

## CHAPTER II SALES TAX/VAT

### 2.1 Tax administration

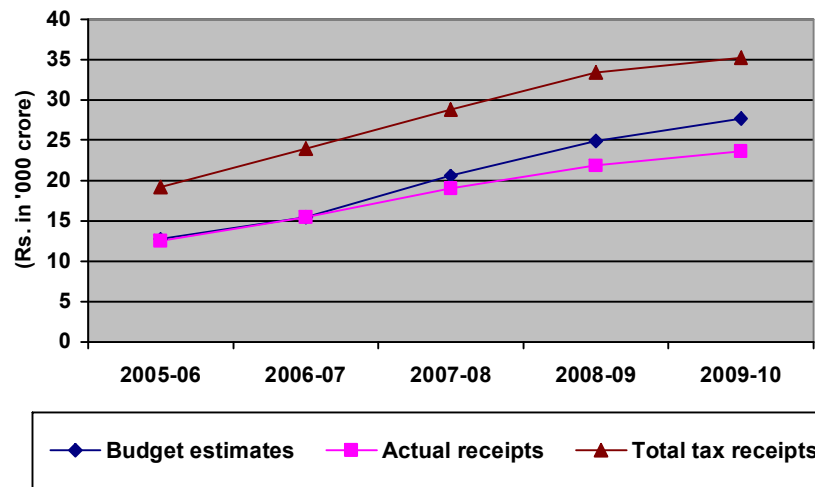
The Commercial Taxes Department is under the purview of Principal Secretary to Revenue Department at the Government level. The Department is mainly responsible for collection of taxes and administration of the AP Value Added Tax (VAT) Act, the Central Sales Tax Act, the AP Entertainment Tax Act, the AP Luxury Tax Act and the rules framed thereunder. The Commissioner of Commercial Taxes is the Head of the Department entrusted with the over all supervision and is assisted by Additional Commissioners, Joint Commissioners, Deputy Commissioners and Assistant Commissioners. Commercial Tax Officers at circle level are primarily responsible for tax administration and are entrusted with the registration of dealers and collection of taxes.

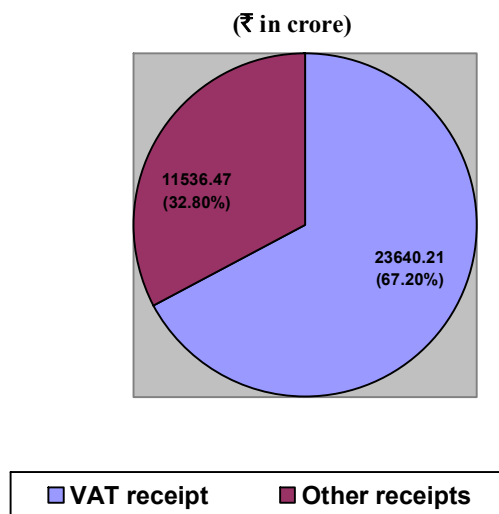
### 2.2 Trend of receipts

Actual receipts from VAT during the last five year period 2005-06 to 2009-10 along with the total tax receipts during the same period is exhibited in the following table and graphs.

(₹ in crore)

Year	Budget estimates	Actual receipts	Variation Excess (+)/shortfall (-)	Percentage of variation	Total tax receipts of the State	Percentage of actual VAT receipts vis-à-vis total tax receipts
2005-06	12,706.16	12,541.61	(-) 164.55	(-) 1.30	19,207.41	65.30
2006-07	15,465.33	15,467.08	(+) 1.75	(+) 0.01	23,926.20	64.64
2007-08	20,568.00	19,026.49	(-) 1,541.51	(-) 7.49	28,794.05	66.08
2008-09	24,887.28	21,851.66	(-) 3,035.62	(-) 12.20	33,358.29	65.51
2009-10	27,685.00	23,640.21	(-) 4,044.79	(-) 14.61	35,176.68	67.20





Though the actual receipts under Sales Tax/VAT during 2006-07 to 2008-09 recorded increase each year between 14.85 *per cent* and 23.33 *per cent* over the previous year, the increase of revenue in 2009-10 fell down steeply to 8.18 *per cent* over the previous year. Further there was significant variation of the actual receipts when compared with the budget estimates ranging from 7.49 *per cent* in 2007-08 to 14.61 *per cent* in 2009-10 indicating unrealistic budgeting. The Department did not furnish (January 2011) the reasons for shortfall despite being requested in May 2010.

### 2.3 Assessee profile

The Commercial Taxes Department had 1,98,640 VAT dealers registered under the AP VAT Act, out of which 625 dealers were Large Tax Payers. The following table indicates the position of returns received by the Department during 2009-10.

No. of assessee on rolls	No. of assessee required to file monthly returns	No. of returns received in 2009-10 (12 months)	No. of returns not received
1,98,640	1,98,640	21,41,156	1,21,419

The Department did not furnish (January 2011) the action initiated by the Department against the dealers who failed to file the returns and pay taxes.

### 2.4 Cost of VAT per assessee

The Commercial Taxes Department spent ₹ 215.88 crore on their tax administration during 2009-10 with reference to 1,98,640 VAT dealers on their rolls, the average cost of VAT per assessee stood at ₹ 0.11 lakh *per annum* during 2009-10, and the cost *per cent* at 0.05.

## 2.5 Arrears in assessment

2.5.1 The details of assessments relating to Sales Tax, Motor spirit tax, Professions tax, Entry tax, Lease tax, Luxury tax, pending at the beginning of the year, additional cases that due for assessment during the year, cases disposed during the year and cases pending at the end of each year during 2005-06 to 2009-10 as furnished by the Commercial Taxes Department were as under:

Year	Opening balance	Cases which became due for assessment	Total	Cases disposed during the year	Cases pending at the end of the year	Percentage of disposed to total assessment
2005-06	1,26,507	3,41,983	4,68,490	3,69,326	99,164	78.83
2006-07	99,164	27,077	1,26,241	97,768	28,473	77.45
2007-08	28,473	14,469	42,942	40,192	2,750	93.60
2008-09	2,750	17,052	19,802	17,042	2,760	86.06
2009-10	2,760	13,704	16,464	12,658	3,806	76.88

The above table indicates that the percentage of assessments completed to the total assessment ranged between 76.88 *per cent* and 93.60 *per cent*. Further, the percentage of completion of assessments to the total assessments in 2009-10 was 76.88, which was the lowest when compared to the previous four years. The Department, however, did not attribute any reasons for the decline (January 2011).

2.5.2 There is no concept of assessment under the APVAT Act. But, as per paras 3.1(i) and 4.8.2 of the APVAT Manual of Commercial Taxes Department, all the VAT dealers should be audited in a period of two years and such audits should not exceed 12.5 *per cent* in a quarter. The progress of audits conducted during the years 2007-08 to 2009-10 as furnished by the Department is given in the following table:

Year	Total no. of dealers	No. of dealers to be audited	No. of dealers actually audited	Shortfall in audits	Percentage of shortfall
2007-08	2,38,088	1,19,044	17,225	1,01,819	85.53
2008-09	2,69,153	1,34,576	18,693	1,15,883	86.11
2009-10	1,98,640	99,320	22,254	77,066	77.59

The percentage of completion of audits to the total audits to be conducted during the above three years was consistently less than atleast 25 *per cent* of audits required to be done.

## 2.6 Cost of collection

The figures of gross collection of Commercial Taxes Department, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2007-08, 2008-09 and 2009-10 along with the relevant all India average percentage of expenditure on collection to gross collection for the previous year is given below:

(₹ in crore)

Head of revenue	Year	Gross collection	Expenditure on collection of revenue	Percentage of cost of collection to gross collection	All India average percentage for the previous year
Taxes/VAT on sales, trade etc.,	2007-08	19,026.49	175.73	0.92	0.82
	2008-09	21,851.66	190.79	0.87	0.83
	2009-10	23,640.21	215.88	0.91	0.88

The expenditure on collection of taxes was higher than the all India average consecutively for the last three years and the Government needs to look into this aspect.

## 2.7 Revenue impact

During the last five years, audit had pointed out non/short levy, non/short realisation, underassessment/loss of revenue, incorrect exemption, concealment/suppression of turnover, application of incorrect rate of tax, incorrect computation etc., with a revenue implication of ₹ 1,199.69 crore in 6,634 cases. Of these, the Department/Government had accepted audit observations in 3,577 cases involving ₹ 347.14 crore and had since recovered ₹ 5.99 crore. The details are show in the following table:

(₹ in crore)

Year	No. of units audited	Objected		Accepted		Recovered	
		No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
1	2	3	4	5	6	7	8
2004-05	253	1,531	135.87	1,202	52.75	80	1.21
2005-06	212	1,577	210.16	910	48.01	568	2.33
2006-07	227	1,264	389.08	548	122.22	14	0.24
2007-08	209	980	196.63	141	80.26	43	1.02
2008-09	198	1,282	267.95	776	43.90	21	1.19
<b>Total</b>	<b>1,099</b>	<b>6,634</b>	<b>1,199.69</b>	<b>3,577</b>	<b>347.14</b>	<b>726</b>	<b>5.99</b>

The insignificant recovery of ₹ 5.99 crore as against the money value of ₹ 347.14 crore relating to the accepted cases during the period 2004-05 to 2008-09 highlights the failure of the Government/Department machinery to act promptly to recover the Government dues even in respect of the cases accepted by them.

