purchase of goods like cleaning powder, fire extinguisher, soap, iron products etc. which were used for purposes other than resale or manufacture of taxable goods etc. This resulted in short assessment of tax of

₹ 8.23 lakh.

We pointed out the matter to the Department in August 2010 and reported to the Government (May 2011). The Department stated (August 2010) that goods were purchased in the course of a continuing business and that it is not remaining unused or unsold and hence reverse tax will not apply. The reply is not acceptable as the items pointed out by audit were not used for resale or manufacture of taxable goods and hence would attract reverse tax.

2.14.8.4 (CTO, Special circle, Kannur; August 2010)

Section 11(5) (e) of the KVAT Act stipulates that no input tax credit shall be allowed on purchase of goods used in manufacture, processing and packing of goods mentioned in Schedule I. The input tax credit already availed of in respect of such goods shall be assessed as reverse tax.

We noticed from the assessment records that a manufacturer availed input tax credit for the year 2008-09 on raw materials used in production of Schedule I goods. The input tax credit availed was not assessed as reverse tax. This resulted in short levy of tax and interest

of ₹ 3.00 lakh.

We pointed out the matter to the Department (October 2010) and the Department stated in December 2010 that the assessment had been finalised under Section 25(1) creating an additional demand of ₹ 3.91 lakh based on audit objection.

The case was reported to the Government in February 2011. We have not received further information (December 2011).

2.14.9 Irregular exemption

2.14.9.1 (CTO(WC), Palakkad; October 2009)

Section 8 of the KVAT Act stipulates that any works contractor, may at his option instead of paying tax in accordance with the provisions of Section 6 of the said Act, pay tax at four *per cent* of the whole contract amount received during 2007-08 and at three *per cent* during 2008-09. The Act also provides that an assessing authority can proceed to determine, to the best of his judgement, the turnover which has escaped assessment to tax and assess the tax payable thereon.

We noticed from the assessment records that an assessee who is engaged in works contract of building flats did not assess tax on whole contract amount of ₹ 12.02 crore while paying tax under Section 8 for the year 2007-08. The assessee deducted ₹ 5.31 crore from the whole contract amount stating that the amount represented value of land. This was not correct as the assessee was liable to pay tax on the whole contract amount. The AA did not detect the mistake and revise the assessment under Section 25(1). This resulted in short levy of

tax and interest of ₹ 24.87 lakh.

We pointed out the matter to the Department (November 2009). The Department stated in August 2010 that the assessment was revised with an additional demand of ₹ 26.57 lakh. We reported the case to the Government in January 2011. We have not received further information (December 2011).

- (CTO (WC & LT), Kottayam; August 2010)

We observed from the assessment records that two works contractors who opted to pay tax at the compounded rate of three *per cent* claimed exemption under Rule 10 on account of labour etc. of ₹ 2.14 crore during 2008-09. As no exemption under the compounding is permissible, the irregular exemption resulted in short levy of tax and interest of ₹ 7.44 lakh.

We pointed out the matter to the Department (August 2010) and the Government (May 2011). The AA stated (December 2010) that action was initiated to realise the short levy. We have not received further information (December 2011).

2.14.9.2 (CTO, Chathannur; July 2009)

Item 67(6) of the notified list of goods under the KVAT Act, provides that bodies of motor vehicles are taxable at the rate of 12.5 *per cent*. Blacksmith products of units approved by Khadi and Village Industries are exempted from tax.

We noticed from the assessment records that a Khadi and Village Industries unit sold tipper bodies of Mahindra and Tata for ₹ 1.14 crore during 2007-08. The assessee paid tax on sales turnover of tipper bodies upto

September 2007 at four *per cent*. From October 2007 the assessee claimed exemption treating tipper body as product of blacksmithy, approved by Khadi and Village Industries. However, Mahindra and Tata bodies built by the unit would not come under products of blacksmithy. Failure to assess tax at the correct rate of 12.5 *per cent* resulted in short levy of tax and interest of ₹ 13.83 lakh.

We pointed out the case to the Department in July 2009 and the Government in December 2009. The Government stated in July 2010 that the assessment was completed demanding tax and interest of ₹ 16.21 lakh. We have not received further information(December 2011).

