CHAPTER II
SALES TAX/VAT

EXECUTIVE SUMMARY

Appreciable increase in tax collection	As indicated at para 1.1.2 of Chapter-I, in 2010-11, the collections of taxes from Sales Tax and Central Sales Tax increased by 23.18 *per cent* and 24.93 *per cent* respectively over the previous year.
Lack of a structured Internal Audit Wing	The Department did not have a structured Internal Audit Wing that would plan audits in accordance with scheduled audit plan, conduct audits and follow up thereof. However this function was being performed under the supervision of Divisional head and rectificatory action is taken on the observations made in the Internal Audit Report.
Very low recovery by the Department in respect of observations pointed out by us in earlier years	During the period 2005-06 to 2009-10, we 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 ₹ 1,343.43 crore in 6,749 cases. Of these, the Department/Government had accepted audit observations in 3,022 cases involving ₹ 366.85 crore but recovered only ₹ 7.61 crore in 710 cases. The recovery position as compared to acceptance of objections was very low at 2.07 *per cent* during the five year period.
Results of audits conducted by us in 2010-11	In 2010-11 we test-checked the records of 223 offices of the Commercial Taxes Department and noted underassessments of tax and other irregularities involving ₹ 373.64 crore in 1,622 cases. The Department had accepted underassessments and other deficiencies of ₹ 87.55 crore in 582 cases, of which 145 cases involving ₹ 42.05 crore were pointed out in audit during the year and the rest in earlier years. An amount of ₹ 49.78 lakh was realised in 43 cases during the year 2010-11.
What we have highlighted in this chapter?	In this chapter we present two performance audits on 'Taxation of works contracts under APVAT Act' involving tax effect of ₹ 35.23 crore and 'Cross verification of Declaration Forms used in Inter-State Trade' involving tax effect of ₹ 77.31 crore and illustrative cases involving ₹ 58.13 crore. These cases were selected from observations noticed during

	our test check of records relating to Commercial Taxes Department in the offices of Commercial Tax Officers (CTOs) and Large Tax Payers Units (LTUs), where we found that the provisions of the Acts/Rules were not observed. It is a matter of concern that similar omissions were pointed out by us repeatedly in the Audit Reports for the past several years, but the Department had not taken corrective action. We are also concerned that though these omissions were apparent from the records which were made available to us, the CTOs and Assistant Commissioners failed to detect them. With reference to performance audit on 'Taxation of works contracts under APVAT Act', we observed that the Department had not made enough efforts to register works contracts dealers, check/scrutinise their returns by using information of TDS remittances received and by cross verification with other tax Departments. There was no system to monitor the filing of option for Composition Scheme for the dealers, as a result of which concessional rate of tax was being allowed to ineligible dealers. Though the Departmental Audit Manual prescribed the percentage of audits to be conducted, audit of most of the contractors was in arrears. As regards performance audit on 'Cross Verification of Declaration Forms used in Inter-State Trade, we observed that there were several deficiencies in the printing and custody of declaration Forms as well as in acceptance of these Forms governing Inter-State Sales. These included absence of a system for ascertaining the genuineness and correctness of declaration Forms submitted by the dealers for claiming concessions and exemptions of tax on inter-state sales/stock transfers through cross verification of transactions from the States concerned, absence of system for blacklisting dealers and absence of a reliable database for concessions and exemptions and the revenue forgone.
Our conclusion	The Department needs to improve the internal control system including establishment of a structured Internal Audit Wing so that weaknesses in the system are noted timely for appropriate remedial action by the Department. It also needs to initiate immediate action to recover the non/short-levy of tax, interest/penalty etc., pointed out by us, more so in those cases where it has accepted our contention.

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 (CST) Act, the AP Entertainments Tax Act, the AP Luxury Tax Act and the Rules framed thereunder. The Commissioner of Commercial Taxes (CCT) is the Head of the Department entrusted with over all supervision and is assisted by Additional Commissioners, Joint Commissioners (JC), Deputy Commissioners (DC) and Assistant Commissioners (AC). Commercial Tax Officers (CTO) at circle level are primarily responsible for tax administration and are entrusted with the registration of dealers and collection of taxes while the DCs are controlling authorities with overall supervision of the circles under their jurisdiction. There are 218 offices (25 Large Tax Payer Units (LTUs) headed by the ACs and 193 Circles headed by the CTOs) functioning under the administrative control of the DCs. Further, there is an Inter-State Wing (IST) headed by a Joint Commissioner within the Enforcement wing, which assists CCT in cross verification of inter-state transactions with different states.

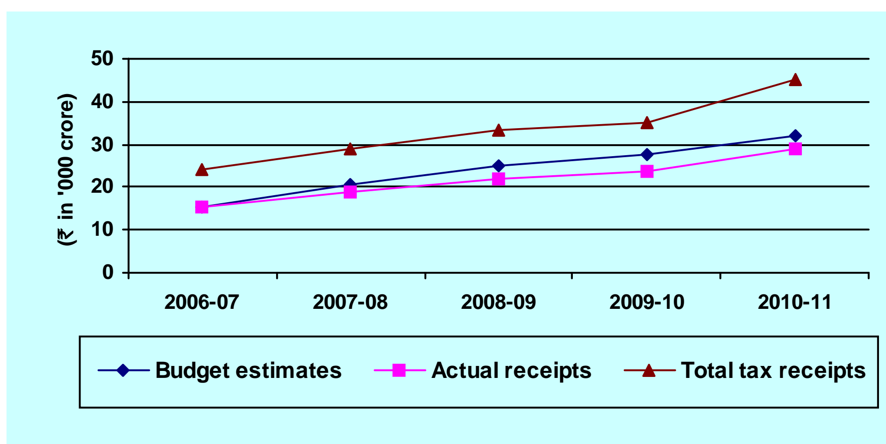
2.2 Trend of receipts

Actual receipts from VAT during the last five year period from 2006-07 to 2010-11 along with the total tax receipts during the same period are exhibited in the following table and graphs:

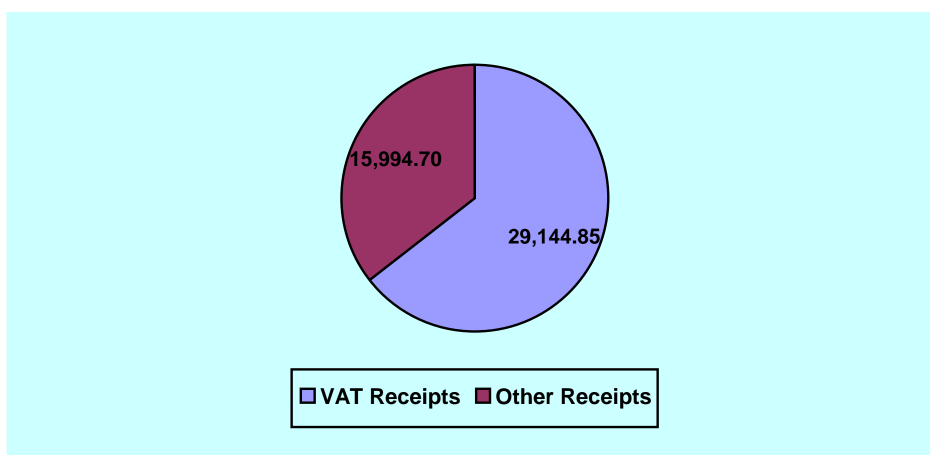
(₹ in crore)

Year	Budget estimates	Actual receipts	Variation excess (+)/ shortfall (-)	Percentage of variation	Total tax receipts of the State	Percentage of actual VAT receipts vis-a-vis total tax receipts
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
2010-11	31,838.00	29,144.85	(-) 2,693.15	(-) 8.46	45,139.55	64.57

Graph 1: Budget estimates, actual receipts and total tax receipts



Graph 2: Actual receipts vis-à-vis Other tax receipts
(₹ in crore)



The variations in the budget estimates and actual revenue persisted during the years 2007-08 to 2010-11 thus failing to give an assurance that the budget estimates prepared are realistic. The Department did not furnish (October 2011) the reasons for shortfall despite being requested in May 2011.

2.3 Assessee and returns profile

The CTD had 2,16,110 VAT dealers registered under the APVAT Act as on 31 March 2011, out of which 625 dealers were Large Tax Payers. The following table indicates the position of returns received by the Department during 2010-11:

No. of assessees on rolls	No. of assessees required to file monthly returns	No. of returns received in 2010-11 (12 months)	No. of returns not received	No. of returns scrutinised by Department
2,16,110	2,16,110	23,48,684	1,18,718	NA

The Department did not furnish (October 2011) the details of action initiated against those dealers who have not filed the monthly returns.

2.4 Cost of VAT per assessee

The Commercial Taxes Department spent ₹ 256.98 crore on their tax administration during 2010-11 with reference to 2,16,110 VAT dealers on their rolls. The average cost of VAT per assessee stood at ₹ 0.12 lakh *per annum* during 2010-11, and the cost *per cent* at 0.05.

2.5 Status of VAT Audit

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 2008-09 to 2010-11 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
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
2010-11	2,16,110	1,08,055	1,04,390	3,665	3.39

It is seen from the above that the percentage of audits completed to the total audits to be conducted had shown an improvement during the year 2010-11 as compared to the preceding two years.

2.6 Analysis of arrears of revenue

The arrears of revenue as on 31 March 2011 amounted to ₹ 5,113.53 crore. A comparative figure of arrears of revenue for the last five years is mentioned below:

(₹ in crore)

Year	Opening balance	Additions*	Collection	Balance
2006-07	9,059.81	NA	691.02	8,368.79
2007-08	8,368.78	NA	1,112.69	7,256.09
2008-09	7,256.09	NA	609.00	6,647.09
2009-10	6,647.09	NA	629.44	6,017.65
2010-11	6,017.65	NA	904.12	5,113.53

* Information not furnished by the Department.

2.7 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 2008-09, 2009-10 and 2010-11 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.	2008-09	21,851.66	190.79	0.87	0.83
	2009-10	23,640.21	215.88	0.91	0.88
	2010-11	29,144.85	261.98	0.90	0.96

The percentage of cost of collection to gross collection decreased by 0.01 *per cent* during 2010-11 over the previous year.

2.8 Impact of Local Audit

During the last five years, audit had pointed out non/short levy, non/short realisation, under assessment/loss of revenue, incorrect exemption, concealment/suppression of turnover, application of incorrect rate of tax, incorrect computation etc., with a revenue implication of ₹ 1343.43 crore in 6,749 cases. Of these, the Government/Department had accepted audit observations in 3,022 cases involving ₹ 366.85 crore and had since recovered ₹ 7.61 crore. The details are shown 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
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
2009-10	210	1,646	279.61	647	72.46	64	2.83
Total	**1,056**	**6,749**	**1,343.43**	**3,022**	**366.85**	**710**	**7.61**

The insignificant recovery of ₹ 7.61 crore (2.07 *per cent*) as against the money value of ₹ 366.85 crore relating to the accepted cases during the period 2005-06 to 2009-10 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.

2.9 Working of Internal Audit Wing

The Department did not have a structured Internal Audit Wing that would plan audits in accordance with a scheduled audit plan, conduct audits and follow up thereof. Internal audit is organised at Division level under the supervision of Assistant Commissioner (CT). There are 25 Large Tax Payers Units (LTUs) and 193 circles in the State. The internal audit of returns is conducted during the first quarter of the financial year and gets extended up to September. Each LTU/Circle is audited by audit team consisting of five members headed by either CTOs or Deputy CTOs. The internal audit report is submitted within 15 days from the date of audit to the DC (CT) concerned, who would supervise

the rectification work giving effect to the findings in such report on internal audit.