## 2.8 Working of internal audit wing

Internal Audit in Commercial Taxes Department is organised at Division level under the control of Deputy Commissioner (CT). There are 25 Large Tax Payers Units (LTUs) and 193 circles in the State. Each LTU/circle, is audited by audit team consisting of officers from other LTUs/circles. The internal audit of a circle office is conducted by audit team and report is submitted within 15 days from the date of audit to the DC (CT) concerned. The DC (CT) will supervise the rectification work giving effect to the findings in such report of internal audit. The audit of circles is planned according to the

parameters, risk areas mentioned in the internal audit manual. Majority of the irregularities noticed in internal audit are related to filing of returns, and default in payment of tax and penalty etc.

We noticed in audit that in 105 cases involving ₹ 11.98 crore mentioned in the succeeding paragraphs though these cases were checked by the Departmental internal audit, they failed to detect the irregularities.

## 2.9 Results of audit

Test check of the records of 210 offices of the Commercial Taxes Department during 2009-10 relating to VAT, revealed underassessments of tax and other irregularities involving ₹ 279.61 crore in 1,646 cases, which fall under the following categories:

(₹ in crore)			
Sl. No.	Category	No. of cases	Amount
1	Short levy of tax under VAT/excess ITC	271	71.48
2	Short levy of tax under works contract	137	38.80
3	Incorrect grant of exemption	115	6.00
4	Short/non-levy of penalty/TOT	53	1.58
5	Application of incorrect rate of tax	29	0.62
6	Short levy due to excess set off	2	0.06
7	Other irregularities under VAT/other irregularities	1,039	161.07
<b>Total</b>		<b>1,646</b>	<b>279.61</b>

During the course of the year 2009-10, the Department accepted underassessments and other deficiencies of ₹ 72.46 crore in 647 cases, of which 90 cases involving ₹ 12.38 crore were pointed out in audit during the year 2009-10 and the rest in the earlier years. An amount of ₹ 2.83 crore were realised in 64 cases during the year 2009-10.

A few illustrative audit observations involving ₹ 68.57 crore are mentioned in the following paragraphs.

## **2.10 Audit observations**

*During scrutiny of the records in the offices of the Commercial Taxes Department relating to revenue received from VAT, APGST and CST we observed several cases of non-observance of the provisions of the Acts/Rules resulting in non/short levy of tax/penalty 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 by us. We pointed out such omissions in audit each year, but not only do the irregularities persist; these remain undetected till an audit is conducted. There is a need for the Government to consider directing the Department to improve the internal control system including strengthening internal audit so that such omissions can be avoided, detected and corrected.*

## **2.11 Sales tax incentives for industrial units**

With a view to encourage growth of industries in the State, the Industries and Commerce Department of Government of Andhra Pradesh notified certain incentive schemes from time to time viz., Liberalised State Incentive Scheme (LSIS) (vide G.O.Ms.No.498, dated 16 October 1989), New Comprehensive Scheme of State Incentives (NCSSI) (vide G.O.Ms.No.117, dated 17 March 1993) and New Industrial Policy under Target-2000, providing, inter-alia, deferment of sales tax/sales tax exemption (holiday) to industrial units. These schemes provided for deferment of sales tax for 10 years and they have become due for payment in 1999 and 2002 onwards respectively. With the introduction of the APVAT Act, which came into effect from 1 April 2005, the incentive “sales tax holiday” being availed was converted as “deferment of sales tax”.

We scrutinised the performance of the schemes with a view to ascertain the effectiveness of the Department in recovering deferred sales tax under the respective schemes between May 2009 and March 2010. For this purpose we test checked three Large Tax Payers Units<sup>1</sup> (LTU) and 14<sup>2</sup> circles out of 25 LTUs and 193 circles of the Commercial Taxes Department selected based on revenue consideration and

risk perception. The results of the scrutiny revealed the following deficiencies.

**2.11.1** According to the conditions stipulated in the Government orders issued in 1989 and 1993 the period of Sales Tax deferment sanctioned under the schemes was for 10 years. The total amount of sales tax deferred would become payable without interest in as many annual instalments as the number of years for which the tax deferment was allowed and would commence

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<sup>1</sup> Hyderabad Rural, Kakinada and Vijayawada-II.

<sup>2</sup> Anantapur-II, Bhimavaram, Hyderabad (Nacharam, Keesara, Jeedimetla, IDA Gandhinagar, Hydernagar) Rajahmundry, Sangareddy, Siddipet, Tirupati-II, Vijayawada (Benz Circle), Visakhapatnam (Kurupam Market) and Vuyyurru.

immediately after the expiry of the deferment period. Further, belated payment attracts interest at the rate of 21.5 per cent per annum.

### **2.11.1.1 Non-recovery of deferred sales tax**

We noticed in the test check of the records (December 2009) of IDA Gandhinagar Circle, that a unit was sanctioned sales tax deferment of ₹ 25.53 lakh under LSIS scheme to be availed during the period 24 September 1991 to 23 September 2001. Out of this limit, the unit had availed ₹ 20.67 lakh between 1991-92 and 1998-99, which was repayable from 23 September 2001 onwards. However, we noticed the unit had not paid the sales tax deferment amount availed by them, as prescribed. Further, we also ascertained that no demand had been raised by the Department till April 2010 to recover the deferred amount. This resulted in non-realisation of ₹ 20.67 lakh.

### **2.11.1.2 Non-levy of interest on sales tax deferment paid belatedly**

We noticed in the test check of the records (June 2009) of Nacharam circle that in case of one industrial unit that stopped production in 2002, deferred sales tax of ₹ 5.87 lakh was repaid in 2005 with delay ranging from 36 to 39 months. However, interest of ₹ 4.03 lakh leviable on belated payment of deferred sales tax was not levied by the Department. This resulted in non-realisation of revenue of ₹ 4.03 lakh.

When we pointed out this case, the AA stated that whereabouts of the dealer was not known and hence enforcement of recovery of interest was not possible.

### **2.11.2 Non-recovery of deferred sales tax from the units closed/stopped production**

According to the guidelines, if the units availing tax deferment/holiday go out of production for a period exceeding one year before the stipulated period for availment, the cumulative incentive availed shall be repaid to the Government account.

We noticed in the test check of the records (February and December 2009) of seven<sup>3</sup> circles that 42 units, which were sanctioned incentives between 1994-95 and

2001-02 closed their business/stopped production before the stipulated period. The cumulative incentive of ₹ 22 crore availed by these units had, however, not been repaid. Further, in LTU Kakinada in one case ₹ 4.59 lakh was realised against the entire availed incentive of ₹ 1.43 crore from the unit, which stopped production after availing the entire sanctioned incentive. This resulted in non-realisation of revenue of ₹ 23.38 crore.

The Government stated that in five cases notices were issued between October 2007 and September 2010, in five cases Form-V was issued between

<sup>3</sup> Anantapur-II, Hyderabad (IDA Gandhinagar, Jeedimetla, Keesara and Nacharam), Sangareddy and Tirupati-II.

September 2009 and June 2010 under the Revenue Recovery (RR) Act, in two cases an amount of ₹ 14.46 lakh out of ₹ 39.16 lakh was recovered. It was stated that in two cases the units were in continuous production and filed returns upto March 2007. The reply is not acceptable as the objection was about closure of these units from April 2007, much before the stipulated period. Reply in the remaining cases has not been received (January 2011).

### **2.11.3 Incorrect allowance of sales tax deferment**

The sales tax deferment/holiday is to be availed by the units upto the amount sanctioned to the products mentioned in the Final Eligibility Certificate (FEC).

**2.11.3.1** We noticed in the test check of the records (June and December 2009) of four<sup>4</sup> circles that 10 units availed tax

deferment/ holiday of ₹ 38.41 lakh between 2000 and 2009 over and above the amount sanctioned in the FEC. The incorrect deferment was allowed due to non-watching of the incentive limits of FEC at the time of assessment or accepting the monthly VAT returns. Lack of internal system to watch the incentive limits resulted in excess availment of ₹ 38.41 lakh for which the Department had not initiated action to recover the same.