2.14.9.3 (CTO, first circle, Tripunithura; March 2009)

Section 2(iv) of the KVAT Act provides that works contract includes any agreement for carrying out for cash or for deferred payment or other valuable consideration the construction, fitting out, improvement, repair, manufacture, processing, fabrication, erection, installation, modification or commissioning of any movable or immovable property. Further where the labour cost involved in works contract is not ascertained, the taxable turnover shall be arrived at after deducting labour charges as provided in the table to Rule 10(2).

We noticed from the assessment records that a dealer engaged in the manufacture of plastic moulded components considered receipts on works contract of ₹ 39.60 lakh and ₹ 38.44 lakh during 2005-06 and 2006-07 as labour charges even though goods were used in the above works. The AA did not detect this which resulted in short levy of tax of ₹ 7.32 lakh.

We pointed out the matter to the Department in March 2009 and to the Government in January 2010. The Government stated in March 2010 that the assessment had been revised creating an additional demand of ₹ 8.75 lakh. We have not received further information (December 2011).

2.14.10 Short/Non-assessment of CST

2.14.10.1 (CTO(WC), Ernakulam; February 2010)

Section 7(5) of the CST Act 1956 stipulates that a registered dealer may apply not later than six months before the end of a year for the cancellation of registration, and the authority shall, unless the dealer is liable to pay tax under this Act, cancel the registration accordingly. The cancellation shall take effect from the end of the year.

We noticed from the assessment records that the AA accepted the application for cancellation of CST registration filed by a dealer in June 2005. The assessee opted for compounding and assessed contract receipt of ₹ 6.67 crore for the year 2005-06 to tax at two *per*

cent plus purchase tax. As the cancellation of CST registration takes effect only from the end of the year, the assessee was liable to four *per cent* tax for the entire year (2005-06). Further, the assessee had not paid the tax assessed and admitted in full and the AA did not initiate action to collect the balance tax.

Hence, interest under Section 31(5) read with Rule 31(6) of KVAT Act and Rules of ₹ 6.10 lakh is leviable. Total short remittance works out to ₹ 19.65 lakh.

We pointed out the matter to the Department in March 2010 and reported the Government in June 2010. The Government stated in December 2010 that the assessment was revised in April 2010 assessing tax at compound rate of four *per cent*. We have not received further information from the Government (December 2011).

2.14.10.2 (CTO, special circle, Mattancherry at Aluva; August 2010)

The CST Act provides that interstate sales turnover covered by C form shall be taxed at the rate of three *per cent* from April 2007 to May 2008 and at two *per cent* thereafter.

We noticed from the monthly returns that a dealer assessed tax on interstate sales turnover of power tiller for ₹ 13.37 crore pertaining to April and May 2008 at the rate of two *per cent* instead of correct rate of three *per cent*. This resulted in

short levy of tax and interest of ₹ 15.51 lakh.

We pointed out the matter to the Department in October 2010. The Department replied that the assessee, a public limited company, had enjoyed concessional rate till March 2005 and it had applied for similar concessions and was awaiting Government orders. The reply is not tenable as tax is payable as per extant provisions till concessions are permitted. We reported the case to the Government in May 2011. We have not received further information (December 2011).

2.14.10.3 (CTO, special circle, Alappuzha; June 2010)

Section 8(2)(b) of Central Sales Tax Act 1956 provides that the tax payable by any dealer on his turnover in so far as the turnover or any part thereof relates to the sale of goods in the course of interstate trade or commerce not falling within sub section (1), shall be calculated at the rate applicable to the sale or purchase of goods inside the appropriate State. Electrical goods come under entry 33 of the notified list of goods taxable at the rate of 12.5 *per cent*.

We noticed from the assessment order that the AA assessed tax on interstate sales turnover of electrical goods of a dealer for ₹ 4.73 crore not covered by declaration in form C for the year 2007-08 at 10 *per cent* instead of at the correct rate of 12.5 *per cent*. This resulted in short levy of tax and interest of ₹ 14.89 lakh.

We pointed out the matter to the Department (June 2010) and to the Government (January 2011), the Government stated (July 2011) that the assessment was revised based on the audit

observation, demand notice issued, and amount advised for Revenue Recovery. We have not received further information (December 2011).

2.14.10.4 (CTO, special circle, Alappuzha; June 2010)

By an amendment to Central Sales Tax Act, Government had withdrawn concessional rate of tax on interstate sale of goods to Government Departments granted on production of Form D with effect from April 2007 and the goods are liable to tax at the rate mentioned in the schedules to the KVAT Act. Sales to Railways is taxable at four *per cent*.