2.10 Results of audit

Test check of the records of 223 offices of the Commercial Taxes Department during 2010-11 relating to VAT, revealed under assessments of tax and other irregularities involving ₹ 373.64 crore in 1,622 cases, which fall under the following categories:

(₹ in crore)

Sl. No.	Category	No. of cases	Amount
1	**"Taxation of Works Contracts under the APVAT Act" (A Performance Audit)**	**1**	**35.23**
2	**"Cross verification of Declaration Forms used in Inter-State Trade" (A Performance Audit)**	**1**	**77.31**
3	Short levy of tax under works contract	313	88.07
4	Non/Short-levy of tax under VAT	377	44.67
5	Excess allowance of input tax	266	27.36
6	Incorrect exemption of taxable turnover	137	17.53
7	Non-payment of VAT by rice millers	1	10.13
8	Application of incorrect rate of tax	55	6.47
9	Non-levy of interest/penalty/TOT	78	6.57
10	Cross verification of transit passes	7	2.62
11	Irregularities in availment of sales tax incentives by industrial units	11	2.53
12	Other irregularities	375	55.15
Total		**1,622**	**373.64**

During the course of the year 2010-11, the Department accepted under assessments and other deficiencies of ₹ 87.55 crore in 582 cases, of which 145 cases involving ₹ 42.05 crore were pointed out in audit during the year and the rest in the earlier years. An amount of ₹ 34.49 lakh was realised in 40 cases during the year 2010-11.

After the issue of three draft paragraphs, the Department reported (August 2011) recovery of ₹ 15.29 lakh in respect of three cases.

This chapter also includes two Performance Audits on **"Taxation of works contracts under the APVAT Act"** involving ₹ 35.23 crore and "**Cross verification of Declaration Forms used in Inter-State Trade"** involving ₹ 77.31 crore. The paragraphs cover systems and compliance deficiencies relating to VAT administration pertaining to incorrect application of rates, non/short levy of tax, excess allowance of input tax credit and non/short levy of penalty in violation of the VAT provisions. Illustrative audit observations involving ₹ 58.13 crore are also reported in the Chapter.

2.11 Performance Audit of "Taxation of Works Contracts under APVAT Act"

Highlights

- The number of registered works contractors and taxes collected increased during the period 2005-06 to 2009-10 but the Department could have ensured more revenue collections by bringing more dealers under the tax net by utilising Tax Deducted at Source (TDS) details to detect the unregistered dealers and by establishing systems of cross verifications with agencies and Government Departments/bodies. We have cross verified TDS details in just four circles and have estimated tax dues of ₹ 3.42 crore due to non-registration of contractors in construction and sale of apartments besides penalty of ₹ 0.86 crore.

(Paragraph 2.11.7.1)

- Though the VAT provisions came into force since 1 April 2005, the Department has not established a system of cross verification of transactions with other Taxation Departments as envisaged in the White Paper issued by the Empowered Committee of State Finance Ministers for VAT (ECSFM) for preventing revenue leakages. We have estimated tax dues of ₹ 141.73 crore due to non-registration of works contractors under the Act, by cross verification of data with the Income Tax Department. Further, due to under reporting of turnovers, we have estimated tax dues of ₹ 36.15 crore in nine cases by cross verifying Income Tax returns details.

(Paragraph 2.11.7.2)

- We saw that there were systems deficiencies relating to TDS collections in the form of unique form ID not being followed for TDS credits; non-maintenance of registers for monitoring of receipt of TDS cheques and their credit to Government Account; non-monitoring of receipt of returns with TDS remittances; absence of a system to monitor the filing of option under the prescribed form for claiming benefit of the Composition Scheme. We detected incorrect declaration of tax under the composition scheme of ₹ 1.53 crore.

(Paragraph 2.11.8.3)

- There was irregular claim of tax credit of ₹ 4.91 crore by nine dealers due to non-submission of TDS certificates with the returns.

(Paragraph 2.11.12.2)

- There was under declaration of tax of ₹ 6.26 crore by 20 Works Contractors due to incorrect allowance of exemption; of ₹ 5.84 crore in 83 cases due to suppression of turnovers with reference to payment received from their contractees and of ₹ 0.66 crore in two cases due to incorrect exemption of turnover.

(Paragraphs 2.11.13.2, 2.11.13.3 & 2.11.13.4)

- There were incorrect/excess claims of Input Tax Credits (ITC) in composition/non-composition contracts.

(Paragraphs 2.11.14.2 & 2.11.14.3)

- Misclassification of sales as works contracts in nine cases resulted in under declaration of tax of ₹ 4.82 crore.

(Paragraph 2.11.16)

- Incorrect determination of taxable turnover in 10 cases resulted in under declaration of tax of ₹ 0.96 crore and incorrect authorisation of refunds in two cases resulted in excess refund of ₹ 1.78 crore.

(Paragraphs 2.11.17.2 & 2.11.17.4)

2.11.1 Introduction

Consequent on the amendments made by the Constitution (46 Amendment) Act, 1982, States derived power to levy tax on the transactions of works contracts. In accordance with the amendments made from 1 July 1985, the goods involved in the execution of works contract became taxable under the APGST Act, 1956, at the rates mentioned in the Schedules to the Act or at the reduced rates contained in the notifications issued. A separate charging section 5F was inserted in the Act and a uniform rate of tax for all goods used in the works contract, except declared goods had been provided with effect from 1 April 2005. The following are the provisions governing taxation of works contractors under the APVAT Act, 2005 and Rules there under including the composition of Tax Scheme for works contractors.

Subject	Details/Provisions	Section	Rule
Definition	'Works Contract' includes any agreement for carrying out for cash or for deferred payment or for any other valuable consideration, the building construction, manufacture, processing, fabrication, erection, installation, laying, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.	2(45)	Nil
Levy of tax under Regular Scheme	Tax is payable on the value of goods at the time of incorporation, at the rates applicable to the goods. Such dealer is eligible for Input Tax Credit (ITC) to the extent of 90 *per cent* of the related input tax.	4(7)(a)	17(1)(e)
	In the absence of the detailed accounts, tax has to be paid on the value of goods at the rate of 12.5 *per cent* after availing the statutory deductions. The dealer shall not be eligible to claim ITC.	4(7)(a)	17(1)(g)
Levy of tax under Optional Scheme (Composition) in respect of works executed for the Government or local authority	Any dealer executing any works contract for the Government or local authority may opt to pay tax by way of composition at the rate of four *per cent* on the total value of the contract executed for the Government or the local authority. Such contractor has to opt for composition and file form VAT 250 before commencement of execution of works.	4(7)(b)	17(2)
Levy of tax under Optional Scheme (Composition) in respect of works executed for other than the Government or local authority	Any dealer executing any works contract other than for Government or local authority may opt to pay tax by way of composition at the rate of four *per cent* of the total consideration received or receivable for any specific contract subject to conditions as may be prescribed. Such contractor has to opt for composition and file form VAT 250 before commencement of execution of works.	4(7)(c)	17 (3)

Subject	Details/Provisions	Section	Rule
Levy of tax under Optional Scheme (Composition) for builders	Tax has to be paid at the rate of four *per cent* of 25 *per cent* of the consideration received or market value, whichever is higher, under composition subject to filing of option in form VAT 250 before commencement of the work.	4(7)(d)	17(4)
Exemption towards payments made to sub-contractors	No tax shall be payable on the turnover relating to amounts paid to the sub-contractor as consideration for the execution of works contract. In other words sub-contractor is liable to pay tax on his turnover whereas the same is allowed exemption in the hands of main contractor.	4(7)(h)	17(1)(c) 17(2)(h) and 17(3) (g)
Provisions relating to Input Tax Credit under Composition Scheme	No input tax credit shall be allowed on the works contracts where the dealer pays the tax under the provisions of clauses (b), (c) and (d) of Section 4 (7).	Sn.13 (5) (a)	Rule 17(2), (3) and (4)
Provisions relating to Input Tax Credit under Non-Composition Scheme	Where any VAT dealer pays tax under Section 4 (7) (a), the input tax credit shall be limited to the 90 *per cent* of the related input tax.	Sn.13 (7)	Rule 17(1)
Registration	Every dealer whose estimated taxable turnover for 12 consecutive months is more than ₹ 40 lakh shall be liable to be registered as a VAT dealer before the commencement of the business.	17 (2)	4
	Every dealer executing any works contract exceeding ₹ 5 lakh for the Government or local authority and every dealer opting to pay tax by way of composition on works contract shall be liable to be registered as a VAT dealer.	17(5)(g)	17 (2), (3) and (4)
Tax deducted at source (TDS)	The rate of tax for the purpose of TDS shall be as prescribed below: i. All categories of contracts except mentioned in sub clause (ii) at four *per cent* of 70 *per cent* of consideration. ii. Contracts for laying or repairing of roads and contracts for canal digging, lining and repairing at two *per cent* of 70 *per cent* of consideration. Tax deducted at source under the Act by the contractees is to be remitted in the manner as prescribed. Such contractee shall issue certificate of TCS/TDS in form VAT 501 and 501A to the contractor from whom tax was deducted. Credit shall be given to the said contractor on production of certificate of TCS/TDS along with monthly returns.	22(3)	18(1)(bb)

Subject	Details/Provisions	Section	Rule
Transfer of TDS relating to sub-contractor	Where any tax is deducted at source in respect of works contract and work in whole or any part of such work is awarded to a registered sub-contractor, the tax proportionate to the amounts paid as consideration to the sub-contractor out of the tax deducted by the contractee shall be transferred to the sub-contractor by issuing Form 501B.	22 (3)	18(1)(e)
Forfeiture of excess tax deducted	Where tax collected at source is in excess of the liability of the contractor, who has not opted for payment of tax by way of composition, such amount of tax, collected in excess of the liability shall be deemed to have been payable by the contactor and shall be liable to be forfeited.	22 (3A)	18(3)(b)

2.11.2 Organisational set up

The Commercial Taxes Department is under the purview of the Principal Secretary, Revenue Department at the Government level. At the Commissionerate level, CCT heads the Department and is assisted by AC, JC, DC, and AC. Divisional offices at field level are headed by the DC who is assisted by the CTO, DCTO and ACTO at the circle level.

There are 218 offices (25 Large Tax Payer Units headed by the AC's and 193 circles headed by the CTO's) functioning under the administrative control of the DC's. The CTOs are entrusted with registration of the dealers and collection of tax while the DCs are controlling authorities with overall supervision of the circles under their jurisdiction.

2.11.3 Audit Objectives

We conducted a review on "Taxation of Works Contract under the APVAT Act" to assess the efficiency and effectiveness of

- the system of registration of works contractors by the Department and monitoring the filing of their returns;
- the system, if any, of cross verification of data with other Departments;
- the system of tax deduction at source and its proper accountal;
- the system of filing of returns/options and supporting documents;
- the system of self assessment by works contractors and scrutiny of such assessments i.e., VAT Audit by the Department;
- the implementation of the Regular and Optional Scheme of assessment of Works Contractors as per the provisions of the APVAT Act ; and
- the system of internal control in the Department.

2.11.4 Scope and Methodology of Audit

We conducted the review for the period from 2005-06 to 2009-10 between September 2010 and March 2011. We covered 120 circle offices and 25 large tax payer units (details vide Annexure II) that were due for audit during the period of review. We also included relevant audit findings raised by the field parties during local audit of the remaining offices as well as those commented in the Local Audit reports of these offices during earlier years.

Based on a Performance Audit of transition from APGST to APVAT regime which was included in Comptroller and Auditor General's Audit Report for the year 2008-09, the following system deficiencies were pointed out:

1. Absence of provision for conducting surveys;
2. Shortfall in audit of the dealers;
3. Failure to register on attaining threshold limits;
4. Ineffective functioning of database of dubious/risky dealers;
5. Non-scrutiny of monthly VAT returns;
6. Absence of cross verification of records with the Departments.

During the course of this review, we examined whether the Department had addressed these issues and have included suitable comments accordingly where the deficiencies continued.

