

CHAPTER I INTRODUCTION

1.1 Introduction

The Empowered Committee (EPC) of the State Finance Ministers set up by the Government of India in its meeting held on 23 January 2002 unanimously decided to introduce Value Added Tax (VAT) in all the States and Union Territories with effect from 1 April 2003. After several rounds of discussions they came out with a white paper in January 2005 defining the basic designs of the state level VAT. However, taxes on sales, trade etc., being a state subject, the states were allowed the flexibility to adopt appropriate variations in their VAT Acts, consistent with the basic design. The VAT system which is a destination/consumption based tax system has provisions for set-off of the tax paid on the previous purchases and seeks to address problems of double taxation of commodities, multiplicity of taxes, surcharge and additional tax on sales tax etc., in the sales tax structure that resulted in a cascading tax burden. Major designs put forth in the white paper are as follows:

- **Manufacturers and traders will be given input tax credit (ITC) for purchase of inputs-including that of capital goods-meant for use in manufacture or resale;**
- **ITC remaining unadjusted at the end of a year and also on export will be refunded to the dealers;**
- **Dealers will submit self assessment returns declaring their tax liability. These returns will be considered as deemed assessment except where notice for audit of books of accounts of the dealer was issued within the prescribed period;**
- **Audit of books of accounts of the dealer will be delinked from tax collection wing to remove any bias;**
- **There would be two basic tax rates of four *per cent* and 12.5 *per cent* plus a specific category of tax exempted goods and special VAT rate of one *per cent* only for gold and silver ornaments, precious stones etc; and**
- **Other taxes like turnover tax, surcharge, etc., to be abolished and phasing out of central sales tax (CST) and rationalisation of overall tax burden.**

The Government of Kerala implemented the Kerala Value Added Tax Act, 2003 (KVAT Act) with effect from 1 April 2005. Aviation turbine fuel, motor spirit, high speed diesel oil, petrol other than naphtha, foreign liquor, ganja and opium, however, continued to be administered under the Kerala General Sales Tax Act, 1963 (KGST Act). The major variations between the pre-VAT and post-VAT scenario are given in the annexure - I.

We undertook a review of the transition process from the sales tax regime to the VAT system.

1.2 Organisational set-up

Principal Secretary, Taxes administers the levy and collection of tax under KGST, KVAT and CST Acts at the Government level and the Commissioner of Commercial Taxes (CCT) at the departmental level in the Department of Commercial Taxes. The CCT functions with the assistance of Joint Commissioners (JC), Deputy Commissioners (DC) and Inspecting Assistant Commissioners (IAC). Assistant Commissioners (AC) in Special Circles and Commercial Tax Officers (CTO) in ordinary circles were in-charge of registration of dealers, scrutiny of returns and levy and collection of tax. There are CTOs (Works Contract) in each district exclusively for registration, scrutiny of the returns and levy and collection of tax on works contract.

1.3 Audit objectives

We conducted the review to ascertain the

- **promptness and effectiveness of planning for implementation of transition from the sales tax regime to VAT system;**
- **adequacy and effectiveness of the organisational structure;**
- **adequacy and proper enforcement of the provisions of the VAT Act and the Rules made thereunder to safeguard the revenue of the State;**
- **adequacy of and effectiveness of the internal control mechanism in the Department to prevent leakage of revenue; and**
- **status of the system after being in place for four years.**

1.4 Scope and methodology of audit

We conducted the review during May to September 2009, covering the period from 2005-06 to 2007-08. During the audit process, we collected data on registration, filing and scrutiny of the returns and grant of ITC on opening stock from the DCs through questionnaires issued through the office of the CCT. Data on preparedness and transitional process were gathered from the records in the office of the CCT and the Taxes Department of Government of Kerala. We have also scrutinised selected files at CTO, Special Circle, Thiruvananthapuram and CTO (Works Contract), Thiruvananthapuram.

1.5 Acknowledgement

On behalf of the Indian Audit and Accounts Department, we acknowledge the co-operation of the Commercial Taxes Department in providing necessary information and records for audit. Before taking up the review, we have organised an entry conference in May 2009 which was attended by the Principal Secretary (Taxes) who was also holding the charge of the CCT, DC (General) and DC (Audit & Inspection), wherein the scope and methodology of audit was explained to the department. An exit conference was also held in July 2009 by the Principal Accountant General with the Principal Secretary (Taxes) in which the findings of the review and the recommendations were discussed. After the exit conference, we have forwarded the draft review report to the Government/department in August 2009 requesting their response. We have included the replies of the Government/department during the exit conference and at other points of time in the relevant paragraphs of the review. We are happy to report that the Government have accepted most of our audit findings and recommendations.

1.6 Results of audit

Our review on 'Transition from Sales Tax to VAT system in Kerala' revealed a number of deficiencies in the transitional process, lacunae in the Act and Rules and other weaknesses of administration of the VAT. Also, we have noticed cases of non/short realisation of revenue worth Rs. 295.24 crore. These are discussed in seven succeeding chapters.