We noticed from the assessment records that the AA did not assess tax on sales turnover of electrical goods for ₹ 2.09 crore, while finalising the assessment for the year 2007-08. The sales were effected to Railways and the turnover was covered by declaration in Form D. As the concessional rate of tax on

the basis of declaration in Form D was withdrawn from April 2007, the assessee was liable to pay tax at four *per cent* applicable to Railways. This resulted in short levy of tax and interest of ₹ 10.52 lakh.

We pointed out the matter to the Department (June 2010) and reported to the Government (January 2011), the Government stated (July 2011) that the assessment was revised based on audit observation assessing the turnover at the rate of 12.5 *per cent* with interest. We have not received further information (December 2011).

2.14.10.5 (CTO, Special circle, Alappuzha; June 2010)

Central Sales Tax Act, stipulates that interstate sales turnover supported by valid declaration in Form C is taxable at the concessional rate of three *per cent* during 2007-08.

We noticed from the assessment records of 2007-08 that the AA, while finalising the assessment of an assessee, did not assess tax at the rate of three *per cent* on interstate sales turnover of electrical goods for ₹ 1.98 crore

covered by declarations in Form C for the year. This resulted in short levy of tax and interest of ₹ 7.50 lakh.

We pointed out the matter to the Department (June 2010) and to the Government (January 2011). The Government stated (July 2011) that the assessment was revised assessing the turnover at the rate of three *per cent*. We have not received further information (December 2011).

2.14.10.6 (CTO, special circle, Mattancherry; August 2010)

The CST Act provides for assessment and collection of interest in respect of delayed payment of tax due under the Act at the rate applicable to tax due under the State Act, as if tax and interest payable under CST Act were a tax and interest under such sales tax law. The KGST Act provides for levy of interest on defaulted payment of tax at the rate of one *per cent* for the first three months and two *per cent* per month thereafter.

We noticed from the assessment records that while completing (July 2007) the CST assessment for the year 1995-96, the AA levied interest on belated payment of tax due at one *per cent* instead of 23 *per cent* for the period from November 1999 to December 2000, resulting in short levy of interest of

₹ 5.49 lakh.

We pointed out this case to the Department (August 2010) and to the Government (May 2011). We have not received further information (December 2011).

2.14.11 Incorrect carry forward of input tax

(CTO, special circle, Malappuram; March 2009)

Rule 16 of the KVAT Rules provides that the net tax payable by a registered dealer for a return period shall be the amount arrived at after deducting the input tax under Section 11 and special rebate under section 12 from the sum of the output tax, tax on the purchases under Section 6(2) and reverse tax under Section 11(7). There is no provision to adjust the excess credit available under the KGST Act against output tax.

We noticed from the assessment records that an assessee included ₹ 30.14 lakh stated to be due to him under the KGST Act in the input tax credit claim for the year 2005-06. After disallowing the incorrect input tax credit of ₹ 30.14 lakh the assessee was liable to pay tax of ₹ 12.55 lakh which was not demanded. This resulted in short levy of tax and interest of ₹ 16.81 lakh.

We pointed out the matter to the Department in April 2009 and to the Government (May 2011). The Department stated (April 2010) that the assessment of the dealer for 2005-06 was completed in February 2010 creating an additional demand of ₹ 16.81 lakh. We have not received further information (December 2011).

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

We noticed from the assessment records that the total input tax credit of an assessee for 2005-06 included ₹ 8.46 lakh being excess carry forward of credits from 2000-01 and 2001-02. The incorrect carry forward of credit against output tax resulted in short assessment of VAT and interest of ₹ 5.48 lakh.

We pointed out the matter to the Department (March 2009) and to the Government (March 2011). The Government stated (August 2011) that the AA completed the assessment (February 2010) and the short levy pointed out was made good. Collection particulars are awaited (December 2011)

2.14.12 Misclassification of goods

(CTO, Chittur; August 2009)

As per Entry 105(28) of the third schedule to the KVAT Act, readymade garments are taxable at the rate of four *per cent*.