When these cases were pointed out, the Government replied that in one case an appeal preferred by the unit was pending before the Sales Tax Appellate Tribunal (STAT). Reply in the remaining cases has not been received (January 2011).

**2.11.3.2** We noticed in the test check of the records (May and June 2009) of two<sup>5</sup> circles in the case of two industrial units that sales tax deferment was sanctioned during the years 2004-05, 2005-06 and 2008-09 for spheroidal graphite iron castings, alloy steel castings and pet bottles, whereas deferment of ₹ 29.99 lakh was allowed to the products of cast iron/steel rough castings and mineral water. Failure to check returns filed by the dealer and to cross verify the name of products mentioned in FEC with those for which incentive was claimed by the units resulted in incorrect grant of sales tax deferment of ₹ 29.99 lakh.

**2.11.3.3** We noticed in the test check of the records (September 2008) of AC (LTU) Warangal that the assessee unit on expansion was sanctioned deferment of tax for the turnover over and above the base turnover<sup>6</sup> of ₹ 236.61 crore. The AA while finalising the assessment in March 2008 for the year 2004-05 incorrectly allowed sales tax deferment of ₹ 6.86 crore instead of ₹ 5.51 crore due to non-adherence to the base turnover limit specified in the FEC. This resulted in incorrect allowance of sales tax deferment of ₹ 1.35 crore.

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<sup>4</sup> Hyderabad (IDA Gandhinagar, Jeedimetla, Keesara and Nacharam).

<sup>5</sup> Hyderabad (Basheerbagh) and Vijayawada (Benz circle).

<sup>6</sup> Base turnover means best production achieved during the three years preceding the year of expansion or the maximum capacity expected to be achieved by the industry, whichever is higher.



After the case was pointed out, the AA stated (August 2009) that the assessment was revised and the excess allowance of the deferment of ₹ 1.35 crore was withdrawn.

As is evident from the preceding paragraphs, inadequate monitoring led to incorrect computation of sales tax deferment allowable and claimed.

#### **2.11.4 Non-obtaining of security of fixed assets under Deferment Scheme**

According to the Government Orders issued between November 1995 and May 1996, the amount of sales tax deferred, treated as loan, shall be allowed against the security of the fixed assets of the unit availing deferment.

We noticed in the test check of the records (May and December 2009) of LTU Hyderabad Rural and eight<sup>7</sup> circles that 185 units<sup>7</sup> availed deferment

of ₹ 133.81 crore without providing any security of fixed assets as prescribed in the G.Os. Further, in the case of 115 units located in six<sup>8</sup> circles, necessary security was not obtained for the tax holiday converted as deferments consequent on introduction of the APVAT Act from April 2005 and the deferment availed by these units without providing any security amounted to ₹ 10.43 crore. Further, obtaining or otherwise of security deposit was not monitored by the Department. Thus, the assessing authorities failed to implement the conditions governing the sanction of deferments and consequently the deferment availed by these units remained unsecured.

The Government replied that in case of 60 units notices were issued between February 2009 and June 2010. It was further stated that in two units the agreements filed were under process and in two cases an amount of ₹ 22.66 lakh out of ₹ 93.17 lakh was recovered. Reply in remaining cases was not furnished.

#### **2.11.5 Short debit of sales tax deferment**

According to Rule 67(4) of the APVAT Rules, the VAT dealer availing tax deferment has to file a declaration in Form 502 for every tax period duly debiting the deferment availed against the sanctioned amount. The Form VAT 502 should be filed along with the monthly return in Form VAT 200.

Test check of the records (September 2009) of Jeedimetla circle indicated that three assessee units furnished declarations for the tax deferment of ₹ 1.63 crore availed during 2000-01 to

2007-08, whereas the amount availed for the period was shown as ₹ 1.20 crore in the data entered in Debt Management Unit software. This resulted in short debit of tax deferment of ₹ 43 lakh in the Departmental accounts.

<sup>7</sup> Bhimavaram, Hyderabad (Keesara, Nacharam, Jeedimetla and IDA Gandhinagar), Tirupati-II, Vijayawada (Benz Circle) and Vuyyurru.

<sup>8</sup> Hyderabad (Jeedimetla, Nacharam and IDA Gandhinagar), Sangareddy, Tirupati-II and Vuyyurru.

When these cases were pointed out, the Government did not furnish the reply.

#### **2.11.6 Summary**

- The availment of incentive was to be taken as demand to DCB Register and on introduction of the APVAT Act, the procedure of maintaining DCB was dispensed with. The VATIS package being used by the department did not have any feature/module to take care of the details of demands and recovery becoming due.
- Inadequate mechanism to watch the closure of the units availing incentive before the stipulated period.
- Failure to monitor and obtain the security of fixed assets of the units rendered the incentive availed by these units unsecured.
- No internal control or system was evolved to check the procedures to be followed in respect of sanctions being availed and the commodities covered under them.

#### **2.12 Short payment of VAT on works contracts**

Under Section 4(7)(a) of the APVAT Act, 2005, every dealer shall pay tax on the value of goods at the time of incorporation of such goods in the works executed at the rates applicable to the goods under the Act subject to the deductions allowed under Rule 17(1)(e) of the APVAT Rules and the dealer is eligible to claim 90 *per cent* of the related input tax. The deductions such as administrative expenses, telephone charges, office rent etc., are not permissible under this Rule. If the accounts are not maintained to determine the correct value of goods at the time of incorporation, such dealer shall pay tax at the rate of 12.5 *per cent* on the total consideration subject to the deductions specified under Rule 17(1)(g) of the APVAT Rules and the dealer is not eligible to claim input tax credit also.

**2.12.1** We noticed in the test check of the records (between March 2008 and July 2009) of AC (LTU) Kadapa and five circles<sup>9</sup> that during the period from April 2005 to March 2009, six works contractors had not maintained the accounts to ascertain the correct value of goods at the time of incorporation of such goods in the works executed by them. Further, these dealers incorrectly declared VAT of ₹ 4.61 crore instead of ₹ 9.97 crore due to allowance of inadmissible deduction

of tax component, declaration of tax at lower rate of four *per cent* instead of 12.5 *per cent*. This resulted in under declaration of tax of ₹ 5.36 crore. Of these, two contractors claimed input tax of ₹ 2.25 crore though not admissible under the Rules. This resulted in overall short payment of VAT of

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<sup>9</sup> Hyderabad (Madhapur, Rajendranagar), Peddapalli, Vijayawada (Suryaraopeta) and Visakhapatnam (Steel Plant).

₹ 7.61 crore. We noticed that respective AAs did not raise the demands for the short paid tax.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in three cases involving ₹ 12.37 lakh and stated that the assessments were revised in two cases, against which ₹ 0.28 lakh was collected in one case. In another case, revision show cause notice was issued to the dealer in February 2010. The replies in respect of the remaining three cases have not been received (January 2011).

**2.12.2** We noticed in the test check of the records (June 2009) of CTO Basheerbagh, that the assessee contractor opted to pay tax under composition for executing some works and not opted for some other works. We also noticed in case of non-composition works that though the works contractor claimed credit for tax collected at source by the contractees, the corresponding taxable turnover relating to such tax collected was not declared in his monthly returns. Besides, the dealer was claiming ITC on the above works. Incorrect declaration of output turnovers in the monthly returns resulted in under declaration of tax of ₹ 1.88 crore.

After we pointed out the case, the AA contended that the contractor had opted for composition for some works and in others he had not opted for composition and that he was claiming input tax credit for non-composition works. The reply is not acceptable, as the dealer was not declaring total turnover at all by claiming the credit for the tax collected at source.

We referred the matter to the Department in August 2009 and to the Government in June 2010; their reply has not been received (January 2011).

**2.12.3** We noticed in the test check of the records (between September 2008 and November 2009) of AC (LTU) Warangal and two<sup>10</sup> circles that during the period from April 2007 to March 2009, three contractors had incorrectly declared VAT of ₹ 0.95 crore instead of ₹ 1.21 crore by claiming ineligible deductions such as administrative expenses, telephone charges, office rent etc., from the taxable turnover which are not admissible under Rule 17(1)(e) of the Rules. This resulted in short payment of VAT of ₹ 26.71 lakh. The AAs did not raise the demands for the short paid tax.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in two cases involving ₹ 20.94 lakh and stated that in one case the assessment was revised and show cause notice has been issued in another case. The reply in respect of the remaining case has not been received (January 2011).

**2.12.4** We noticed in the test check of the records (between May 2008 and August 2009) of two<sup>11</sup> circles that during the period from April 2007 to March 2009, in two cases, where the contractors had not maintained accounts, the AAs while determining the taxable turnover under Rule 17(1)(g) had

<sup>10</sup> Hyderabad (Gandhinagar and Rajendranagar).