2.11.5 Acknowledgement

We acknowledge the cooperation of the Commercial Taxes Department in providing necessary information and records to audit. We had held the entry conference on the 9 September 2010 with the CCT and other departmental officers in which the Department was apprised about the scope and methodology of audit. We held an Exit Conference with the Government/Department on 10 August 2011 during which the audit findings were discussed with the Principal Secretary to Government (Revenue) and CCT.

2.11.6 Trend of revenue

The analysis of the total Sales Tax Revenue and Tax Revenue from Works Contractors during the period from 2005-06 to 2009-10[1] was as under:

(₹ in crore)

Year	Sales Tax	No. of registered works contractors	Tax on works contracts	Percentage of tax on works contracts to total sales tax
2005-06	11,524.24	9,323	310.42	2.69
2006-07	14,222.67	10,548	508.78	3.57
2007-08	17,593.41	12,391	589.17	3.34
2008-09	20,596.47	14,673	643.91	3.12
2009-10	22,278.14	17,452	1,038.28	4.66

[1] Source of figures – Commissioner of Commercial taxes.

Audit findings

The system and compliance deficiencies seen during the Performance Audit are discussed in the succeeding paragraphs.

System Deficiencies

2.11.7 Registration

2.11.7.1 Absence of a system for detection of unregistered works contractors

As per Section 17(2) of the APVAT Act, dealers whose estimated taxable turnover in a period of twelve consecutive months is more than ₹ 40 lakh are required to be registered under the Act. Besides under Section 17(5)(g), contractors executing works of the State Government or local authority exceeding ₹ 5 lakh and contractors opting to pay tax by way of composition are required to be registered as VAT dealers regardless of the turnover. Further, under Section 49 (2) of the Act, penalty shall be leviable for failure to register at 25 *per cent* of the amount of tax due.

The provisions relating to Registration of Works Contractors under the AP VAT Act are given alongside. Besides as per para 5.12.6 of the APVAT Manual, where routine references or intelligence indicate that a dealer may be liable for VAT registration, the CTO should designate a DCTO/ACTO to carry out an inspection/visit to verify the dealers' taxable turnover and establish if there is a liability for VAT Registration. The registration requirements must be enforced rigorously and the Act provides for penalties for failure to apply for registration.

In response to a comment made under para 2.2.8.1 of the Audit Report for the year ended 31 March 2009, regarding non conducting of surveys at regular intervals to enforce additional registrations and generate more revenue, the Department replied that surveys were being conducted at random without disturbing the field officers. However we noted that the same position persists.

We noted that the Department did not put in place any system for detection of unregistered works contractors. Though the executing authorities/Departments deduct tax at source at various rates i.e., 4 *per cent*, 2.8 *per cent*, 1.4 *per cent* and 1 *per cent* the final tax liability needs to be assessed by the Commercial Taxes Department. As the liability of tax is based on various factors such as filing of option for composition, purchases from outside the State that are used in the works contract and deductions allowable under the Act. When the dealers have not been registered by the Department, there is no control mechanism for plugging any loss of revenue.

We noticed in the test check of the records relating to TDS of four circles[2] that 74 contractors engaged in construction and sale of apartments, TDS under provisions of the Act (Sec 22(3)) was deducted at the offices of Sub Registrars at the time of registration of the apartment. A review of the 'register of cheques' received from the Sub Registrar Offices by the Department and our cross verification of the same with the computerised database- Dealer Master from VATIS[3] package revealed that though the Department received cheques/ demand drafts relating to TDS, they did not take efforts to ensure registration of such Contractors. We compiled the annual turnover based on the TDS details and found that these dealers had crossed the threshold limits for registration under the APVAT Act and thus were liable to be registered under the Act.

As these dealers were not registered under the Act and had not opted for payment of tax under composition in terms of Section 4(7)(d) of the Act, the tax was payable at the rate of 12.5 *per cent* under Section 4(7) (a) of the Act on the 70 *per cent* of total consideration received. We have estimated the tax liability after adjusting for the TDS, at ₹ 3.42 crore and penalty of ₹ 0.86 crore was also leviable.

The Government replied (July 2011) that the programme of conducting street survey was being taken up and one third of circles would be covered every year. It was further stated that the objective of such an exercise was to bring every unregistered dealer into the tax net. However, no response was given for action not taken till date on the information of TDS details which was available with the Department itself.

It is recommended that the Department may utilise the TDS payments data available with them to register the contractors under the Act, forthwith.

2.11.7.2 Absence of a system for cross verification of data with other Taxation Departments

The White paper issued by the Empowered Committee of State Finance Ministers (ECSFM) came out with an unanimously approved "White paper on VAT" with an objective of self assessment by dealers, rationalising the tax burden, increase in transparency, allowance of set off for input tax, fall in prices and higher revenue growth. The White paper also emphasised cross verification of data between various taxation Departments viz., Income Tax, Central Excise and Commercial Taxes so as to reduce tax evasion and ensure growth of tax revenue. Thus cross verification is a distinctive feature of the VAT regime. It is imperative that the State Government put in place a system and procedures for enabling cross verification. However, the APVAT Act does not have any provision for cross verification of the Department's information with the other taxation Departments to ensure the correctness of the taxes paid by the dealers. Neither has the cross verification been ensured by Departmental Instructions.

---

[2] Bhimavaram, Eluru, Kothagudem and Mancherial.

[3] Value Added Tax Information System.

Under the APVAT Act, if any dealer wilfully declares lesser output turnover than the actual turnover, he is liable to pay penalty equal to the tax under declared.

A comment was also made under para 2.2.10 of the Comptroller and Auditor General's Audit Report for the year ended 31 March 2009, regarding failure to cross verify the departmental records with other Departments. However we noted that the same position/deficiency persists.

We noticed (December 2010) in the test check of the records with the data collected from the Income tax Department in respect of 20 cases that though the turnover of receipts from works contracts during the period from April 2005 to March 2008 was reported as ₹ 1,295.82 crore by the works contractors as per their audited balance sheet, our cross verification revealed that they were not registered under the APVAT Act, though their turnovers had crossed the threshold limits. The total tax and penalty leviable as estimated by us, in these cases worked out to ₹ 141.73 crore (tax of ₹ 113.38 crore at the rate of 12.5 *per cent* on 70 *per cent* of turnover) and penalty thereon at the rate of 25 *per cent* amounting to ₹ 28.35 crore was also leviable.

Further, we also noticed in the test check of the records (between October 2010 and March 2011) of six circles[4] that during the period from April 2005 to March 2008, in nine cases, the VAT dealers declared their turnovers in the monthly VAT returns lesser than that reported in their annual accounts filed with the Income Tax Department. The estimated tax liability on this turnover works out to ₹ 36.15 crore.

Though it may not be necessary that all the receipts disclosed by them under the Income Tax return was from contracts executed by the dealers in the State of Andhra Pradesh, the Department needs to assess/scrutinise these receipts to determine the receipts taxable under the Act.

The Government replied (July 2011) that this work would be entrusted to two Joint Commissioners to obtain information from the Government Departments (both Central and State) and that the information collected would be supplied to the field officers for cross verification. However, the reply is silent as to why no mechanism of cross verification has been established in the Department till date after introduction of the APVAT Act in 2005, as envisaged in the White Paper for reducing the tax evasion and ensuring growth in revenue.

[4] Chinawaltair and Hyderabad (Hyderguda, Jubilee Hills, Malakpet, Narayanguda and Somajiguda).

2.11.7.3 Non-co-ordination with Other Government Departments

We observed that the Department has also not established an efficient system for cross verification of records relating to TDS received from the local bodies/public sector undertakings with their Dealer Master Database in order to detect un-registered works contractors executing works in these organisations.

We obtained the data relating to TDS deposited by the Greater Hyderabad Municipal Corporation (GHMC) and Andhra Pradesh Eastern Power Distribution Corporation Limited (APEPDCL) in respect of works contractors with the Department and verified the same with the database of dealers of the Department. We found that out of 1,092 cases cross verified by us, 79 dealers were liable to be registered but were not registered. In 35 cases the Tax Identification Number mentioned in the TDS details were found incorrect and in the balance cases TIN was not mentioned and our search by name in the data base of the registered dealers with the Department revealed that these were not registered. These are detailed below:

(₹ in crore)

Sl. No.	Department	No. of works contractors	Turnover
1	GHMC	74	15.52
2	APEPDCL	05	50.12
Total		**79**	**65.64**

Our further study of the document downloaded from the Hyderabad Municipal Corporation website revealed that VAT registration is one of the compulsory requirements of the eligibility criteria for participation in the tenders. Thus it is highly unlikely that the Municipal Corporation had awarded works contracts to unregistered dealers. Though the TIN/names quoted in the TDS details did not match with the data base of registered dealers of the Department, the Department did not take action to verify the details of TDS received. The Department needs to verify them and also to correct its data base to arrive at correct tax liability of these dealers and to detect evasion of tax.

The Government replied (July 2011) that this work would be entrusted to two Joint Commissioners to obtain information from the Government Departments (both Central and State) and that the information collected would be supplied to the field officers for cross verification. The reply is evasive to the fact as to why no mechanism has been instituted in the Department to utilise the TDS data to increase the tax base and to detect the evasion of tax.

It is recommended that the Department may institute a system of cross verification of TDS remitted from the Other Government Departments and also to obtain information from these Departments on regular basis and use the same to detect the evasion of tax.

2.11.8 Tax deduction

2.11.8.1 Non-maintenance of unique form ID of contractors with TDS certificates

According to Rule 17 (1) (f) of the APVAT Rules, where tax is deducted at source, the contactor VAT dealer shall obtain Form 501A with unique form ID from the Asst. Commissioner/ Commercial Tax Officer concerned and supply the same to the Contractee. The Contractee shall complete Form 501A with required information and supply the same to the contractor within 15 days after the end of the month in which the deduction is made. The contractor/ VAT dealer shall submit the form 501A along with the tax return.

We noticed from the test check of the records of all the circles covered under the review that the system of issuing Form 501A with unique form ID by the Commercial Taxes Department to the contractors is not being followed. The contractors were supplying these Forms without unique ID on which credit for TDS was being claimed by the Contractors and allowed by the Department. In the absence of the forms with unique ID, it would not be possible to establish the genuineness of the forms.

The Government replied (July 2011) that the Department had taken a decision to computerise the issue of the Forms 501A and 501B through online system wherein every contractee would enter the details of payment and generate Forms 501A and 501B.

The fact remains that though the APVAT Act has been implemented with effect from 1 April 2005, the Department has not implemented the provisions as per procedures laid down in the Act. The reply is at best an assurance for the future after five to six years of introduction of the Act and that too without a clear time frame.

It is recommended that unique ID Forms may be made available to the contractees to keep track of correct TDS and its remittances to the Government Account.

2.11.8.2 Absence of system for monitoring TDS and returns of unregistered dealers

Under Section 4(7)(d), works contractors engaged in construction and selling of residential apartments, houses, buildings and commercial complexes shall pay tax, under composition, at the rate of four *per cent* of 25 *per cent* of the total consideration received or receivable or market value fixed, whichever is higher. This payment shall be made by way of demand draft in favour of the CTO concerned and presented to the Sub Registrar at the time of registration. The Sub Registrar shall then send the same to the CTO/AC concerned. According to the prescribed procedure, a register for this purpose shall be maintained by the Department, to record the receipt of such DDs properly and watch their remittances into the Government account promptly.

In all the cases, where the TDS amount is received in respect of the unregistered dealers, the assessing authority shall ensure that such dealer complies with all the provisions relating to registration, filing of returns, payment of taxes etc.

We noticed in the test check of the records that no such register was being maintained in the circle offices. In the absence of such record, whether the dealers were complying with the provisions of the Act for filing of returns and payment of taxes and the Departments accountal of demand drafts received could not be verified.

The Government replied (July 2011) that they had issued instructions on 16 July 2011 to all field staff to maintain the register and take action for registering unregistered dealers.

2.11.8.3 Absence of a system for monitoring the prescribed system for payment of tax under composition

A VAT dealer executing works contract may opt to pay tax under composition Under Section 4 (7) (b) and (c) of the APVAT Act, he shall, before commencing the execution of the work, notify the prescribed authority in form VAT 250 of the details including the value of the contract on which the option has been exercised.