We noticed from the assessment records that a dealer in readymade garments assessed taxable turnover of ₹ 0.74 lakh and

₹ 0.83 lakh and non taxable turnover of fabrics for ₹ 1.06 crore and ₹ 98.55 lakh in the annual returns for the years 2006-07 and 2007-08 respectively. However, we noticed that in the audited accounts the assessee had disclosed the cost of goods manufactured as ₹ 1.07 crore and ₹ 92.69 lakh and the sale of finished goods as ₹ 1.10 crore and ₹ 99.38 lakh for the years 2006-07 and 2007-08 respectively. As such the assessee is liable to pay tax on the sale of finished goods disclosed in the annual accounts. The AA did not detect the misclassification of sale of finished (readymade) garments as fabrics which resulted in short levy of tax and interest of ₹ 10.06 lakh.

We pointed out the matter to the Department in September 2009. The Department stated in January 2010 that the assessment was revised with an additional demand of ₹ 8.26 lakh. We reported the case to the Government in February 2011. We have not received further information (December 2011).

2.14.13 Loss due to delay in collection of cheques

(CTO, Manjeri; August 2008)

Rule 98(1) of the KVAT Act stipulates that where any payment by cheque or demand draft is permitted by these rules, the cheque or demand draft shall be of a bank or branch of a bank, which is a member of the clearing house, situated in the headquarters of the authority before whom it is presented.

We noticed from the assessment records that a dealer in vehicles, paid tax by way of cheques drawn on a bank at Kottayam during the year 2005-06. Delay of 18 to 95 days occurred in crediting the amounts to Government account. This resulted in loss

of interest of ₹ 8.66 lakh.

We pointed out the case to the Department in October 2008. The matter was reported to the Government in December 2008. The Government stated (November 2009) that the assessment was completed demanding tax and interest of ₹ 12.40 lakh. We have not received further information (December 2011).

2.14.14 Short levy due to mistake in computation

2.14.14.1 (CTO, special circle, Kottayam; January 2009)

KVAT Act, stipulates that centrifugal latex and skim crepe are taxable at the rate of four *per cent*.

We noticed from the assessment records that an assessee incorrectly computed four *per cent* tax on sales turnover of ₹ 20.87 crore as ₹ 76.57 lakh instead of as ₹ 83.50 lakh during the period 2006-07. Besides, the assessee availed an excess input tax credit of ₹ 1.25 lakh. These resulted in short levy of tax of ₹ 8.18 lakh.

We pointed out the matter to the Department in January 2009 and to the Government in December 2010. We have not received their reply (December 2011).

2.14.14.2 (CTO, special circle III, Ernakulam; June 2010)

Section 6(1) of the Kerala Finance Act, 2008 provides that there shall be levied and collected from dealers a cess at the rate of one *per cent* on the tax payable by them under Section 6 and 8 of the KVAT Act.

We noticed from the assessment records that the AA incorrectly calculated the cess at 0.1 *per cent* on tax of ₹ 6.99 crore related to 2008-09. The short levy worked out to ₹ 6.98 lakh.

We pointed out the matter to the Department (June 2010) and to the Government (April 2011). The Government stated (July 2011) that the AA rectified the mistake under Section 66(1) of the Act and an order was served to the dealer to recover the short levy. We have not received further information (December 2011).

2.14.15 Short levy due to incorrect compounding

2.14.15.1 (CTO, special circle II, Kozhikode; December 2010)

Section 8(f) of the KVAT Act, 2003 provides that any dealer in ornaments or wares or articles of gold, silver or platinum group metals including diamond may at his option, instead of paying tax in respect of such goods in accordance with the provisions of section 6, pay tax at one hundred and fifty *per cent*, in case their annual turnover for the above goods for the preceding year exceeded ₹ one crore, of the highest tax payable by him as conceded in the return or accounts, or tax paid by him under this Act, whichever is higher, for a year during any of the three consecutive years preceding that to which such option relates.

We noticed from the assessment records that a dealer in jewellery remitted compounded tax of ₹ 9.21 lakh for the year 2008-09 being 150 *per cent* of the tax for 2006-07. The tax for 2006-07 was revised to ₹ 10.96 lakh in January 2010. However, the compounded tax for 2008-09 was not correspondingly revised, which resulted in short levy of tax of ₹ 7.30 lakh.

We pointed out the matter to the Department (January 2011) and to the Government (May 2011). The government stated (October 2011) that the assessment was re-opened and revised (February 2011). We have not received

further information (December 2011).