<sup>11</sup> Kurnool - I & III.

incorrectly allowed input tax credit of ₹ 20.42 lakh though it was not admissible. This resulted in short levy of VAT of ₹ 20.42 lakh.

After we pointed out the cases, the Government (December 2010) accepted the audit observation in one case involving ₹ 13.21 lakh and stated that the assessment had been revised. The reply in respect of the remaining case has not been received (January 2011).

**2.12.5** According to Section 4(7)(a) of the AP VAT Act read with Rule 17(1)(e) of the AP VAT Rules, the contractor/ VAT dealer shall arrive at the value of goods at the time of incorporation, tax rate wise, from out of the taxable turnover arrived, on pro-rata basis taking the ratio of value of goods liable to tax at different rates against the total value of purchases relating to such contract. As such, the taxable turnover shall not be determined by simply adding profit margin to the purchase value of goods.

**2.12.5.1** The High Court of Mumbai held<sup>12</sup> that taking out xerox copies on a xerox machine is a works contract. It was further held that in the case of photocopying since paper and ink are used in the works contract and the same are transferred as a property hence tax is leviable on such paper and ink under the works

contract.

We noticed in the test check of the records (between May and June 2009) of Basheerbagh circle that the assessee is works contractor in photocopying and paying taxes under Section 4(7)(a). Thus, he is liable to pay tax on the goods incorporated in the works at the tax rates applicable to those goods. The dealer during the period from April 2008 to March 2009 was reporting both four *per cent* and 12.5 *per cent* purchases of paper and ink toner respectively and claiming input tax credit at 90 *per cent*. However, he reported the entire output as taxable at four *per cent* instead of reporting the same under four *per cent* and 12.5 *per cent* rates applicable to the above goods in contravention of the Rules and declared VAT of ₹ 5.48 lakh instead of ₹ 11.98 lakh. This resulted in under declaration of tax of ₹ 6.50 lakh. We noticed that the respective AA did not raise the demand for the short paid tax.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that assessment had been revised and demand raised.

**2.12.5.2** We noticed in the test check of the records (between October and November 2009) of Gandhinagar circle that during the period from April 2006 to March 2007, in one case, the AA had audited records of a contractor and assessed the turnovers under Section 4(7)(a) read with Rule 17(1)(e). While arriving the taxable turnover relating to the value of the goods at the time of incorporation, the AA had incorrectly arrived the taxable turnover by adding profit to the purchase value of goods instead of determining the taxable turnover in the manner prescribed under Rule 17(1)(e) and thereby arrived at

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<sup>12</sup> Commissioner of Sales Tax Vs M/s. Hari & Co.. (2206) (148 STC P92).

tax of ₹ 4.76 lakh. After allowing the deduction of ₹ 1.10 crore from the total consideration of ₹ 8.02 crore, the taxable turnover worked out to ₹ 6.92 crore and tax leviable thereon was ₹ 33.87 lakh as against ₹ 4.76 lakh levied by the AA. This resulted in short levy of tax of ₹ 29.11 lakh.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that the assessment file was submitted to JC (CT) legal for taking up revision.

**2.12.6** According to Section 4(7)(b) and (c) of the APVAT Act, every dealer executing works contract may opt to pay tax by way of composition at the rate of four *per cent* on the total works contract receipt. However, when a dealer opts for composition of tax, no deduction is admissible and tax is payable on the total amount paid or payable to the dealer towards execution of works contract except amounts paid to the sub-contractor. Further, the dealer is not eligible to claim input tax credit.

**2.12.6.1** We noticed in the test check of the records (between May 2008 and June 2009) of three<sup>13</sup> circles that during the period from April 2005 to March 2009, three dealers under composition had incorrectly claimed input tax credit of ₹ 13.93 lakh though not eligible under the Rules. The AAs did not ensure the correctness of ITC

claimed by the dealers at the time of scrutiny of monthly returns. This resulted in under declaration of VAT of ₹ 13.93 lakh. We noticed that the respective AAs did not raise the demands for the short paid tax.

After we pointed out the cases, the Government (December 2010) accepted the audit observation in one case involving ₹ 4.36 lakh and stated that show cause notice was issued to the dealer. The replies in respect of the remaining two cases have not been received (January 2011).

**2.12.6.2** We noticed in the test check of the records (between August 2007 and September 2009) of 34<sup>14</sup> circles that during the period from April 2005 to March 2009, in 57 cases, the assessee opted for composition to pay tax at concessional rate of four *per cent*. However, they had incorrectly declared VAT of ₹ 4.39 crore instead of ₹ 6.16 crore due to adoption of lesser rate of tax. Besides, in five cases, the dealers under composition though paid tax at four *per cent*, but they incorrectly declared VAT of ₹ 21.55 lakh instead of ₹ 29.69 lakh. This resulted in under declaration of VAT of ₹ 1.85 crore. We noticed that the respective AAs did not raise the demands for the short paid tax.

<sup>13</sup> Hyderabad (Agapura, Khairatabad and Punjagutta).

<sup>14</sup> Ananthapur-I, Bhongir, Hindupur, Hyderabad (Agapura, Ashoknagar, Barkatpura, Basheerbagh, Begumpet, Hyderguda, Hydernagar, Malakpet, Punjagutta, Vengalraonagar and Vidyanagar), Kadapa, Karimnagar-II, Keesara, Kurnool-I, Madanapalli, Mahaboobabad, Medak (Medak and Sangareddy), Nandyal-II, Nellore, Ongole, Peddapalli, Piduguralla, Rajahmundry, Secunderabad (Bowenpally, Gandhinagar, Musheerabad and R.P.Road), Vijayawada (Benz circle) and Visakhapatnam (Dwarakanagar).

After we pointed out the cases, the Government (December 2010) accepted the audit observations in 26 cases involving ₹ 51.81 lakh and stated that the assessments were revised in 10 cases involving ₹ 18.35 lakh, out of which ₹ 5.02 lakh was collected in four cases and notices/show cause notices were issued to the dealers in 16 cases. The replies in respect of the remaining 31 cases have not been received (January 2011).

**2.12.6.3** We noticed in the test check of the records (between April and November 2009) of two<sup>15</sup> AC (LTUs) and three<sup>16</sup> circles that during the period from April 2008 to March 2009, in five cases, the works contractors under composition had incorrectly claimed exemption of a turnover of ₹ 15.33 crore relating to Central Excise Duty, Earth Work Charges, Labour Charges, Services Charges, Power etc., though these were not eligible for deduction from the turnover. This resulted in short payment of VAT of ₹ 65.34 lakh. We noticed that the respective AAs did not raise the demands for the short paid tax.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in two cases involving ₹ 47.64 lakh and stated that show cause notices were issued to the dealers. The Government contended that in one case the dealer engaged in works contracts under composition and also engaged in pure labour contracts. The purchase orders, labour charges bills and service tax returns were verified and found to be purely collections for finishing and completion of services. The reply is not acceptable since the dealer opted for composition to pay tax at four *per cent* irrespective of the turnover relating to material or labour and hence he is not eligible for any further deduction from his turnover. The replies in respect of the remaining two cases have not been received (January 2011).

### **2.13 Misclassification of sales as works contracts**

Elevators, lifts, air conditioners, stone chips, modular furniture and transmission towers are taxable at the rates prescribed in the APGST and the APVAT Acts.

The Supreme Court of India had held in the case of AP State Vs M/s Kone Elevators (I) Limited, Secunderabad that the contract for supply and installation of lifts and elevators constitute sale but not works contract since major component into the end product was the material consumed on producing the lift to be delivered and the skill and labour to be employed for converting the main component into the end product was only incidentally used.

**2.13.1** We noticed in the test check of the records (October 2007 and September 2009) of four circles<sup>17</sup> that during the period from April 2006 to March 2009, in nine cases, the turnover of ₹ 45.95 crore relating to sale of lifts, elevators, air conditioners and modular furniture was treated as works contract and

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<sup>15</sup> Charminar and Secunderabad.

<sup>16</sup> Hyderabad (Agapura), Nellore-III and Secunderabad (R.P. Road).

<sup>17</sup> Hyderabad (Agapura, Basheerbagh, Begumpet and Somajiguda).

declared tax of ₹ 1.15 crore, instead of ₹ 5.74 crore. This resulted in under declaration of tax of ₹ 4.59 crore.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in six cases involving ₹ 2.97 crore and stated that the assessments were revised in three cases involving ₹ 2.36 crore, out of which an amount of ₹ 2.34 lakh was collected in one case; revision was under process in one case and show cause notices were issued in two cases. The replies in respect of the remaining three cases have not been received (January 2011).