Unlike in the repealed APGST Act where a register was prescribed to record the filing and acceptance of option of the dealer/contractor for payment of tax under composition, no such record is prescribed by the Department under the APVAT Act. These details are also not susceptible for verification in the VATIS package. In the absence of such records, it is possible that ineligible dealers could claim the benefit of composition scheme.

We noticed in the test check of the monthly returns (between May and October 2010) in seven circles[5] during the period from April 2008 to March 2010 that in 17 cases, where works were executed for other than State Government, the 11 contractors opted for composition by filing of option in Form 250 after commencement of the work but paid tax under composition rates for the period even before exercising the option for composition which was irregular and the six contractors did not opt for payment of tax under composition by filing of option in Form 250 but paid tax at composition rates. In the absence of the option for payment of tax under composition, tax was payable under Rule 17(1)(g) of the APVAT Rules. Had the Department scrutinised the cases, the irregularity would have been detected. Incorrect declaration of tax of ₹ 0.81 crore under composition (at the rate of four *per cent* on total turnover) instead of ₹ 2.34 crore (i.e. at the rate of 12.5 *per cent* on 70 *per cent* of the turnover) resulted in under declaration of tax of ₹ 1.53 crore**.**

The Government replied (July 2011) that this aspect would be examined on receipt of report from the field.

2.11.9 VAT Audit by the Department

2.11.9.1 Defective planning and shortfall in VAT Audit by the Department

The White Paper envisaged tax audit of sample of dealers based on a scientific risk analysis, by an audit wing that will be independent of the tax collection wing. The audit will be initiated and completed within prescribed time limits. Further, as per Para 3.1 and 4.8.2 of APVAT Manual, all the VAT dealers in a circle should be audited in a period of two years and such audits shall not exceed 12.5 *per cent* in a quarter.

In response to a comment made under para 2.2.12 of the C&AG's Audit Report for the year ended 31 March 2009, regarding shortfall in audit of dealers, the Department replied that the shortfall in conducting Departmental audit was due to lack of sufficient manpower and engagement of the existing staff in revenue collection.

We noted that though the number of audits conducted improved during the period, there remains a huge shortfall, though the VAT audits were authorised by the Deputy Commissioners under random selection system, since programmes for conducting audit in a time bound manner were not drawn up by the CTOs. The status of audits[6] conducted for the period from April 2005 to March 2010, in respect of works contractors, as furnished by the

[5] Hyderabad (Basheerbagh, Hydernagar, Madhapur), Khammam-1, Nandigama, Nandyal-1 and Rajam.

[6] As furnished by the Department of Commercial Taxes.

Department is mentioned in the following table:

Year	Total registered works contractors	To be audited	Actually audited	Shortfall in audits	Percentage of shortfall
2005-06	9,323	4,661	237	4,424	**94.92**
2006-07	10,548	5,265	291	4,974	**94.47**
2007-08	12,391	6,195	517	5,678	**91.66**
2008-09	14,673	7,336	712	6,624	**90.30**
2009-10	17,452	8,726	755	7,971	**91.35**

As seen from the above, the status of audits, in respect of the works contractors, conducted by the Department during the years 2005-06 to 2009-10 indicates that there was a significant shortfall ranging between 90.30 *per cent* and 94.92 *per cent* in conducting VAT Audit.

This shortfall in audit is a departure from the main features of the VAT regime which is built on the premises of voluntary compliance by dealers but with a sample selection for audit of cases which as to act as a deterrent to the dealers from making false declaration of turnover etc.

The Government replied (July 2011) that during the year 2010-11, they had set monthly targets to every officer for audit at four audits per month and added that audit of 11.50 *per cent* of total VAT dealers was completed. The fact remains that ever since inception of VAT, the Department needs to step up the audit of the dealers and cover the backlog already accumulated.

2.11.10 Maintenance of records

We noticed in the test check of the records relating to departmental audit that

- the VAT Audit files did not contain supporting documents such as Profit and Loss Accounts, Agreements, work bills, TDS certificates, purchase details etc., to facilitate the cross verification;

- In the system of jumbling audit, where audit of dealers of a circle were authorised to be audited by the other jurisdictional officers, the files after completion of audit were not transmitted to the jurisdictional officer. This resulted in non-availability of the files in the Jurisdictional Circle.

The Government replied (July 2011) that they had issued instructions for transferring the files to the respective jurisdictional officers.

2.11.11 Internal Audit Wing

The Department did not have a structured Internal Audit Wing that would plan audits in accordance with a scheduled audit plan, conduct audits and follow up thereof. Internal audit is organised at Division level under the supervision of Assistant Commissioner (CT). There are 25 Large Tax Payers Units (LTUs) and 193 circles in the State. The internal audit of returns is conducted during the first quarter of the financial year and gets extended up to September. Each

LTU/Circle is audited by audit team consisting of five members headed by either CTOs or Deputy CTOs. The internal audit report is submitted within 15 days from the date of audit to the DC (CT) concerned, who would supervise the rectification work giving effect to the findings in such report on internal audit.

Compliance Deficiencies

2.11.12 Tax deduction at source

2.11.12.1 Non-verification of TDS/Remittance particulars

Tax deducted at source from the contractor, is paid by the contractees (other than Government Departments) through Cheques or Demand Drafts in favour of the jurisdictional Officer where contractee is registered. As per Rule 18(2) of the APVAT Rules, credit shall be given to the said contractor on production of the certificate furnished by the contractee (TDS certificate in Form 501/501A/501B). According to the VAT Audit Manual (para 5.11.6) proper accountal of TDS is to be checked by the Department while auditing a VAT dealer.

We noticed in the test check of the VAT Audit records (December 2010) in Assistant Commissioner Kadapa, that TDS of ₹ 8.90 crore was stated to have been remitted during the period from April 2007 to December 2009 to various jurisdictional officers at different places. However, we could not verify proper accountal/ remittance of the same into Government account.

The Government replied (July 2011) that this aspect would be examined after a factual report is obtained from the field.

2.11.12.2 Claim of TDS without prescribed certificates

According to Rule 18 (2) of APVAT Rules, tax deducted at source by the contractee, under the provisions of the APVAT Act and Rules made there under, and paid to the State Government, shall be treated as payment of tax on behalf of the dealer and credit shall be given to the said dealer on production of the certificates furnished by the contractee.

We noticed in the test check of the monthly returns (between June 2010 to March 2011) in five circles[7] and AC LTU Kadapa that in nine cases between April 2008 and March 2010, the contactors claimed TDS but did not file the certificates in Form VAT 501 and 501-A issued by the contractees as prescribed under the Act.

The claim of tax credit of ₹ 4.91 crore claimed by the dealers was irregular in absence of the requisite TDS certificates. Had the Department scrutinised the

[7] Bodhan, Hyderabad (Hydernagar, Madhapur, Malkajgiri) and Mancherial.

returns, the deficiency could have been detected and non scrutiny of returns resulted in allowing the TDS claims without requisite certificates.

The Government replied (July 2011) that this aspect would be examined after obtaining a factual report from the field.

2.11.12.3 Excess claim of Tax deducted at Source

We noticed in the test check of the monthly returns (December 2010) in Assistant Commissioner, Kadapa that in one case, the contractor claimed TDS of ₹ 1,02,20,211 and after adjusting the tax payable of ₹ 96,77,747, the dealer carried forward the excess TDS of ₹ 5,42,464. Our examination of the TDS statement filed by the dealer with the return and cross verification with the TDS certificate, issued by the contractee in Form 501, revealed that in respect of a work contract, the dealer had claimed ₹ 5,39,953 as against the actual deduction of TDS of ₹ 53,995 as per certificate issued by the contractee. This resulted in excess claim of tax deducted at source of ₹ 0.05 crore. Had the Department scrutinised the returns, the irregularity might have been detected.

The Government replied (July 2011) that this aspect would be examined after obtaining a factual report from the field.

2.11.12.4 Incorrect exemption of taxable turnover

According to Rule 18 (1) (e) of the APVAT Rules, where any tax is deducted in respect of any dealer executing works contracts and work in whole or any part of such work is awarded to a sub contractor by him, the tax proportionate to the amounts paid as consideration to the sub contractor out of the tax deducted by the contracee shall be transferred to the sub contractor by issuing form 501B to the sub contractor.

We noticed in the test check of the monthly returns (December 2010) in Jubilee Hills circle that in one case between April 2009 and March 2010, the main contractor received a consideration of ₹ 39.26 crore for the works executed for the Government.

The contractor in his returns claimed the entire turnover as exempt on account of payments made to sub contractor. However, from the returns and cross verification with the TDS passed on to sub contractor in Form 501-B, we noticed that only a consideration of ₹ 36.28 crore along with the entire tax of ₹ 1.17 crore deducted at source was passed on to sub-contractor. Thus the balance of the turnover of ₹ 2.98 crore retained by the main contractor was taxable. Incorrect declaration of entire turnover as exempt by the main contractor resulted in under declaration tax of ₹ 0.12 crore (at the rate of four *per cent*) on the turnover retained by the main contractor**.**

The Government replied (July 2011) that this aspect would be examined after obtaining a factual report from the field.

2.11.13 Under declaration of tax

Under Section 4(7) (a) of the APVAT Act, tax is payable on the value of goods at the time of incorporation of such goods in the works at the rates applicable to such goods. To determine such value of goods incorporated in the works contract, deductions as prescribed under Rule 17(1) (e) were allowed from the consideration received. Further, under Rule 17(1) (g) of the APVAT Rules, in the absence of detailed accounts to determine the taxable turnover, tax is payable at the rate of 12.5 *per cent* after allowing the standard deductions as prescribed.

Further, under Section 4(7) (b) and (c), tax on works contract under composition is payable at four *per cent* of the total consideration received or receivable. Under Section 20 of the APVAT Act, every return in form VAT 200 shall be subjected to scrutiny to verify the correctness of arithmetical calculation, application of correct rate of tax and input tax credit claim as well as full payment of tax by a dealer.

In response to a comment made under para 2.2.9.4 of the Audit Report for the year ended 31 March 2009, regarding non-scrutiny of monthly returns by the Department and inadequate documentation leading to inadequate checks, the Department stated that it would be useful for it if supporting documents along with the monthly returns were furnished to make them self sufficient for any future scrutiny in the interest of the revenue.

We observed several cases of under declaration of tax as outlined in the following paragraphs, thus pointing to inadequate scrutiny by the Department.

2.11.13.1 Under declaration of tax due to incorrect determination of taxable turnover

(i) We noticed in the test check of the monthly returns and VAT audit records (between May and September 2010) in two circles[8] that during the period from April 2007 to March 2010, in two cases, tax was determined at ₹ 0.96 crore under Rule 17 (1) (e) but details of deductions allowed were not kept on record. However, from the available records, tax payable worked out to ₹ 1.40 crore. This resulted in under declaration of tax of ₹ 0.44 crore.

The Government replied (July 2011) that notice was issued in one case and the other case would be examined after obtaining a factual report from the field.

(ii) We noticed in the test check of the monthly returns (September 2010) in Seetharampuram circle that during the period from April 2006 to March 2010, in one case, the dealer was a works contractor in printing and paying tax under Section 4 (7) (a) i.e. other than composition. Thus, he is liable to pay tax on the goods incorporated in the works at the tax rate applicable to those goods.

[8] Dwarakanagar and Hyderguda.

However, he reported the entire output as taxable at four *per cent* i.e., ₹ 0.13 crore instead of reporting the same under four *per cent* and 12.5 *per cent* i.e., ₹ 0.18 crore. This resulted in under declaration of tax of ₹ 0.05 crore.

The Government replied (July 2011) that this aspect would be examined after obtaining a factual report from the field.