- (CTO, special circle, Kannur; August 2010)

We noticed from the assessment records that a dealer in jewellery was permitted to pay compounded tax of ₹ 1.52 crore for the year 2008-09 instead of ₹ 1.58 crore. Incorrect determination of compounded tax resulted in short levy of tax of ₹ 6.09 lakh.

We pointed out the matter to the Department in October 2010 and reported to the Government in December 2010. The Department stated (April 2011) that the assessment had been revised creating an additional demand of ₹ 7.12 lakh and the assessee remitted the amount alongwith interest (October 2011).

2.14.15.2 (CTO(WC), Thiruvananthapuram; March 2010)

Works contractors undertaking electrical work were not permitted to opt for payment of compounded tax under Section 8(a) (ii) of the Act as it stood prior to April 2008.

We noticed from the assessment records that an assessee engaged in electrical works during 2007-08 opted to pay tax at the compounded rate of four *per cent* instead of assessing tax under section 6(1) at the rate of 12.5 *per*

cent on a taxable turnover of ₹ 59.86 lakh. This resulted in short levy of tax and interest to the tune of ₹ 5.52 lakh.

We pointed out the matter to the Department in March 2010 and to the Government in December 2010. The Department stated in November 2010 that the assessment was revised creating an additional demand of ₹ 5.79 lakh. We have not received further information (December 2011).

Sales Tax

2.14.16 Incorrect allowance of concessional rate of tax

2.14.16.1 (CTO, Special circle II, Ernakulam; November 2010)

Government by a notification issued in December 1999 had reduced the rate of tax on the sale of goods for use in generation and distribution of power to power generating undertakings in the joint sector, with capacity of above 25 kilo watts, to four *per cent*. Government of India in their guidelines on the formation and functioning of joint sector has stipulated certain conditions which include minimum 26 *per cent* equity ownership by the State Industrial Development Corporations (SIDCs) of Government. Further no private partner can hold equity capital more than the SIDCs and no large Industrial House or foreign majority company can have any holding at all in the projects promoted by SIDCs except with the prior permission of the Central Government.

We noticed from the assessment order that while finalising the assessment of an oil company for the years 2000-01 to 2004-05 and another company for the years 2001-02 to 2003-04 between March 2008 and March 2010, sale of petroleum products to two power generating companies were assessed to tax at concessional rate of four *per cent* applicable to undertakings in the joint sector. However, these undertakings do not qualify as joint

sector undertakings as they did not meet the equity ownership criteria specified by Government of India. Incorrect grant of concessional rate of tax resulted in short levy of tax of ₹ 42.46 crore.

When we pointed out the case to the Department in November 2010, the AA stated that the cases in respect of Naptha & HSD would be examined and remarked that rate of tax applicable to LSHS is 20 *per cent* as per a reduction notification of October 2000. The reply in respect of LSHS is not relevant as the reduced rate was effective only upto 31 March 2002 and the same was considered for computing short levy upto 2001-02. Rate of tax for LSHS from 3 April 2002 was 30 *per cent* as per a notification of April 2002. Thus the rate of tax on LSHS taken in audit was correct.

We reported the case to the Government in May 2011. We have not received further information (December 2011).

2.14.16.2 (CTO, special circle II, Ernakulam; November 2010)

Serial No. 98 of Schedule III to KVAT Act provides for levy of tax at four *per cent* on sale of petroleum products covered under the Act to KSEB, NTPC and other power generating undertakings in the joint sector. The Government of India issued guidelines (February 1973) stipulating conditions to be fulfilled to qualify as a joint sector undertaking. These included minimum 26 *per cent* equity ownership by the State Industrial Development Corporations (SIDCs) and holding of not more than 25 *per cent* share by private partner without prior approval of the Central Government. Under KVAT Act, Low Sulphur Heavy Stock (LSHS), a petroleum product, was taxable at the rate of 12.5 *per cent* (Sl. No. 58).

We noticed from the assessment records that a petroleum company assessed tax on sale of LSHS for ₹ 2.84 crore and ₹ 14.83 crore during 2005-06 and 2007-08 respectively to a power generating unit, BSES Kerala Power Ltd., at concessional rate of four *per cent* applicable to undertakings in the joint sector. However, BSES Kerala Power Ltd. does not qualify as a joint sector undertaking as it did not meet the equity ownership criteria specified by Government of India. The application of incorrect rate of tax of resulted in short remittance of tax ₹ 1.50 crore and interest of ₹ 53.75 lakh.