**2.13.2** We noticed in the test check of the records (between December 2008 and February 2009) of five circles<sup>18</sup> that the AAs while finalising the assessments in six cases between May 2007 and March 2008 for the year 2004-05 incorrectly treated the turnover of ₹ 30.72 crore relating to sale of air conditioning plants, lifts, stone chips and transmission towers, as works contract and levied tax of ₹ 1.86 crore instead of ₹ 3.62 crore. This resulted in short levy of tax of ₹ 1.76 crore.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in four cases involving ₹ 1.67 crore and stated that assessments were revised in two cases; revision show cause notice had been issued in one case and in another case the assessment file was submitted to AC(CT) legal for revision. The replies in respect of the remaining two cases have not been received (January 2011).

**2.13.3** The Supreme Court of India held in the case of *Mc Kenzies Ltd., Vs the State of Maharashtra* that 'construction of bus body building' on the chassis of motor vehicles supplied is a contract of sale. Bus bodybuilding is taxable at the rate of 12.5 *per cent* under V schedule to the APVAT Act, as the same is not included in other schedules.

We noticed in the test check of the records (August and September 2009) of AC (LTU) Nizamabad and CTO Jeedimetla that during the period from April 2007 to March 2009 four dealers had incorrectly

declared VAT of ₹ 1.32 crore instead of ₹ 3.78 crore by treating the sale contract relating to Bus Body building as works contract. This resulted in short payment of VAT of ₹ 2.46 crore. We noticed that the respective AAs did not raise the demands for the short paid tax.

After we pointed out the cases, the Government (December 2010) accepted the audit observation in one case involving ₹ 2.09 crore and stated that the assessment file was submitted to JC (CT) legal for taking up revision. The replies in respect of the remaining three cases have not been received (January 2011).

<sup>18</sup> Hyderabad (Srinagar colony and IDA Gandhinagar), Proddutur-II, Secunderabad (Mahankali Street and Tarnaka).

**2.13.4** Security document books are “Stationery articles” which fall under entry 225 of I schedule to the APGST Act and liable to tax at the rate of eight *per cent* at the point of first sale in the State. Sale of goods in the course of inter-state trade or commerce not supported by declarations are taxable under the CST Act at 10 *per cent*.

We noticed in the test check of the records (August 2008) of Jeedimetla circle that the assessee was a printer and engaged in the printing of security documents

like lottery tickets, railway tickets etc., in Andhra Pradesh and selling the same in the inter-state trade to the customers situated in others states. We also noticed that the AA while finalising the assessment in March 2008 for the year 2004-05, incorrectly treated the turnover of ₹ 4.45 crore relating to the inter-state sales of printed security documents as inter-state works contract (which was incorrect as the printing and purchases were done in Andhra Pradesh) and levied tax of ₹ 15.42 lakh instead of ₹ 28.74 lakh. This resulted in short levy of Central Sales Tax of ₹ 13.32 lakh.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that revision show cause notice had been issued to the dealer.



**2.14 Non/short levy of tax and penalty on inter-state sales**

The Central Sales Tax Act, 1956 provides that inter-state sales/ consignment transfers not supported by a declaration in Form 'C', 'D' & 'F' are taxable at twice the rate applicable to the sale or purchase of these goods inside the State in respect of the declared goods and in respect of the other goods at 10 *per cent* or at the rate applicable to the sale or purchase of such goods within the State whichever is higher.

As per Section 9(2A) of the CST Act read with Section 7-A (2) of the APGST Act, if any dealer produces false/fake declarations and claims exemption/ concessional rate of tax in support of these documents, he is liable to pay a penalty of three to five times of the tax due for such transaction.

Under section 6-A of the CST Act read with Rule 9A(2) of the CST (AP) Rules, each declaration in Form 'F' shall cover transactions effected during a period of one calendar month. According to Rule 10(b) read with Rule 12(1) of CST (R&T) Rules 1957, each declaration in Form 'C' and 'H' shall cover transactions of inter-state sales/ export sales, which takes place in a quarter of a financial year between the same two dealers. Therefore, a single declaration issued to cover transactions for more than one month in case of consignment transactions and for one quarter relating to inter-state sales and export sales are to be treated as invalid and the turnover has to be brought to tax treating it as inter-state sales not covered by proper declarations.

We noticed in the test check of the records (between October 2007 and November 2009) of AC (LTU) Kakinada and 25 circles that in 41 cases tax/penalty of ₹ 9.04 crore was either not levied or levied short on the turnovers relating to inter-state sales, consignment sales and export sales covered by fake/ invalid declarations/ not covered by declarations.

(₹ in crore)

Name of the circle/ assessment period	Nature of irregularity	Turnover involved	Non/short levy of tax and penalty	Remarks
Special Commodities circle, Hyderabad 2003-04	Consignment sales/branch transfer of goods in four cases supported by 'F' Forms were exempted from tax by the AA while finalising the assessments. Our cross verification of the Forms with the issuing State of Tamilnadu revealed that the Forms were not issued by the Commercial Taxes Department of Tamilnadu and thus they were fake. The AA failed to detect the fake Forms and levy tax and penalty on the turnover relating to false/fake declarations.	12.77	1.28/3.83	Reply from the Department/Government is awaited (January 2011).
AC (LTU) Kakinada and 13 <sup>19</sup> circles 2003-04 to 2007-08	Consignment sales/ branch transfer of goods were supported by 'F' Forms in 24 cases covering transactions of more than one month. Since one Form covering transactions of one month as prescribed was not submitted, the Forms were liable to be treated as invalid. But the AAs incorrectly exempted the turnover from levy of tax.	15.94	1.55	The Government (December 2010) accepted the audit observations in eight cases involving ₹ 72.54 lakh and stated that assessments were revised in six cases involving ₹ 49.46 lakh, out of which an amount of ₹ 6.82 lakh was collected in three cases; show cause notice was issued in one case and assessment file was submitted to DC(CT) Secunderabad in one case. The replies in respect of the remaining 16 cases have not been received (January 2011).
Siddipet 2005-06	Export sales of goods were supported by 'H' Forms covering transactions of more than one quarter and the same were liable to be treated as invalid. But the AA incorrectly exempted the turnover from levy of tax.	2.81	0.35	The Government stated in December 2010 that revision show cause notice was issued to the dealer.

<sup>19</sup> Ambajipeta, Guntur (Patnambazar), Hindupur, Hyderabad (Balnagar, Rajendranagar; Saroornagar, Somajiguda), Medak (Sangareddy), Peddapuram, Proddatur-II, Ramachandrapuram, Secunderabad (Tarnaka) and Warangal.

(₹ in crore)

Name of the circle/ assessment period	Nature of irregularity	Turnover involved	Non/short levy of tax and penalty	Remarks
8 <sup>20</sup> circles 2003-04 to 2005-06	Inter-State sales/branch transfer of goods were not supported by declarations in the prescribed 'C' and 'F' Forms in 10 cases. The AAs while finalising the assessments either levied tax at lower rate or omitted to levy tax.	84.78	1.81	The Government (December 2010) accepted the audit observations in three cases involving ₹ 9.58 lakh and stated that in two cases, revision show cause notices were issued to the dealers and in one case, the assessment file has been submitted to DC (CT) Secunderabad for revision. The replies in respect of the remaining seven cases have not been received (January 2011).
Benz circle, Vijayawada 2004-05	The AA while finalising the assessment in one case incorrectly levied tax on inter-state sale of pre-engineered building systems at the concessional rate of one <i>per cent</i> instead of four <i>per cent</i> though not applicable to the dealer.	3.31	0.10	The reply from Department /Government is awaited (January 2011).
Osmanjunj 2005-06	The AA while finalising the assessment in one case incorrectly exempted the turnover of wire mesh supported by 'C' Form covering transactions of more than one quarter. Further, in one case, concessional rate of tax was allowed on the strength of 'C' Form covering transactions for the period (1 April 2005 to 15 September 2005) prior to the date of CST registration (23 September 2005) by the purchasing dealer. As the date of issue of Forms was stamped on them, the 'C' Forms were liable to be treated as invalid.	1.41	0.12	The reply from Department /Government is awaited (January 2011).
<b>Total</b>		<b>121.02</b>	<b>9.04</b>	

<sup>20</sup> Hyderabad (Agapura, Ashoknagar, Jeedimetla, Khairatabad, Lord Bazar and Somajiguda) Tanuku-I and Vanasthalipuram

## 2.15 Excess claim of input tax credit

Under the provisions of the APVAT Act, ITC should be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods made by that dealer during the tax period if such goods were used in the business of the VAT dealer. According to Section 13 of the APVAT Act, 2005 read with Rule 20(8) of the APVAT Rules 2005, where transactions involve sale of taxable goods as well as exempt transaction of taxable sales, the claim for eligible input tax credit (ITC) should be restricted as per the formula prescribed i.e.,  $A \times B/C$  where A is input tax for common inputs for each tax rate, B is the taxable turnover and C is the total turnover.