2.11.13.2 Underdeclaration of tax due to incorrect allowance of exemption

We noticed in the test check of the monthly returns in 20 cases and VAT assessment in one case (between November 2008 and November 2010) of 19 circles[9] that during the period from April 2007 to March 2010, tax was declared under section 4(7)(a) of the Act without supporting documents/information such as payments made to labour, details of materials purchased/consumed and other expenditure related to labour. These dealers had not maintained the accounts to ascertain the correct value of goods at the time of incorporation and incorrectly declared VAT of ₹ 2.90 crore instead of ₹ 8.77 crore and claimed inadmissible ITC of ₹ 0.39 crore. This resulted in under declaration of tax of ₹ 6.26 crore.

The Government replied (July 2011) that this aspect would be examined after obtaining a factual report from the field.

[9] Anakapalle, Dabagardens, Gajuwaka, Gudiwada, Hyderabad (Basheerbagh, Hyderguda, Hydernagar, Madhapur, Nacharam, Punjagutta, R.P. Road, Tarnaka, Vanasthalipuram) Kadapa-2, Khammam-2, Kothagudem, Kurnool-1, Kurnool-3 and Seetharampuram.

2.11.13.3 Under declaration of tax due to suppression of turnover

Under Section 4(7) (b) and (c) tax on works contract under composition is payable at the rate of four *per cent* of the total consideration received or receivable. In such case, the dealers are not eligible for any input tax credit.

Under Section 20 of the APVAT Act, if a return is found to be in order it shall be accepted as self assessment. Every return shall be subject to scrutiny and if any mistake is detected as a result of such scrutiny the authority prescribed shall issue a notice of demand for any short payment of tax or for recovery of any excess ITC claimed.

We noticed in the test check of the monthly returns (between May 2008 and March 2011) of 53 circles[10] and LTU Warangal that during the period from September 2005 to March 2010, in 83 cases, the dealers opted for payment of tax under composition at the rate of four *per cent*.

Our cross verification with the TDS (Form 501 & Form 501-A) indicated that these dealers had declared less turnovers than the payment received by them from their contractees thereby suppressing turnovers and consequential tax of ₹ 5.84 crore. The monthly returns and the TDS details had not been scrutinised by the Department, resulting in the suppression of the tax liability remaining undetected.

The Government replied (July 2011) that the demand was raised in two cases; notices were issued in seven cases; VAT Audit is proposed in two cases; under revision in one case and the remaining cases would be examined after obtaining a factual report from the field.

---

[10] Alcot gardens (Rajahmundry), Anakapalle, Bhimavaram, Bodhan, Brodipet, Chinawaltair, Dabagardens, Hindupur, Hyderabad (Ashoknagar, Barkatpura, Begumpet, Bowenpally, Ferozguda, Gandhinagar, Hyderguda, IDA Gandhinagar, Jubileehills, Keesara, Mahankalistreet, Malakpet, Malkajgiri, Musheerabad, Nampally, Rajendranagar, R.P. Road, Saroornagar, Srinagarcolony, Tarnaka, Vanasthalipuram, Vengalraonagar, Vidyanagar), Kadapa-1, Khammam-2, Khammam-3, Kothagudem, Krishnalanka, Kurnool-3, Madanapalle, Nandyal-1, Nandyal-2, Nellore-1, Nellore-2, Nellore-3, Nizamabad-2, Ongole-2, Palakol, Rajampet, Rajahmundry, Ramannapet, Suryabagh, Tadipatri, Tirupathi-1 and Vizianagaram.

2.11.13.4 Under declaration of tax due to incorrect claim of exemption

According to Rule 17 (3) (i) of the APVAT Rules, where any tax is deducted at source in respect of works contract and work in whole or any part of such work is awarded to a registered sub-contractor, the tax proportionate to the amounts paid as consideration to the sub contractor out of the tax deducted by the contractee shall be transferred to the sub-contractor by issuing Form 501B.

We noticed in the test check of the monthly returns in two circles[11] that in two cases between April 2009 and March 2010, though the TDS relating to sub contractors was passed on proportionately, the entire turnover was claimed to be exempted. This resulted in under declared tax of ₹ 0.66 crore**.**

The Government replied (July 2011) that in one case VAT Audit is under process and the aspect would be examined in another case.

2.11.13.5 Non-declaration of tax on non-creditable purchases used in works contracts

According to Section 4(7)(e) of the APVAT Act, every dealer who opted for payment of tax on works contract under composition under clauses (b), (c) and (d) of Section 4(7) of the Act, purchases or receives any goods, from outside the State or India or from any other dealer other than a VAT dealer in the State, and uses such goods in the execution of the works contracts shall pay tax on such goods at the rates applicable to such goods under the Act. Value of such goods shall be excluded from the total turnover for the purpose of computation of turnover on which tax by way of composition is payable.

i. We noticed in the test check of the monthly returns (four cases) and VAT audit records (one case) (between May 2009 and January 2011) of four circles[12] and AC (LTU) Kadapa that during the period from April 2005 to March 2010, in five cases the assessees purchased goods like diesel, cement and general goods for ₹ 52.69 crore from outside the State and used the same in the execution of the works contract. As such, tax of ₹ 7.11 crore was to be declared/paid on these purchases.

However the dealers declared tax at the rate of four *per cent* under composition on the total turnovers without excluding value of non creditable purchases. This resulted in non-declaration/payment of tax of ₹ 6 crore after excluding tax of ₹ 1.11 crore declared under composition.

[11] Hyderabad (Jubilee hills and Madhapur).
[12] Governorpet, Hyderabad (Ferozguda, Rajendranagar) and Nandyal-2.

The Government replied (July 2011) that demand was raised in one case; notices were issued in three cases and the remaining cases would be examined.

According to Section 4 (7) (a) of APVAT Act, every dealer executing works contract shall pay tax on the value of goods at the time of incorporation of such goods in the works contract executed at the rates applicable to the goods under the Act.

ii. We noticed in the test check of the monthly returns (January 2011) of Market Street circle in one case, during the period from April 2009 to March 2010, that the assessee received goods of ₹ 1.92 crore from outside the State and used the same in works contract executed within the State. However, the turnover relating to works contract was incorrectly exempted. This resulted in under declared tax of ₹ 0.24 crore.

The Government replied (July 2011) that notice was issued.

2.11.14 Input Tax Credit (ITC)

2.11.14.1 Excess carry forward of ITC

We noticed in the test check of the monthly returns (between October and November 2010) in two circles[13] that during the period from April 2009 to March 2010, in two cases, though the ITC available to the end of previous month was ₹ 0.83 crore, ITC of ₹ 1.63 crore was carried forward to the subsequent month. This resulted in excess carry forward of ITC to a tune of ₹ 0.80 crore.

The Government replied (July 2011) that they had taken a decision that the return VAT 200 should be filed without any enclosures except the documents relating to adjustment of tax. Thus the excess carried forward was not detected by the Department.

2.11.14.2 Incorrect claim of ITC

Under Section 4(7) (b) and (c) of the APVAT Act, tax on works contract under composition is payable at the rate of four *per cent* of the total consideration received or receivable. In such case, dealers are not eligible for any input tax credit under Section 13 (5) (a) of the APVAT Act.

During test check of the monthly returns of six circles[14] in respect of six works contractors for the period from April 2008 to March 2010, we noticed that two dealers disclosed turnover taxable at the rate of four *per cent* and they adjusted ITC of ₹ 12.10 lakh against the disclosed turnover and two works contractors have carried forward ITC of ₹ 3.38 lakh disclosed on the purchases but disclosed turnover taxable at the

[13] Ashoknagar and Hydernagar.

[14] Dabagardens, Hyderabad (Malkajgiri, Hyderguda, Hydernagar, R.P.Road, Somajiguda).

rate of four *per cent* only. In the other two cases only purchases and ITC of ₹ 10.83 lakh was disclosed and no taxable turnover was disclosed.

Claiming of ITC of ₹ 12.10 lakh against the disclosed turnover taxable at the rate of four per cent was incorrect as no ITC is admissible against such sales on contracts except for Government contracts. These dealers, however, did not disclose it as sales to Government Departments. In the absence of details in the balance four cases we could not verify whether the ITC was finally adjusted against the composition contracts. The Department may take necessary steps to avoid the allowance of ITC against receipts from composition contracts.

The Government replied (July 2011) that audit is under process in two cases; notices were issued in three cases; and the remaining case would be examined after obtaining a factual report from the field.

2.11.14.3 Excess claim of ITC under non-composition

According to Section 13 (7) of the APVAT Act, where any VAT dealer pays tax under Section 4 (7) (a) of the Act, (i.e., other than composition) the input tax credit shall be limited to 90 *per cent* of the related input tax.

We noticed in the test check of the monthly returns in five circles[15] that during the period from April 2008 to March 2010, in five cases, the dealers were works contractors and paying tax under non-composition. They claimed 100 *per cent* input tax credit of ₹ 0.71 crore instead of 90 *per cent* i.e., ₹ 0.57 crore. Further, in one case while claiming deductions under Rule 17 (1) (e), ineligible items were also allowed as deductions with an impact of short levy of tax of ₹ 0.02 crore. This resulted in excess claim of input tax credit and under declaration of tax of ₹ 0.16 crore.

The Government replied (July 2011) that this aspect would be examined after obtaining a factual report from the field.

2.11.15 Non-forfeiture of excess collection of tax

Under Rule 18 (3) (b) of APVAT Rules, with effect from 1 May 2009, where tax collected at source is in excess of the liability of the contractor, who has not opted for payment of tax by way of composition, such amount of tax, collected in excess of the liability shall be deemed to have been payable by the contactor and shall be liable to be forfeited.

We noticed in the test check of the monthly returns of two circles[16] that during the period from April 2009 to March 2010, in three cases, the dealers had not opted for composition and had collected tax in excess of liability. However, excess collection of tax of ₹ 4.69 crore was not forfeited.

---

[15] Chinawaltair, Hyderabad (Maredpally), Kadapa-1, Kavali and Nirmal.

[16] Hyderabad (Jubileehills and Srinagar Colony).

The Government replied (July 2011) that since the TCS amounts are remitted to the exchequer there is no need for issuing separate orders for forfeiture. The reply is not acceptable as the dealers are claiming credit for tax deducted at source (remitted by the Contractee) and excess credit was being carried forward which was not disallowed. This treatment does not ensure forfeiture of the tax, as envisaged under the Rules and would result in incorrect set off of this tax against tax liability in subsequent assessment years.

2.11.16 Misclassification of sale as works contracts

The Supreme Court of India had held in the case of State of AP Vs M/s Kone Elevators (India) Ltd., (2005) 140 STC 22, that contract for supply and installation of lifts and elevators constitute sale but not works contract. It was held that the major component into the end product was the material consumed on providing the lift to be delivered and the labour to be employed for converting the main component into end product was only incidentally used. Similarly all other transactions of such type where major component was the material consumed in delivering the end product and labour was incidentally used also were classifiable as 'sale' but not 'works contract'. The commodity lift/elevator, Air conditioner and writing boards falls under Schedule-V to the APVAT Act and were liable to tax at 12.5 *per cent* up to 14 January 2010 and 14.5 *per cent* thereafter.

2.11.16.1 We noticed in the test check of the monthly returns (between May and October 2010) of eight circles[17] that during the period from April 2007 to March 2010, in nine cases, the turnover relating to sale of lifts, air conditioners, fire fighting equipment, digital sign boards and writing boards was treated as works contracts, resulting in under declaration of tax of ₹ 4.77 crore based on tax payable on these items under the Act.

The Government replied (July 2011) that demand was raised in four cases; notices were issued in two cases; matter is under examination in one case and the remaining cases would be examined after obtaining a factual report from the field.

2.11.16.2 The Supreme Court of India held in the case of M/s. Mekenzies Ltd. Vs. State of Maharashtra (16 STC 518) and various other cases that construction of bus body building on the chassis supplied by the Government is a contract sale. The CCT vide Ref. No. LV(1)/892/2008 dated 30 December 2008 clarified that bus body building constitute sale with retrospective effect from 9 June 2005. Subsequently the Government clarified that collection of VAT at the rate of 12.5 *per cent* would be applicable prospectively from the date of issue of subsequent clarification i.e. 31 December 2008.