When we pointed out the case to the Department in November 2010, the Department stated that the genuineness of the Form 41²⁰ would be

examined on the basis of assessment under Section 24 or 25 of the Act. The reply is not correct as all assessments are not taken up under Section 24 or 25. Further the assessment for 2005-06 was revised under Section 25 and the AA did not detect the above omission.

The case was reported to Government. We have not received any further information (December 2011).

2.14.16.3 (CTO, special circle II, Ernakulam; November 2010)

Government by a notification issued on 4 January 2001 under the KGST Act reduced the rate of tax on the sale of bitumen to State and Central Government Departments to four *per cent*. The reduction was extended for sale to local bodies also with effect from 11 April 2003. Bitumen was taxable at 24 *per cent* during 2001-02 and 30 *per cent* thereafter.

We noticed from the assessment orders that, while finalising the assessment of four petroleum companies, turnover of bitumen sold to local bodies prior to 11 April 2003 and to the State Farming Corporation during 2004-05 were assessed to tax

at four *per cent* applicable to Government Department. Incorrect grant of concession resulted in short levy of tax of ₹ 80.07 lakh.

²⁰ Declaration form for concessional rate of tax for purchase of petroleum product by power generating public sector undertaking

We pointed out the matter to the Department (November 2010) and to the Government (April 2011). We have not received further reply (December 2011).

2.14.17 Non-forfeiture of illegal collection of tax

(CTO, special circle II, Ernakulam; November 2010)

The KGST Act, provides that any sum collected by way of tax against the provision of the Act should be forfeited to the Government. The Government of India vide notification in November 2002, exempted from the levy of all taxes and duties in India, fuels and lubricants filled into receptacles forming part of any aircraft registered in any other country and operating international air services to and from India, with effect from 23 November 2002.

We noticed from the assessment records that the AA did not forfeit to Government, an amount of ₹ 1.89 crore being tax illegally collected by an oil company in respect of Aviation Turbine Fuel sold to international aircraft from 23 November 2002 to 15 January 2003.

We pointed out the matter to the Department in January 2011 and to the Government (May 2011). We have not

received further information (December 2011).

2.14.18 Turnover escaping assessment

2.14.18.1 (CTO, special circle II, Ernakulam; November 2010)

A notification issued (December 1999) under KGST Act provided for reduced rate of tax of four *per cent* on sales turnover of goods for use in generation and distribution of power to National Thermal Power Corporation (NTPC) provided a certificate in Annexure I to the notification was produced. The Act empowers the assessing authority to assess to the best of his judgement the turnover escaping assessment.

We observed from the assessment records of an oil company that it had in 2000-01 returned turnover of naphtha taxable at the concessional rate of four *per cent* as ₹ 539.09 crore against ₹ 550.38 crore as revealed by the declaration furnished by the purchaser. This resulted in escapement of turnover of ₹ 11.28 crore and consequent short levy of tax and interest of ₹ 1.16 crore.

We pointed out the matter to the Department in January 2011. The Department accepted the matter (May

2011) and stated that action will be taken to make good the loss. We reported the case to the Government (May 2011). We have not received further information (December 2011).

2.14.18.2 (CTO, special circle, Mattancherry at Aluva; August 2010)

As per the KGST Act, sales turnover of Duty Entitlement Pass Book (DEPB) was to be taxed at the rate of eight *per cent* under first schedule to the Act.

We noticed from the assessment records that while finalising the assessments of a dealer for the period from 2000-01 to 2002-03, the AA did not assess tax on sales turnover of DEPB for ₹ 41.29 lakh resulting in short levy of tax, AST and interest of ₹ 8.27 lakh.

We pointed out the matter (October 2010) to the Department and to the Government (May 2011). We have not received further information (December 2011).

2.14.19 Non-levy of tax

(CTO, special circle II, Ernakulam; November 2010)

Goods specified in the Fifth schedule are taxable at two points if the sale is to a registered dealer under Section 5(v) of KGST Act. Petroleum products were under the Fifth schedule during 1 and 2 April 2002 as amended vide Finance Act 2002. First point of levy being sale by an oil company to another oil company was taxable at four *per cent*.