As per Section 55(2) of the Act, any VAT dealer who issues a false tax invoice or receives and uses a tax invoice, knowing it to be false, shall be liable to pay a penalty of 200 per cent of tax shown on the false invoice. Further, under the APVAT Rules, no ITC is eligible on goods used in construction of buildings and sheds for the purpose of the business and coal.

Further, under Section 20(3) of the Act, every return shall be subject to scrutiny to verify the correctness of calculation, application of correct rate of tax and input tax claimed therein and full payment of tax payable for such tax period. If any mistake is detected as a result of such scrutiny made, the authority prescribed shall issue a notice of demand in the prescribed form for any short payment of tax or for recovery of any excess input tax credit claimed.

**2.15.1** We noticed in the test check of the records (between April 2008 and February 2010) of two LTUs<sup>21</sup> and 18 circles<sup>22</sup> that between April 2005 and March 2009, in 34 cases, though the transactions involved both taxable sales and exempt transactions the input tax credit was not restricted as per the formula prescribed. This resulted in short payment of tax of ₹ 2.50 crore<sup>23</sup>.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in 13 cases involving ₹ 38.62 lakh and stated that the assessments were revised in eight cases involving ₹ 30.83 lakh, out of which an amount of ₹ 6.37 lakh was

collected / adjusted against the refund in five cases; show cause notices were issued in three cases and the assessment files were submitted to AC (LTU) Secunderabad in two cases. The replies in respect of the remaining 21 cases have not been received (January 2011).

<sup>21</sup> Nizamabad and Saroornagar.

<sup>22</sup> Adoni-I, Chilakaluripeta, Hindupur, Hyderabad (Basheerbagh, Hyderguda, Malakpet, Rajendranagar, Somajiguda and Vanasthalipuram), Jadcherla, Jagannaikpur, Kadapa-I, Medak, Secunderabad (Market Street, R.P Road and S.D. Road), Tanuku-I and Tirupati-II.

<sup>23</sup> ITC eligible: ₹ 29.37 crore; ITC claimed: ₹ 26.87 crore; Excess claim: ₹ 2.50 crore.

### 2.15.2 Incorrect allowance of input tax credit

According to Rule 23(6)(a) of the APVAT Rules, if any VAT dealer finds any omission or incorrect information in VAT 200, he shall submit an application in Form VAT 213 within a period of six months from the end of relevant tax period. As per Rule 23(6)(b) of the APVAT Rules, on receipt of Form VAT 213 in the case of over declaration of tax, Form VAT 308 shall be issued.

We noticed in the test check of the records (between April 2009 and February 2010) of AC LTU Saroornagar and CTO-II Nandyal circle that during the period 2006-07 and 2008-09, in two cases, dealers claimed ITC without submitting Form VAT 213 after

lapse of six months. In one case, the dealer claimed tax of ₹ 14.86 lakh on the purchases made during July 2006 in February 2007 even though the period of six months lapsed and in another case, the dealer claimed tax of ₹ 14.60 lakh relating to purchase of MS TMT bars, MS Angles etc., made during the months of March 2008 and April 2008 without filing Form VAT 213. This resulted in incorrect allowance of ITC of ₹ 29.46 lakh.

We referred the matter to the Department between February and May 2010 and to the Government between May and June 2010; their reply has not been received (January 2011).

### 2.16 Application of incorrect rate

VAT is leviable at the rates prescribed in schedules I to IV & VI to the APVAT Act. Commodities not specified in any of the schedules fall under schedule V and are liable to VAT at 12.5 per cent from 1 April 2005.

According to Section 20(3) every monthly return submitted by a dealer shall be subjected to scrutiny to verify the correctness of calculation, application of correct rate of tax and ITC claimed therein and full payment of tax payable for such tax period.

**2.16.1** We noticed in the test check of the records (August 2007 and November 2009) of 15 circles<sup>24</sup> that during the period from April 2005 to March 2009, 21 dealers declared VAT of ₹ 82.71 lakh instead of ₹ 1.86 crore on the turnover relating to flavours, paneer, sale of cement products, welded items, fire

fighting equipment, stone ballast etc., due to application of incorrect rate. This resulted in under declaration of VAT of ₹ 1.04 crore.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in 11 cases involving ₹ 54.22 lakh and stated that the assessments were revised in seven cases involving ₹ 16.18 lakh, of these

<sup>24</sup> East Godavari (Ramachandrapuram), Gadwal, Hyderabad (Agapura, Barkatpura, Fathenagar, Malakpet, Punjagutta, Rajendranagar, Vanasthalipuram), Kadapa-I, Kodak, Medak (Sangareddy), Peddapally, Secunderabad (Malkajgiri) and Vizianagaram West.

₹ 0.70 lakh was collected in two cases and notices/show cause notices were issued to the dealers in four cases. In one case, the Government replied that tax on sale of homeo hair oil was regulated in terms of Government order<sup>25</sup> dated 6 November 2006. The reply is not acceptable since the rate of tax on the commodity was made four *per cent* from 1 September 2006 through this Government order and the sales were related to the prior period i.e., April 2005 to August 2006. Hence tax is leviable at 12.5 *per cent* for the period prior to 1 September 2006. The replies in respect of the remaining nine cases have not been received (January 2011).

**2.16.2** Tax at the rates specified in schedules I to VI to the APGST Act, 1957, is leviable on the commodities included in these schedules. Commodities not specified in any of the schedules fall under VII schedule and are taxable at 12 *per cent* from 1 January 2000.

We noticed in the test check of the records (May 2008 and July 2009) of 11 circles<sup>26</sup> that the AAs while finalising the assessments in 13 cases between January 2006 and March 2009 for the years 2004-05, levied tax on air electrical control

transformers, medicines, aluminium foils, palm fatty acids, ACSR conductors, imitation jewellery etc., at rates lower than those specified in the Act resulting in short levy of tax of ₹ 71.01 lakh.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in seven cases involving ₹ 25.36 lakh and stated that assessments were revised in four cases; show cause notice has been issued in one case and assessment files were submitted to concerned DC (CT) for revision in two cases. The replies in respect of the remaining six cases have not been received (January 2011).

### **2.17 Non/short levy of tax on the works contracts**

Under Section 5F of the APGST Act, every dealer has to pay tax at the prescribed rate on his turnover of transfer of property either as goods or in some other form involved in the execution of works contract subject to exemptions and deductions provided for, under sub clauses (a) to (l) of Rule 6(2) of the APGST Rules.

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<sup>25</sup> G.O.Ms.No.1625 Rev Department Dated 6 November 2006.

<sup>26</sup> Hyderabad (Ferozguda, IDA Gandhi Nagar, Keesara, Musheerabad, Narayanaguda, Srinagar colony and Vanasthalipuram), Karimnagar-I, Secunderabad (S.D. Road and Tarnaka), Special Commodities.

### 2.17.1 Incorrect computation of turnover

In determining the turnover of a dealer, deductions specified under Rule 6(2) of the APGST Rules shall be allowed from the turnover of the dealer if accounts are maintained as required under the Rule 45(1-C) of the APGST Rules. Deductions on account of service tax, freight charges, printing charges, office expenses, salaries, depreciation, metal cutting charges, factory maintenance charges etc., are not admissible under the Rules. If detailed accounts are not maintained and the amounts specified under the Rule 6(2) are not ascertainable from the accounts of a dealer, the turnover of the dealer shall be determined after deducting the amount calculated at percentages prescribed under Rule 6(3) (ii). Where the execution of the works contract extends over a period of more than one year, the value of material at the time of incorporation in works contract during that year shall be taxable turnover under Rule 6(3)(i).

We noticed in the test check of the records (between April 2007 and July 2009) of 22 circles<sup>27</sup> that the AAs while finalising the assessments in 35 cases between June 2006 and March 2008 for the year 2004-05, incorrectly arrived at the taxable turnover of ₹ 45.61 crore instead of ₹ 72.86 crore. The short determination of taxable turnover of ₹ 27.25 crore

with a tax effect of ₹ 1.91 crore was due to allowance of inadmissible deductions on account of service tax, freight charges, printing charges, office expenses, salaries, depreciation, metal cutting charges, factory maintenance charges etc.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in 18 cases involving ₹ 1.32 crore and stated that assessments were revised in 12 cases involving ₹ 76.14 lakh, out of which ₹ 5.36 lakh was collected in three cases. Notices/show cause notices were issued in five cases and in one case, the assessment file was submitted to DC(CT) Punjagutta for revision. In one case, the Government contended that according to Section 2(S) sales tax collection was eligible for deduction. The reply is not acceptable as Section 5F is a separate charging Section and other provisions of the Act are not applicable to this Section. The replies in respect of the remaining 16 cases have not been received (January 2011).