[17] Hyderabad (Aghapura, Ashoknagar, Begumpet, Mehdipatnam, Musheerabad, Sanathnagar, Somajiguda) and Lalapet (Guntur).

We noticed in the test check of the records (December 2009) of IDA Gandhinagar circle that despite Government's clarification, the turnover relating to bus body building was treated as works contract and tax was declared accordingly for the period from January to March 2009. This resulted in under declaration of tax of ₹ 0.05 crore.

The Government replied (July 2011) that show cause notice was issued.

2.11.17 Deficiencies in VAT Audit done by the Department

The white paper envisaged tax audit of sample of dealers, based on a scientific risk analysis, by an audit wing that will be independent of the tax collection wing. We noted the following deficiencies in the VAT audits conducted by the Department in respect of the selected circles and large tax payers units.

2.11.17.1 Short levy of tax due to non filing of option

Under Section 4(7) (b), (c) and (d) of the APVAT Act, payment of tax on works contract at a concessional rate under composition is allowable provided the dealer opts so in the prescribed form before commencement of each work.

VAT Audit in respect of 13 dealers of Hydernagar Circle was completed under jumbling audit system by other jurisdictional officers and received by the circle during 2009-10. We noticed in the test check of above records in October 2010 that, in one case, for the period from April 2007 to March 2008, the dealer filed option for payment of tax under composition on 31 August 2007. Thus the benefit of rate of tax under composition was to be given from the date of filing the option of composition.

However, the consideration of ₹ 6.86 crore received for execution of works contract for the period prior to filing of option between (April 2007 to 30 August 2007) was also taxed at the rate under composition. This turnover was taxable under Section 4(7) (a) of the AP VAT Act read with Rule 17(1) (g) and no input tax credit was to be allowed as the dealer had not produced the books of accounts. The incorrect assessment of turnover received prior to date of composition resulted in short levy of ₹ 0.51 crore**.**

The Government replied (July 2011) that notice was issued to produce the books of accounts.

2.11.17.2 Incorrect determination of taxable turnover

Tax on works contract, under Section 4(7) (a) of the Act, is payable on the value of goods incorporated at the rates applicable to such goods. To determine the value of goods incorporated, deductions as prescribed under Rule 17(1) (e) were to be allowed from the total consideration received or receivable.

We noticed in the test check of the records between October 2010 and March 2011 of five circles[18] that in 10 cases, where VAT Audit was completed, tax under section 4(7) (a) of the Act was incorrectly determined due to allowance of inadmissible deductions such as establishment charges not relatable to labour such as business promotion, insurance, salaries, tax deducted at source and percentage of profit added on purchase value of goods. This resulted in under declaration of tax of ₹ 0.96 crore.

The Government replied (July 2011) that this aspect would be examined after obtaining a factual report from the field.

2.11.17.3 Short levy of tax under composition due to allowance of inadmissible deductions

Tax on works contract under composition is payable on the total consideration received/receivable. No other deductions are allowable except payments made to sub contractors.

We noticed in the test check of VAT Audit records (August 2010) of Madhapur Circle that during the period from October 2006 to December 2009, in one case, tax was levied on the net amounts received after allowing inadmissible deductions such as income tax, security deposit, seigniorage charges etc which are not admissible. This resulted in short levy of tax of ₹ 0.02 crore.

The Government replied (July 2011) that this aspect would be examined.

2.11.17.4 Incorrect authorisation of refund

Under Section 38 of the APVAT Act, every VAT dealer shall be eligible for refund of tax, if the input tax credit exceeds the amount of tax payable, subject to the conditions as prescribed.

We noticed in the test check of the VAT Audit records (between August and October 2010) of Daba Gardens circle and LTU Nellore that during the period from April 2005 to March 2009, in two cases, while determining the taxable turnover deductions towards profit and other expenses relatable to labour etc. were allowed in excess by the assessing authority resulting in short levy of tax and consequent excess authorisation of refund of ₹ 1.78 crore.

---

[18] Anakapalle, Dabagardens, Kothagudem, Hyderabad (Malkajgiri) and Nellore-2.

The Government replied (July 2011) that this aspect would be examined.

2.11.17.5 Non-levy of penalty

According to Section 53(3) of the APVAT Act, any VAT dealer who has under declared tax, and where it is established that fraud or willful neglect has been committed, shall be liable to pay penalty equal to the tax under declared, besides being liable for prosecution. Further, as per Section 49 (2) of the Act, any dealer who fails to register as a VAT dealer is liable to pay penalty at 25 *per cent* of the tax due prior to the date of registration.

We noticed in the test check of the records (February 2011) of Anakapalle circle that during the period from February 2006 to August 2009, the Department conducted VAT audit of unregistered works contractors who executed works contracts and under declared tax of ₹ 0.12 crore, penalty of ₹ 0.03 crore i.e. equal to the 25 *per cent* of the tax due (us 49/2), leviable was not levied by the AA.

In another case in Aryapuram Circle, we noticed (April 2010) that the dealer under declared tax of ₹ 0.03 crore on which penalty of ₹ 0.03 crore i.e. equal to the tax under section 53(3) was leviable but was not levied.

The Government replied (July 2011) that this aspect would be examined.

2.11.18 Conclusion

The number of registered work contractors increased from 9,323 in the year 2005-06 to 17,452 in the year 2009-10 and the percentage of tax on works contracts to total sales tax/VAT revenue has also increased from 2.69 in the year 2005-06 to 4.66 in the year 2009-10. Effectiveness of tax administration depends on the effectiveness of the systems in place for overseeing the entire spectrum of issues that deal with registration, levy, assessment, collection, accounting and monitoring. Our performance audit revealed that the Department has not made enough efforts to register works contract dealers, check/scrutinize their returns by using information of TDS remittances received, cross verification with other tax Departments. There is a huge scope to increase the tax base and maximise the revenue by effective cross-verification of transactions. As there was no system to monitor the filing of option for composition Scheme for the dealers, concessional rate of tax was being allowed to ineligible dealers. Though the Departmental Audit Manual prescribed the percentage of audits to be conducted, audit of most of the contractors was in arrears. There was no independent internal audit wing for timely prevention, detection and correction of deficiencies.

2.11.19 Summary of recommendations

The Government may consider directing the Department to:-

- ***institute a system of cross verification of TDS remitted from the Other Government Departments and also to obtain information from these Departments on regular basis and use the same to detect the evasion of tax and registration of unregistered works contractors;***
- ***ensure implementation of issuing TDS certificates in Form 501A with unique ID to facilitate the verification of proper accountal of tax deducted/collected at source;***
- ***put in place a system to monitor the filing of option for composition and update the VATIS package to enable verification of correctness of payment of tax;***
- ***ensure the completion of VAT Audits as prescribed in the manual in order to detect any leakage of revenue before the cases become time barred; and***
- ***establish an independent internal audit wing for timely detection of errors and initiating suitable remedial measures.***

2.12 Performance Audit of "Cross Verification of Declaration Forms used in Inter-State Trade"

Highlights

- The Department did not maintain a comprehensive database of concessions and exemptions given in inter-state trade.

(Paragraph 2.12.8)

- The Department did not have a system for blacklisting dealers utilising fake/invalid declarations.

(Paragraph 2.12.9.2)

- Evasion of tax by fraudulent utilisation of fake 'F' forms in support of branch/consignment transfers resulted in non-levy of tax and penalty of ₹ 73.07 crore.

(Paragraph 2.12.12.1)

- Evasion of tax by fraudulent utilisation of fake 'C' forms in support of inter-state sales resulted in short levy of tax of ₹ 8.65 lakh and non-levy of penalty of ₹ 17.31 lakh.

(Paragraph 2.12.12.2)

- Grant of incorrect exemption from payment of tax of ₹ 2.27 crore due to acceptance of invalid forms (F-forms).

(Paragraph 2.12.12.3)

- Grant of incorrect concession of tax of ₹ 43.19 lakh due to acceptance of invalid forms (C Forms).

(Paragraph 2.12.12.4)

- Non-levy of penalty of ₹ 35.45 lakh on mis-utilisation of the 'C' Forms on inter-State purchases.

(Paragraph 2.12.12.5)

- Incorrect claim of exemption from payment of tax of ₹ 8.40 lakh on forms issued by dealers whose registrations were cancelled.

(Paragraph 2.12.12.6)

- Incorrect allowance of concessional rate of tax of ₹ 83.48 lakh in the absence of declaration forms (C Forms).

(Paragraph 2.12.13)

2.12.1 Introduction

Under CST Act, registered dealers are eligible to avail certain concessions and exemptions of tax on inter-state transactions on submission of prescribed declarations in Forms 'C' and 'F'.

Under the provisions of 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 rates under the Act as applicable from time to time on his turnover, provided such sales are supported by declarations in form 'C'.

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. However, the Act provides for enquiries to be made by the AA necessary to satisfy himself on bonafides of the transfer such as sale and despatch particulars, way bills etc. If the dealer fails to furnish such declarations then, the movement of such goods shall be deemed to be local sales chargeable under the State VAT/ST Act.

2.12.2 Audit Objectives

The audit was taken up to assess whether

- there exists a system for printing, custody and issue of the declaration forms;
- concessions and exemptions were allowed by the AAs against valid/original, duly filled in and relevant declaration forms under the CST Act;
- there is a system of uploading the particulars in the TINXSYS[19] website and the data available therein is utilised for verifying the correctness of forms;
- appropriate steps are taken on detection of fake, invalid and defective (without proper or insufficient details) declaration forms;
- there exists an effective and adequate internal control mechanism; and
- there was an adequate monitoring and control mechanism, for preventing and detecting revenue leakage.

[19] Tax Information Exchange System (TINXSYS) is a centralized exchange of all interstate dealers spread across the various States and Union territories of India.

2.12.3 Audit Criteria

The audit objectives were benchmarked against the following audit criteria.

- The Central Sales Tax Act, 1956;
- The Central Sales Tax Rules, 1957;
- The Central Sales Tax (Andhra Pradesh Rules) 1956;
- The Central Sales Tax (Registration and Turnover) Rules 1957;
- The Andhra Pradesh General Sales Tax Act 1957; and
- Notifications and Orders issued by the Government of Andhra Pradesh from time to time.

2.12.4 Scope and Methodology of Audit

This Performance Audit covers cross verification of 'C' and 'F' forms in respect of assessments finalised by the Commercial Taxes Department during the years 2007-08 to 2009-10 where exemptions/concessions were granted under the CST Act. We audited 55 circles (25 *per cent* of total circles) and selected 'C' and 'F' forms, which were forwarded to our Accountant General offices in various states for cross verification to check the genuineness of the exemptions/ concessions claimed by the local dealer. Further, cases of short/non-levy of tax on inter-state transactions noticed during local audit are also included in the review.

2.12.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the co-operation of the Commercial Taxes Department in providing necessary information and records for audit. An entry conference was held in February 2011, during which the Department was appraised about the scope and methodology of audit. The report was forwarded to the Government in September 2011 and their reply is awaited.

2.12.6 Trend of Revenue under CST

The year wise budget estimates and actual realisation under CST Act for the period 2006-07 to 2010-11 is exhibited in the table below:

(₹ in crore)

Year	Budget estimates	Actual Receipts	Variation excess/short fall	Percentage of variation.
2006-07	1,390.50	1,244.41	(-) 146.09	(-) 10.51
2007-08	1,791.06	1,433.08	(-) 357.98	(-) 19.99
2008-09	2,167.18	1,255.19	(-) 911.99	(-) 42.08
2009-10	2,218.05	1,362.07	(-) 855.98	(-) 38.59
2010-11	2,218.30	1,701.61	(-) 516.69	(-) 23.29

As seen from the above, there is a variation between budget estimates and actuals ranging between (-) 10.51 *per cent* in 2006-07 to (-) 42.08 *per cent* in 2008-09 indicating that budget estimates were not realistic. Reasons for the variations have been called for from the Department. Reply is awaited (October 2011).