We noticed from the assessment records that while finalising the assessment for the year 2002-03 in December 2009 of an oil company, the AA did not assess tax on turnover of first sale of petroleum product effected on 1 and 2 April 2002. Short levy of tax and additional sales tax on this account, on a proportionate turnover of ₹ 24.79 crore, worked

out to ₹ 1.14 crore.

We pointed out the matter to the Department (November 2010) and the Government (April 2011). We have not received further reply (December 2011).

2.14.20 Incorrect compounding

(CTO, second circle, Mattancherry; December 2010)

Section 7 of the Kerala General Sales Tax Act, 1963, as amended from July 2006, stipulates that any bar attached hotel not being a star hotel of and above three star hotel, heritage hotel or club, may, at its option, pay turnover tax on the turnover of foreign liquor calculated at one hundred and forty *per cent* of the purchase value of such liquor or at one hundred and fifteen *per cent* of the highest turnover tax payable by it as conceded in the return or accounts or the turnover tax paid for any of the previous consecutive three years, whichever is higher.

We noticed from the assessment order that a bar attached hotel in municipal corporation area, was assessed to compounded tax during 2006-07 and 2007-08 on the basis of 140 *per cent* of purchase value of liquor, even though 115 *per cent* of tax paid/payable for the preceding years was higher. Incorrect determination of compounded tax resulted in short levy of ₹ 19.39 lakh.

We pointed out the matter to the Department (December 2010) and reported it to the Government (May 2011). The Government replied (October 2011) that the assessments were completed based

on the audit observation (April 2011) and RR action initiated. We have not received further information (December 2011).

2.14.21 Incorrect grant of exemption

(CTO, special circle II, Ernakulam; November 2010)

The Goods specified in the Fifth schedule are taxable at two points unless the sale is to a person other than a registered dealer. Petroleum products were under the Fifth schedule during 1 and 2 April 2002 as amended by the Finance Act 2002. First point of levy was at the point of first sale by an oil company to another oil company and second point of levy was at the point of second sale by an oil company. Liquified petroleum gas was taxable at four *per cent* and eight *per cent* at the first point and at the second point of sale respectively.

We noticed from the assessment records that while finalising the assessments for the year 2002-03 of three oil companies²¹ in January 2010, the AA did not assess tax on second sale of LPG. This included proportionate turnover of 1 and 2 April 2002 which was liable to be taxed at eight *per cent*. Incorrect grant of exemption resulted in short levy of tax of ₹ 15.75 lakh.

When we pointed out the matter to the Department in November 2010, the AA stated that action will be

²¹ Bharat Petroleum Corporation, Hindustan Petroleum Corporation Limited and Indian Oil Corporation Limited.

taken to make good the loss. We reported the case to the Government in April 2011. We have not received further reply (December 2011).

2.14.22 Non-assessment of additional sales tax

(CTO, special circle, Mattancherry at Aluva; August 2010)

The KGST Act stipulates that the tax payable under Section 5 and Section 5 A shall be increased by an additional sales tax (AST) at the rate of 15 *per cent* of the tax payable under the said section.

We noticed from the assessment order that the AA did not assess AST from July 2003 in respect of an assessee, though the same was mentioned in the assessment order (October 2010). This resulted in short

levy of AST of ₹ 12.99 lakh.

We pointed out the matter to the Department (October 2010) and to the Government (May 2011). The Government stated (October 2011) that the assessment was revised (June 2011) rectifying the defect as pointed out by audit. We have not received further information (December 2011).

2.14.23 Application of incorrect rate of tax

2.14.23.1 (CTO, first circle, Mattancherry; July 2009)

Entry 113 of Schedule I to the KGST Act provides that HDPE sheets are taxable at the rate of 12 *per cent*.

We noticed from the assessment order that while finalising the assessment of a dealer for the years 2003-04 and

2004-05, the AA assessed sales turnover of HDPE Sheets used for covering autorikshaws, jeeps etc. at four *per cent* treating it as packing materials against the correct rate of 12 *per cent*. Application of incorrect rate of tax resulted in short levy of tax and interest of ₹ 12.13 lakh.

We pointed this out to the Department (September 2009) and to the Government (December 2010). The Government stated (February 2011) that the assessments for the years 2003-04 and 2004-05 were revised in October 2010 creating an additional demand of ₹ 7.59 lakh and that the amount has been advised for revenue recovery. Further reply has not been received (December 2011).