<sup>27</sup> Adilabad, Ananthapur-II, Guntur (Brodipet), Hyderabad (Charminar, Hydernagar, Narayanaguda, Musheerabad, Sanathnagar, Somajiguda and Srinagar colony), Karimnagar-I, Medak (Sangareddy), Nizamabad-III, Prakasam (Markapur, Ongole), Secunderabad (Malkajiri, M.G. Road, Tarnaka, Vidyanagar) Tadepalligudem, Tenali (Gandhi chowk) and Visakhapatnam (Dwarakanagar).

### **2.17.2 Incorrect grant of exemption on the inter-state purchases**

Under the proviso to Section 5F of the APGST Act, tax shall be leviable on the turnover of goods either obtained or purchased from other states by the contractor and used in the execution of the works contracts.

We noticed in the test check of the records (between June and July 2009) of CTO-I Keesara that the assessing authority while finalising the assessment in one case in January 2008 for the year 2004-05,

incorrectly exempted turnover of ₹ 2.39 crore relating to the purchase of material from out side the state by the contractor and used in the execution of the works contract. This resulted in short levy of tax of ₹ 19.09 lakh.

We referred the matter to the Department in November 2009 and to the Government in June 2010; their reply has not been received (January 2011).

### **2.17.3 Short levy of tax under composition**

The rate of tax payable on the works contracts under Section 5F of the APGST Act was eight *per cent* and under Section 5G of the Act, the tax could be compounded at the rate of four *per cent* with effect from 1 January 2000. However, when an assessee opts for composition of tax, no deduction is admissible and tax is payable on the total amount paid or payable to the assessee towards the execution of works contract excluding the payments made to registered sub-contractors.

**2.17.3.1** We noticed in the test check of the records (between October and November 2008) of Hydernagar circle that the works contractor opted for composition of tax under Section 5G for assessment of his turnover at the rate of four *per cent* in the assessment year

2004-05. However, the AA while finalising the assessment in March 2008 relating to the year 2004-05, incorrectly assessed the turnover of ₹ 9.75 crore under Section 5F instead of Section 5G, of the Act after allowing the deduction of ₹ 6.37 crore towards labour charges, machinery hire charges, value of locally purchased goods etc. This resulted in short levy of tax of ₹ 11.96 lakh.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that assessment was revised and demand raised.

**2.17.3.2** We noticed in the test check of the records (between December 2008 and January 2009) of Musheerabad circle that an assessee did not opt for composition of tax but the AA while finalising the assessment in December 2007 for the year 2004-05, incorrectly assessed the turnover under Section 5G of the Act instead of Section 5F read with Rule 6(3)(i). This resulted in short levy of tax of ₹ 6.24 lakh.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that assessment has been revised.



**2.18 Short levy of tax due to incorrect computation of turnover**

All liquors bottled and packed fall under entry 202 of I Schedule to the APGST Act, 1957, and taxable at the rate of 70 *per cent* at the point of first sale in the State.

According to the Government order No.234 dated 31 March 2001, tax on the amount of additional trade margin of 10 *per cent* charged by Andhra Pradesh Beverages Corporation Limited to pay a special privilege fee on the sale of IML Beer to the Government is exempted. For this purpose, sale value at cost will be arrived and 10 *per cent* of the amount arrived will be exempted.

We noticed in the test check of the records (between July and August 2008) of Agapura circle that the AA while finalising the assessment in one case, in February 2008 for the year 2004-05, incorrectly arrived the sale value at cost of ₹ 213.29 crore instead of ₹ 211.25 crore without deducting the discounts received on purchases. This resulted

in excess exemption of turnover of ₹ 2.04 crore relating to trade margin and consequential short levy of tax of ₹ 1.43 crore.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that the DC (CT) has passed the revision orders in November 2009.

**2.19 Short levy of VAT due to incorrect computation of turnover**

**2.19.1** Mosquito/cockroach repellants, rat killing cakes and treated chalk pieces are not specified in schedules I to IV and VI, hence, these are taxable at 12.5 *per cent* under V schedule to the APVAT Act.

We noticed in the test check of the records (November 2009) of AC(LTU) Secunderabad that during the period 2007-08 and 2008-09, in one case, the AA while

conducting the audit of dealer's records, noticed that the dealer declared tax on the above goods at four *per cent* instead of 12.5 *per cent*. However, verification of department audit records revealed that while computing the short levy of tax, the AA incorrectly arrived at the VAT payable as ₹ 38.16 lakh instead of ₹ 127.51 lakh relating to sale of mosquito/cockroach repellants, rat-killing cakes, treated chalk pieces etc., due to incorrect computation of turnover. This resulted in short levy of tax of ₹ 89.35 lakh.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that assessment has been revised.

**2.19.2** 'All kinds of Machinery and parts thereof' falls under entry 83 of I schedule to the APGST Act, and are liable to tax at the rate of eight *per cent*.

We noticed in the test check of the records (between February and March 2009) of Sangareddy circle that the AA while finalising the

assessment in one case, in January 2008 for the year 2004-05, incorrectly computed the turnover of ₹ 19.60 crore instead of ₹ 20.67 crore relating to machinery parts. The AA did not consider the correct turnover of ₹ 20.67 crore depicted in the Profit and Loss Account. The short determination of taxable turnover of ₹ 1.07 crore resulted in short levy of tax of ₹ 8.64 lakh.

We referred the matter to the Department in October 2009 and to the Government in June 2010; their reply has not been received (January 2011).

## **2.20 Non-levy of turnover tax**

**2.20.1** According to Section 5A of the APGST Act, when total turnover of a dealer in a year exceeds ₹ 10 lakh, turnover tax at one *per cent* is leviable with effect from 1 August 1996 on second and subsequent sales of goods specified in the first, second, fifth and seventh schedules to the Act.

We noticed in the test check of the records (between June 2008 and January 2009) of four circles<sup>28</sup> indicated that the AAs while finalising the assessments in five cases between March 2007 and March 2008

for the year 2004-05, failed to levy turnover tax on a turnover of ₹ 14.01 crore relating to Machinery tools and Machinery spares, fire security equipment, imitation jewellery etc., though turnover in these cases exceeded ₹ 10 lakh. This resulted in non-levy of turnover tax of ₹ 14.01 lakh.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in four cases involving ₹ 13.37 lakh and stated that assessments were revised in three cases involving ₹ 12.30 lakh out of which an amount of ₹ 6.66 lakh was collected and in one case, revision show cause notice was issued to the dealer. The reply in respect of the remaining case has not been received (January 2011).

**2.20.2** According to Section 5A(1-A) of the APGST Act, every dealer shall in addition to tax payable shall pay each year a turnover tax on his turnover liable to tax at the rate of two *per cent* on the first sale turnover of lubricant oils.

We noticed in the test check of the records (between June 2008 and January 2009) of AC (LTU) Karimnagar and CTO Tarnaka that the AAs while finalising the assessments in two

cases in March 2008 for the year 2004-05, failed to levy turnover tax on the first sale turnover of ₹ 17.33 crore relating to lubricant oils. This resulted in non-levy of tax of ₹ 34.66 lakh.

After we pointed out the cases, the Government (December 2010) accepted the audit observation in one case involving ₹ 0.76 lakh and stated that assessment was revised and demand raised. The reply in respect of the remaining case has not been received (January 2011).

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<sup>28</sup> Hyderabad (Ferozguda, Malkajgiri, Ramagopalapet and Somajiguda)

**2.21 Excess set-off against tax due**

Under the provisions of the APGST Act, and notifications issued there under, set-off can be allowed against tax due on the sale of finished goods in which tax paid raw material was used in the manufacture of such finished goods, provided transactions at both ends take place within the State.

We noticed in the test check of the records (between October 2008 and August 2009) of five circles<sup>29</sup> that set-off of ₹ 63.60 lakh was allowed in March 2008 against the admissible set-off of ₹ 22.86 lakh

during the assessment year 2004-05 in six cases relating to purchase of gold, electrical goods, footwear and stock transfer of poultry feed to other States. This resulted in short levy of tax of ₹ 46.74 lakh.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in two cases involving ₹ 21.24 lakh and stated that assessments were revised in two cases against which an amount of ₹ 0.63 lakh was collected in one case. The replies in respect of the remaining four cases have not been received (January 2011).

**2.22 Non-levy of penalty**

**2.22.1** Under Section 53(3) of the APVAT Act, any dealer who has under declared tax and where it is established that fraud or willful neglect has been committed, he shall be liable to pay penalty equal to the tax under declared.

We noticed in the test check of the records (October 2009) of Mehidipatnam circle that the records of two VAT dealers for the period from April 2005

to March 2008 were examined by the departmental officers and assessed the under declared tax of ₹ 19.27 lakh on unaccounted purchases. But the penalty of ₹ 19.27 lakh on the under declared tax amount was not levied.

After we pointed out the cases, in both the cases, the AA stated that the audit officer who had levied tax had not proposed penalty and the same would be proposed now.