Audit findings

System deficiencies

2.12.7 Printing and custody of declaration forms

The Department, in pursuance of Government orders[20] gave the task of printing of statutory forms to private printers. Consequent on receipt of statutory forms from the printer, the same would be kept under the safe custody in the premises of CCT. We observed from the records relating to statutory forms that before entering into agreement with printer of the forms, the Department sends the specimen copy of the form to the technical officer Government Printing Press, Chanchalguda, Hyderabad to ensure that all the security features as evolved and indicated in the tender notification are duly incorporated in the statutory forms.

In this connection, we noticed that the Department did not have a system of sending the printed forms at periodic intervals to the said technical officer for ensuring that the suppliers had adhered to the norms as stipulated in the tender notification. In view of the above, there is a risk of the supplier deviating from the prescribed norms.

The Department in their reply (May 2011) did not furnish any specific explanation to the above observation.

2.12.8 Non-maintenance of database of concessions/exemptions

Under CST Act, 1956, registered dealers are eligible to certain concessions and exemptions of tax on inter State transactions on submission of prescribed declarations in Forms 'C' and 'F' and revenue is forgone in the process. A database of revenue forgone in concessions and exemptions is essential so that the Department could be vigilant on the commodities where the dealers prefer claims of concessions and exemptions in large number.

We noticed during audit that the Department did not maintain any database or any record to show year wise position of sales against C/F forms. In the absence of this crucial data, the Department could not quantify the amount of revenue forgone due to concessions and exemptions, nor was it possible for the Department or audit to carry out a systematic study of the trend analysis on revenue forgone. The Department's reply is awaited (October 2011)

[20] vide Memo no.33759/913 /BG/A1/9 dated.13.10.1998 (Finance & Planning).

2.12.9 Enforcement measures

2.12.9.1 Inter State (IST) Wing

The Inter-State Trade (IST) wing is headed by one Joint Commissioner who is assisted by one ACTO, one Superintendent, one Senior Assistant and one Junior Assistant. The duties of the wing are liaisoning with visiting teams from other States and sending teams from Andhra Pradesh to other states for cross verification of statutory forms. The selection of declaration forms for cross verification was done by the IST wing on the basis of evasion prone commodities.

We ascertained from the records of the IST wing that the Department, as a result of cross verification of declaration forms worth of ₹ 1437.26 crore, relating to consignment sales and inter-state sales, detected bogus forms worth of ₹ 319.94 crore involving tax effect of ₹ 31.99 crore.

We observed that the teams that are sent for cross verification of the forms comprise officials from the same circle to which the statutory forms relate to or from other circles. This practice of forming teams comprising officials from the same circles that received forms is fraught with the risk of conflict of interest.

In reply, the Department stated (January 2011) that its practice of sending teams from the same circle was followed due to the officer's familiarity with the dealers/transactions etc., and added that the suggestion of audit would be kept in view while deputing teams in future.

2.12.9.2 Absence of a system for blacklisting dealers utilising fake/ invalid declarations

We observed that the Department did not have a system for blacklisting the dealers who were found to be utilising the fake declaration forms in the past and consequently keeping such dealers under close watch and supervision.

We noticed that some dealers falling under the jurisdiction of Special Commodities Circle, Saroornagar Division and Hyderabad were submitting fake declaration forms from the year 2000-01 onwards. In this regard the Government issued orders[21] in respect of 12 vegetable oil dealers who submitted bogus 'F' forms for the transactions relating to the year 2000-01, to assess their bogus 'F' form turnover under APGST Act treating the transaction as local sales. Audit had pointed out during the verification of the records for the assessment years 2004-05, 2005-06 and 2006-07 that certain dealers were repeatedly filing bogus 'F' forms. A para (2.14) was also featured in the Audit Report (Revenue Receipts) for the year 2009-10 regarding fake 'F' forms. Out of the four dealers that featured in the para, the particulars of two[22] dealers who had submitted fake 'F' forms have been pointed out in Para 2.12.12.1 of this report. From this it is evident that there was no practice of blacklisting such dealers despite the inputs given by the audit.

---

[21] G.O.MS.No.456 dated 5 July 2004.

[22] M/s Shalimar Agro tech Private Limited and M/s Sheetal Refineries Private Limited.

The Department in their reply (January 2011) stated that there was a system of blacklisting the dealers utilising the fake declaration forms and such dealers are kept under close watch and supervision. The reply of the Department is not tenable as is evident from the above observations.

2.12.9.3 Non-existence of system of alerting other States in respect of dealers utilising fake forms

> As per the provisions of 10(1) to (7) of CST (AP) Rules, if any declaration in forms 'C' and 'F' is found lost, destroyed, stolen, by a dealer, it shall be reported to concerned authority for taking necessary action to declare such forms as invalid by giving wide publicity through issue of circulars to all divisions and other State Governments, including defective forms noticed by the Department.

We noticed that there was no system of alerting other States about dealers utilising fake forms.

The Department replied (July 2011) that the visiting team's verification exercise alerts the CT Departments of other States. It is suggested that a system may be adopted for fake forms as is prescribed for lost or destroyed or stolen forms and similar action for intimation to other Governments for publication in their gazettes may be taken by the Department in case of dealers who were found to be utilising fake forms.

2.12.10 Internal Control System

2.12.10.1 Absence of Internal audit

Internal audit is an important part of internal control mechanism for ensuring proper and effective functioning of a system for detection and prevention of control weaknesses. It also provides a reasonable assurance on enforcement of law, rules and Departmental instructions.

We observed that there was no system of internal audit for conducting periodical physical verification of statutory forms held by it so as to ensure that old, obsolete, defective or unused forms are either destroyed after obtaining the approval of the competent authority or otherwise secured by taking the same into their custody so as to obviate the possibility of their misuse. In reply, the Department stated (July 2011) that they did not have an Internal Audit wing. Reply in respect of non-conducting of periodical physical verification of stock of forms is awaited (October 2011).

2.12.10.2 Absence of information regarding security features of statutory forms of other States

The information regarding dealer details and details of statutory forms issued to the dealer were uploaded to the TINXSYS Server (intermediate Server) every day. Further it is ascertained that the Department was verifying declaration forms through TINXSYS in case of doubts while finalising the assessments under CST Act.

We also observed that the Department had no data/information regarding security features or the specimen copies of statutory forms of all the States either in the physical form or in the website of TINXSYS to have the knowledge of fake forms so as to initiate action on prima facie evidence regarding the doubtful forms.

When this was pointed out the Department replied (January 2011) that the CCT had addressed the CT Departments of other States in January 2011 to furnish the information/data regarding the security features of statutory forms (like C, F and H[23] forms) so as to communicate the same to the field officers and enable them to detect fake declaration forms.

2.12.11 Computerisation

2.12.11.1 Absence of Access controls

It is observed through discussions with the Departmental officers that the Department had neither formulated any password policy nor issued any instructions to the users to follow the guidelines released by the Government of Andhra Pradesh in May 2006 with respect to information security. Despite the fact that the software was being developed by the Commercial Taxes Department to provide online issue of forms through internet by the dealers, basic password control procedures like minimum length, unique user name and password, periodical compulsory change, limiting the consecutive unsuccessful attempts to login by the dealers etc., were not followed.

The Department replied (February 2011) that they were in the process of following all the security policies issued by the Government.

We noticed in CDSC[24] in CCT office and in eDSC[25] while conducting the audit of circle offices that while issuing the 'C' forms to the dealers the said package/software was not integrated to obtain information from different sources and to capture the commodities mentioned in the registration certificate to ensure that the dealer is purchasing the commodity for which he is registered. Due to this the very purpose of issuing forms online was defeated. Further, while issuing the forms the said package/software was unable to check the genuineness of the other end dealer from whom the dealer of AP had stated to have purchased the goods.

The Department replied (February 2011) that as the selling dealer belongs to other States, the validation could not be ensured.

Since the Department had not integrated the locally developed software/ package with other State Departments or with TINXSYS, the genuineness of the existence of the dealers of other States and verification of the commodities as per registration certificate could not be ensured.

---

[23] Form 'H' is used in the course of export sales.
[24] Central Dealer Service Centre.
[25] Electronic Dealers Service Centre.

2.12.11.2 Security Policy not implemented

In order to improve quality of service to the dealers the CTD has introduced the system of online issue of statutory forms post transactions on quarterly basis through CDSC located at office of the CCT (the dealers can obtain the forms online from CCT) and eDSC (divisional level) with effect from 17 January 2007.

Audit observed that the information security policy formulated by the Government of Andhra Pradesh and issued (May 2006) to all Government Departments and agencies was not followed. Though the CTD had embarked upon large-scale automation of their operations, they had not formulated any security policy in respect of online issue of statutory forms even after completion of four years. Absence of security features exposes the data to the threat of accidental or intentional errors which would lead to loss of data and its misuse.

Compliance deficiencies

The number of assessment records verified, declaration forms selected and sent for cross verification to other States and number of forms confirmed as fake are exhibited in the table below:

(₹ in crore)

Year	No. of circles covered	No. of assessment records verified	No. of forms sent for cross verification to other States	No. of forms found fake	Total Turnover involved in the forms	Total Tax effect
2007-08	55	1,426	235	51	12.39	1.24
2008-09	55	1,521	460	107	162.32	16.22
2009-10	55	1,578	661	18	66.20	6.57
Total	**55**	**4,525**	**1,356**	**176**	**240.91**	**24.03**

The lacuna in the control mechanism and weakness in monitoring system resulted in several irregularities leading to non/short levy of tax as illustrated in the succeeding paragraphs.

2.12.12 Utilisation of declaration forms

2.12.12.1 Evasion of tax by fraudulent utilisation of fake forms in support of branch/consignment transfers

As per the amended provisions made in the notification issued under section 8(5) of the CST Act, inter-state sales of goods supported by prescribed declaration forms i.e., 'Form C' are liable to tax at concessional rate of three *per cent* from 1 April 2007 and two *per cent* with effect from 1 June 2008 and sale of commodities falling under schedule IV to APVAT Act, which are not covered by 'C' forms are liable to tax at the rate of four *per cent.* Goods other than those specified in Schedules I, III, IV and VI and which fall under Schedule V to APVAT Act were to be taxed at standard rate as applicable from time to time and the same rate is applicable in case the transactions are not supported by 'C' forms. Tax on goods not covered by such declarations in case of declared goods shall be calculated at twice the rate applicable in the State.

As per Section 9(2A) of the CST Act read with Section 7A(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 16 of the APVAT Act, where a dealer issues or produces a false bill, voucher, declaration, certificate or other document with a view to support or make any claim that a transaction of sale or purchase effected by him or any other dealer, is not liable to tax or liable to be taxed at a reduced rate is guilty of an offence under section 55 of APVAT Act.

(i) We noticed from the check of records of assessments finalised during the period 2007-08 to 2009-10 that in two circles mentioned below, four dealers claimed exemption on their branch transfers/Consignment sales on the turnover of ₹ 12.44 crore for the year 2004-05 and a turnover of ₹ 227.01 crore for the years 2005-06 and 2006-07. In support of the claims, the dealers filed 'F' forms obtained from their respective branches/Agents located in other States. The concerned AAs finalised the assessments allowing the exemptions based on the declarations filed during the years 2007-08, 2008-09 and 2009-10.

Our cross verification of these forms with the records of the sales tax authorities of other States revealed that these forms were not issued to the purchasing dealers of the concerned States as confirmed by the Sales Tax authorities of that State. Thus prima facie, the concessional rate of CST allowed was irregular resulting in non-levy of tax of ₹ 23.94 crore.