2.14.23.2 (CTO, special circle III, Ernakulam; June 2010)

Non-stick Cookware and utensils are taxable at the rate of 12 *per cent* under Schedule I of the KGST Act

We noticed from the assessment order that turnover assessed at the rate of four *per cent* by the AA included sales turnover of non-stick cookware and utensils amounting to

₹ 37.95 lakh and ₹ 36.33 lakh respectively for the years 2003-04 and 2004-05.

Application of incorrect rate of tax resulted in short levy of tax of ₹ 6.83 lakh and interest of ₹ 4.87 lakh (total ₹ 11.70 lakh).

We pointed out the matter to the Department (June 2010) and to the Government (April 2011). The Government stated (September 2011) that the assessments were reopened under section 17 D(2) of the Act and revised (February 2011). We have not received further information (December 2011).

2.14.23.3 (CTO, special circle III, Ernakulam; June 2010)

Canon Kinetiser (Hot Plate) comes under entry 54(1) of Schedule I to the KGST Act and is taxable at the rate of 12 *per cent* from 1 April 2004.

We noticed from the assessment order that while completing the assessment for the year 2004-05 (July 2009) sales turnover of Canon Kinetiser (Hot Plate)

of ₹ 1.50 crore was assessed to tax at the rate of eight *per cent* instead of correct rate of 12 *per cent*. Application of incorrect rate of tax resulted in short levy of tax and interest of ₹ 11.13 lakh.

We pointed out the matter to the Department (June 2010) and to the Government (April 2011). The Government stated (October 2011) that the assessment was reopened and completed applying correct rate of tax (February 2011). We have not received further information (December 2011).

2.14.23.4 (CTO, first circle, Kollam; October 2010)

The KGST Act, 1963 stipulates that footwear of all kinds are taxable at the rate of 12 *per cent*.

We noticed from the assessment orders that while completing (February 2010) the assessments of a dealer in footwear for the years 2003-04 and 2004-05 tax

was assessed at the rate of eight *per cent* instead of at 12 *per cent* on the turnover of ₹ 21.18 lakh and ₹ 25.42 lakh respectively. This resulted in short levy of tax of ₹ 3.67 lakh.

We pointed out the matter to the Department (November 2010) and to the Government (May 2011). The Government stated (September 2011) that the assessments were reopened under section 17 D(2) of the Act and revised (June 2011) taking into consideration all aspects pointed out by audit. We have not received any further information (December 2011).

2.14.24 Short levy of turnover tax

(CTO, Kottarakkara; December 2009)

Section 5(2c) of the KGST Act, provides that every dealer of foreign liquor in a bar hotel shall pay turnover tax on the sales turnover of liquor at the rate of 10 *per cent*.

We observed from the assessment order that while completing the assessment of a dealer of foreign liquor in a bar hotel for the year 2004-05, on best judgement basis, the assessing officer assessed

turnover tax of ₹ 13.42 lakh on escaped turnover of ₹ 1.11 crore. Against this tax assessed, the AA gave credit of ₹ 11.30 lakh being tax paid on the turnover already conceded by the assessee. This resulted in short levy of tax of ₹ 11.30 lakh.

We pointed out the matter to the Department (January 2010) and reported it to the Government (October 2010). The Government stated (October 2011) that the assessments were reopened and revised rectifying the mistake. We have not received further information (December 2011).

2.14.25 Short levy of tax and interest due to non-appropriation of payment

(CTO, special circle, Palakkad; February 2009)

Section 55C of the KGST Act stipulates that where any tax or any other amount due or demanded under the Act is paid by any dealer, the payments so made shall be appropriated first towards interest accrued on such tax on such date of payment and the balance available shall be appropriated towards principal outstanding.

We noticed from the assessment records that the AA while finalising the assessment (August 2007) of a dealer for the year 2002-03, had incorrectly appropriated the amount paid by the assessee towards tax due instead of appropriating it first towards interest. This resulted in short levy of tax and interest of ₹ 9.34 lakh.

We pointed out the matter to the Department (February 2009) and to the government (February 2010). The Government stated (August 2011) that the assessment has been revised creating additional demand of ₹ 14.52 lakh and that necessary directions have been issued to initiate RR action. We have not received further information (December 2011).