We referred the matter to the Department in December 2009 and to the Government in June 2010; their reply has not been received (January 2011).

<sup>29</sup> Hyderabad (Somajiguda), Kurnool-I, Secunderabad (Ramagopalapet, R.P. Road) and Visakhapatnam (Dwarakanagar).

**2.22.2** Under Section 14(8)(a) of the APGST Act, 1957, the penalty leviable shall not be less than three times which may extend to five times the tax due in a case where the assessing authority is satisfied that the failure of the dealer to disclose the whole or part of the turnover or any other particulars correctly, or to submit the return before the prescribed date was willful.

turnover of ₹ 64.95 lakh and levied tax of ₹ 6.61 lakh. But a minimum penalty of ₹ 19.83 lakh being the three times the tax due was not levied, though the dealer did not disclose the correct turnovers in the returns.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that the levy of penalty is not feasible at this juncture as the same is barred by limitation. Not initiating of timely action by the Department resulted in loss of revenue.

### **2.23 Short payment of tax due to non-conversion of TOT dealers as VAT dealers**

Under the provisions of the APVAT Act, every dealer whose taxable turnover in the preceding three months exceeds ₹ 10 lakh or in the 12 preceding months exceeds ₹ 40 lakh upto 30 April 2009 shall be liable to be registered as VAT dealer. From 01.05.2009 every dealer whose taxable turnover in the 12 preceding months exceeds ₹ 40 lakh shall be registered as a VAT dealer. Any dealer who fails to apply for registration shall be liable to pay penalty of 25 per cent of the amount of tax due prior to the date of registration. Further, there shall be no eligibility for input tax credit for sales made prior to the date from which the VAT registration is effective.

We noticed in the test check of the records (between December 2008 and January 2009) of Musheerabad circle that the AA while finalising the assessment in one case in December 2007 for the year 2004-05, assessed the suppressed

We noticed in the test check of the records (between July 2008 and November 2008) of the two circles<sup>30</sup> that though the turnover of eight TOT dealers exceeded ₹ 10 lakh in preceding three months between October 2006 and April 2008, the AAs did not convert these dealers into VAT dealers. The dealers were liable to pay VAT of ₹ 21.92 lakh. But neither the dealers applied for registration

nor were they registered by the AAs. This resulted in short realisation of revenue of ₹ 21.92 lakh towards VAT. Besides penalty of ₹ 5.46 lakh was also leviable.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in four cases involving ₹ 14.19 lakh and stated that in one case, the assessment was revised and collected ₹ 60,486; show cause notices

<sup>30</sup> Hyderabad (Agapura) and Special Commodities circle.

were issued to the dealers in three cases. The replies in respect of the remaining four cases have not been received (January 2011).

## **2.24 Short levy of tax due to incorrect adoption of turnover/application of concessional rate**

Under section 5B of the APGST Act 1957, any sale of goods by a dealer to another for use by the latter as raw material, component part, sub-assembly part, intermediary part, consumables or packing materials of any other goods which he intends to manufacture inside the state, tax at four percent shall be paid subject to production of 'G' form issued by the purchaser who has to get himself registered as a manufacturer.

According to case law (M/s Bose Abraham Vs State of Kerala) held by Honourable Supreme Court of India, the item 'Crane' was classifiable as Motor Vehicle since it is liable to be registered under the Motor Vehicle Tax Act. Under entry 1 of first schedule to the APGST Act 'Motor Vehicles' are taxable at 12 *per cent* at the point of first sale in the state.

**2.24.1** We noticed in the test check of the records (between December 2008 and January 2009) of Srinagar colony circle that the AA while finalising the assessment in one case in March 2008 for the year 2004-05, incorrectly levied tax on a turnover of ₹ 8.28 crore against the sale turnover of ₹ 8.76 crore covered by 'G' Forms submitted by the assessee. This resulted in

escapement of turnover of ₹ 47.61 lakh. Besides, while computing the turnover, a turnover of ₹ 1.43 crore covered by a 'G' Form was not taken into account. This resulted in overall short levy of tax of ₹ 7.64 lakh on the escaped turnover of ₹ 1.91 crore.

We referred the matter to the Department in August 2009 and to the Government in June 2010; their reply has not been received (January 2011).

**2.24.2** We noticed in the test check of the records (January 2009) of AC (LTU), Saroornagar that the AA while finalising the assessment in one case, in March 2008 for the year 2004-05, incorrectly levied tax at concessional rate of four *per cent* on the first sale turnover of ₹ 2.05 crore of Hydraulic Mobile cranes on the strength of 'G' forms issued by the purchasing dealer even though the commodity does not fall under any of the categories of goods specified in section 5B of the Act rendering him ineligible for issue of 'G' Form for concessional rate. This resulted in short levy of tax of ₹ 18.46 lakh including turnover tax.

We referred the matter to the Department in June 2009 and to the Government in June 2010; their reply has not been received (January 2011).

## **2.25 Incorrect allowance of transitional relief**

The APVAT Act and Rules 2005, provide relief on sales tax at the commencement of the Act provided such goods are for use in the business of the VAT dealer. According to the APVAT Rules, on the first day of the commencement of the Act, if a dealer has in stock any goods on which sales tax has been paid under the APGST Act, that dealer shall be entitled to claim credit of sales tax for such goods which were purchased from 1 April 2004 to 31 March 2005.

We noticed in the test check of the records (July 2009) of Agapura circle that during the period 2005-06, in one case, transitional relief claimed on goods like lifeboats, electronic gates, television sets etc., was allowed by AAs, though the dealer is not dealing in the business of goods for which transitional relief

was claimed. This has resulted in short realisation of tax of ₹ 13.16 lakh.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that the assessment file was submitted to JC (CT) for revision.

## **2.26 Under declaration of tax under Section 4(9)**

**2.26.1** Under Section 4(9) of the APVAT Act, 2005, every VAT dealer running any restaurant, eating house, catering establishment, hotel, coffee shop, sweet shop or any establishment by whatever name called and any club, who supplies, by way of or as part of any services or in any other manner whatsoever of goods being food or any other article for human consumption or drink other than liquor shall pay tax at the rate of 12.5 *per cent* on 60 *per cent* of the taxable turnover, if the taxable turnover in a period of preceding twelve months exceeds ₹ 5 lakh or in the preceding three months exceeds ₹ 1.25 lakh.

We noticed in the test check of the records (between October 2007 and September 2009) of five circles<sup>31</sup> that in five cases, the dealers declared VAT on their turnover relating to sales made across the counter. However, they incorrectly declared 60 *per cent* of the turnover instead of 100 *per cent* though these sales do not fall under section 4(9). This resulted in short payment of VAT

of ₹ 9.63 lakh.

After we pointed out the cases, the Government (December 2010) accepted the audit observations in three cases involving ₹ 2.89 lakh and stated that assessments were revised in three cases, out of which an amount of ₹ 1.31 lakh was collected in two cases. The replies in respect of the remaining two cases have not been received (January 2011).

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<sup>31</sup> Hyderabad (Basheerbagh, Malakpet and Somajiguda), Kadapa-I and Kavali

**2.26.2** Under Rule 20(2)(f) of the APVAT Rules any goods purchased and accounted for in the business but utilised for the purpose of providing facilities to employees are not eligible for input tax credit.

We noticed in the test check of the records (July 2009) of Agapura circle that during the period 2008-09, in one case, a dealer corporation paid VAT on the amounts charged for supply of food in the restaurants/hotels but incorrectly claimed input tax credit on purchases of goods like uniforms to drivers, boats, cell phones etc., which were used for other than business activities. This resulted in under declared tax of ₹ 10.99 lakh. The AA did not raise the demand for short paid tax.

After we pointed out the case, the Government (December 2010) accepted the audit observation and stated that notice had been issued to the dealer.

### **2.27 Short levy of tax due to incorrect exemption of transit sales**

Under Section 6(2) of the CST Act, where a sale of any good in the course of inter-state trade or commerce has either occasioned the movement of such goods from one state to another or has been effected by a transfer of documents of title to such goods during their movement from one state to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods to a registered dealer, shall be exempt from tax under this Act.

We noticed in the test check of the records (July 2009) of Marredpally circle that AA exempted the transit sales of machinery goods amounting to ₹ 66.87 lakh. As noticed from the monthly VAT returns, these goods were purchased in March 2006 whereas the transit sales of the goods were made between August 2005 February 2006. Thus, the sales were prior to the purchases in the month of March 2006, which is irregular. Hence the turnover is to be treated as sales within the State taxable at the rate of 12.5 *per cent.* Incorrect exemption of turnover resulted in short levy of tax of ₹ 8.36 lakh.

We referred the matter to the Department in November 2009 and to the Government in June 2010; their reply has not been received (January 2011).