(ii) We noticed that though the dealers as indicated in the table below had submitted fake forms and deliberately tried to evade tax, penalty leviable at three times the tax so assessed for the year 2004-05 and two times of the tax so assessed for the years 2005-06 and 2006-07 was not levied. This resulted in non-levy of penalty of ₹ 49.13 crore.

Details of tax not levied and penalty leviable thereof are given below:

(₹ in crore)

Sl. No.	Name of the circle	Name of the assessee/Asst. No. and Date	Commodity/ Schedule in APGST/ APVAT Act/Rate of tax %	Name of the State to which 'F' forms relate	Turnover involved / Rate of tax leviable	Non-levy of tax	Non-levy of penalty [26]	Total
1	Special Commodities Circle, Hyderabad	M/s Maheswari Oil Industries/ SAR /10/1/1066/2004-05 (CST), dt. 31 March 2008	Vegetable Oil /Entry 24A of Ist schedule of APGST Act/4	Maharashtra	1.29 10%	0.13	0.39	0.52
		M/s Shalimar Agro Tech.Pvt ltd./1719/2004-05 (CST) dt. 31 March 2008	Vegetable Oil /Entry 24A of Ist schedule of APGST Act 4	Maharashtra, Jharkhand	5.41 10%	0.54	1.62	2.16
		M/s Sheetal refineries/ SAR/10/1/1023/2004-05 (CST) dt.27 March 2008	Vegetable Oil /Entry 24A of Ist schedule of APGST Act/4	Gujarat West Bengal, Tamilnadu, Jharkhand, Chattisgarh,	5.74 10%	0.57	1.72	2.29
2	Special Commodities Circle, Hyderabad	M/s Shalimar Agro Tech. Pvt. Ltd.,/28760168173/05-06(CST), dt.5.12.08 /TIN No. 28760168173 /06-07(CST), dt.28 February 2009	Vegetable Oil /Item 67 of Schedule-IV of APVAT Act/4	Tamilnadu	13.05 10%	1.31	2.61	3.92
3	Special Commodities Circle, Hyderabad	M/s Sheetal refineries SAR/10/1/1023/2005-06(CST), dt. 16.8.2008 /TIN No 28680173252/06-07/CST, dt.13 March 2009	Vegetable Oil /Item 67 of Schedule-IV of APVAT Act/4	West Bengal, Tamilnadu, Jharkhand, Chhattisgarh, Maharashtra, Gujarat	6.81 10%	0.68	1.36	2.04
4	Vanasthali-puram, Hyderabad	M/s Sanghi Polysters Ltd., Asst.No.1092/2005-06 & 2006-07 (CST) dt. 23 March 2009 and dt.31 March 2010	Polyster yarn chips /Item 6 of Schedule-IV of APVAT Act/4	Gujarat	207.15 10%	20.71	41.43	62.14
	Total				**239.45**	**23.94**	**49.13**	**73.07**

[26] Non-levy of Penalty worked out three times under APGST Act for the year 2004-05 and two times under APVAT Act for the year from 2005-06.

2.12.12.2 Evasion of tax by fraudulent utilisation of fake forms in support of Inter State Sales

We noticed in five circles[27] that 14 dealers claimed concessional rate of tax on their inter-state sales amounting to ₹ 146.70 lakh for the years 2005-06 to 2007-08 producing 30 'C' forms issued by dealers/firms from various States. However, on cross verification of the same, it was informed by the CT Departments of other States that dealers on whose 'C' forms concessions were claimed by AP dealers were found to be either non-existent or these forms were not issued by them. Thus the Department needs to take action in these cases to levy tax and penalty of ₹ 8.65 lakh and ₹ 17.31 lakh respectively.

2.12.12.3 Grant of incorrect exemption due to acceptance of invalid forms (F-forms)

Branch/consignment transfers not supported by 'F' forms are liable to tax at rates applicable to inter State sales not covered by 'C' form. To claim exemption on branch transfers, dealers are required to furnish forms obtained from purchasing dealers with full details of goods transferred including quantity and value of goods at the time of transfer from the State concerned etc.

Further, as per provisions of CST Act, CST(R&T) Rules and CST (AP) Rules, a single declaration in form 'F' is sufficient to cover transfer of goods effected during the period of one calendar month to any other place of business or to an agent or principal as the case may be.

We noticed in 19 circles[28] and five LTUs[29] that in 27 cases where assessment was completed (between February 2008 and March 2010), exemptions on branch/ consignment transfers were allowed on 'F' forms covering transactions of more than one calendar month. The transactions of more than one month in these 'F' forms were liable to be rejected and attracted tax of ₹ 2.27 crore on these transactions valued at ₹ 25.07 crore.

After we pointed out the cases, the Department accepted (August 2011) the audit observations in two cases and intimated that assessment was revised in one case and action was initiated for revision in other case. In 14 cases the AAs replied (between January 2010 and February 2011) that notices would be issued/action would be taken to revise the assessments. In remaining cases it was replied (between January and August 2010) by the AAs that the matter would be examined.

---

[27] Adoni-I, Parchur, Rajampet, Special Commodities and Warangal (Beet bazaar).

[28] Beet Bazar. Gudivada, Guntur (Eluru bazaar and Kothapet), Hyderabad (Jeedimetla, Keesara, Khairatabad, Maharajgunj, Mehdipatnam, Musheerabad, Narayanaguda, Somajiguda), Jadcherla, Khammam-II, Proddatur-I and II, Sangareddy, Secunderabad (Malkajgiri) and Srikakulam.

[29] Ananthapur, Guntur, Hyderabad (Saroornagar) Secunderabad and Vizianagaram.

2.12.12.4 Grant of incorrect concessional rate of tax due to acceptance of invalid forms (C-forms)

According to Rule 12(1) of the CST Rules, every dealer should file a single declaration form covering all transactions of sale, which take place in a quarter of financial year with effect from1 October 2005.

As per Section 8(2)(a) of CST Act the rate of tax on sales in the course of interstate sales not covered by 'C' forms, in the case of declared goods shall be calculated at twice the rate applicable to the sale or purchase of such goods inside the appropriate state. Further according to Section 8(2)(b) of CST Act, the rates of tax in the case of goods other than declared goods not covered by 'C' form shall be calculated at the rate of 10 *per cent* or at the rate applicable to the sale or purchase of such goods inside the appropriate State, whichever is higher (upto 2006-07). From 2007-08 onwards according to Section 8(2) of CST Act, the rates of tax shall be calculated at the rate applicable to the sale or purchase of such goods inside the appropriate State under the sales tax law of that State.

We noticed in 20 circles[30] and two AC (LTUs)[31] that in respect of 35 cases, while finalising assessments between March 2008 and March 2010, concessional rate of tax was allowed on 'C' Forms covering transactions more than a quarter in a financial year. This resulted in short levy of tax of ₹ 43.19 lakh.

After we pointed out the cases, the Department stated (August 2011) that in 11 cases revision was under process. In seven other cases the AAs while accepting (between June 2009 and August 2010) the audit observations stated that the assessments would be revised. In remaining cases, the AAs stated (between August 2009 and March 2011) that the matter would be examined and action taken intimated to audit.

[30] Guntur (Lalapet, Main Bazaar), Hyderabad (Balanagar, Barkatpura, Begumpet, Bowenpally IDA-Gandhinagar, Keesara, Maharajgunj, Mehdipatnam, M.G.Road, Nampally, Somajiguda), Khammam-II, Nandyal-II, Peddapuram, Piduguralla, Secunderabad (Ranigunj), Visakhapatnam (China waltair) and Vizianagaram.

[31] Secunderabad and Vizianagaram.

2.12.12.5 Penalty leviable on mis-utilisation of 'C' forms on inter State purchases

A dealer registered under Section 7 of the CST Act who carried on business in inter-state under section 3 is eligible for purchase of any goods from the dealers outside the state. The selling dealer would get benefit of concessional rate of tax on sale of goods by providing C-form under section 8 (4) read with Rule 12 (1) of CST Act and (R&T) Rules given by the purchasing dealer.

As per section 8 (3) (b) of the CST Act, the goods purchased from outside the state shall be specified in the Registration certificate (Form B) of the purchaser and those goods shall be intended to be used in the events of (i) resale; (ii) for use in the manufacture or processing of goods for sale; (iii) to use in mining; (iv) for use in the generation or distribution of electricity or any other form of power; (v) for use in the packing of goods for sale/resale.

According to statutory provisions cited supra, the dealers who purchase goods from outside the State for any one of the purposes referred to above are eligible to issue C-form provided those goods shall be notified in their Registration Certificates.

Under Section 10A of the CST Act, 1956, penalty not exceeding one and half times is required to be levied if the dealer violates the provisions mentioned under section 8(3)(b) of CST Act. As per statute, if the goods which are purchased from the dealers of outside the state by issuing C-forms are not specified in the registration certificate, it is authorised to impose penalty under Section 10A for the said offence falling under section 10 (b) of the CST Act.

(i) We noticed (between September and December 2009) during the test check of the assessment files of two circles[32] that three dealers were eligible to purchase explosives, mining machinery, cement, copper wire, aluminum wire and insulation material in the course of inter-state trade as mentioned in the certificates of CST registration. We noticed that these dealers had purchased diesel oil, pressboards, brass rods, M S rounds, M S angles etc., which were not mentioned in their CST Registration Certificate and issued Form 'C'. Thus, the issue of Form 'C' for the purchase of commodity, which was not included in the certificate of registration, had resulted in mis-utilisation of 'C' Form. The Department should have cross linked and verified the commodities purchased in inter-state sales that were mentioned in the "Forms utilisation statement" submitted by the dealer with goods mentioned in the CST Registration Certificate. The penalty leviable in these cases works out to ₹ 31.82 lakh.

[32] Ananthapur-II and Fathenagar.

After we pointed out the cases, in two cases, the AA stated (September 2010) that the files would be submitted to the higher authority for taking up revision. In the remaining case it was stated that the matter would be examined.

(ii) We noticed (January 2011) during the audit of Suryabagh circle, that one dealer during the year 2008-09 purchased commodities 'Granites and Transformers' from outside the State on concessional rate by issuing 'C' forms. A scrutiny of CST registration certificate of the above dealer revealed that the dealer had registered for issuing forms for 'readymade garments and Jewellery'. It is evident from the above that the Department had issued 'C' forms to the dealer without duly verifying the commodities in his Registration Certificate. Thus, issuance of 'C' forms for the commodities which were not specified in the Registration Certificate of the dealer is irregular and attracts levy of penalty under section 10A. Penalty leviable in this case worked out to ₹ 3.63 lakh, which was not levied by the Department.

On this being pointed out, the Department accepted (January 2011) the audit observation and assured to issue notice to the dealer under intimation to audit.

2.12.12.6 Incorrect claim of exemption from tax on forms issued by dealers whose registrations were cancelled

As per the provisions of the CST Act and CST (AP) Rules, every registered dealer has to maintain registers with full details of his inter-state transactions furnishing all the details of inter-state sales, purchases and transfers of goods which should be made available to the AA as and when required to do so.

The AA is required to cross verify doubtful inter-state transactions. However, we did not find evidences of any such enquiries made for cross verification. One such case is illustrated below.

We noticed in Alcot gardens circle, that the dealer in connection with transit sale claimed exemption on 'C' forms issued by two dealers of Chennai valued at ₹ 83.99 lakh, for the transactions taken place during the period from January 2007 to March 2007. However, our cross verification of the 'C' forms with TINXSYS website revealed that registration of the purchasing dealers i.e. in Chennai had been cancelled on 1 January 2007 i.e., prior to the date of transactions and issue of 'C' forms. This resulted in allowing ineligible exemption on transit sales, with consequent non-levy of tax of ₹ 8.40 lakh.

On this being pointed out, it was replied (February 2011) that objection would be examined and action taken report intimated in due course. Reply is awaited (October 2011).

2.12.13 Incorrect allowance of concessional rate of tax in the absence of declaration forms (C Forms)

As per Section 8(2) of the CST Act read with Rule 12 of the CST (R&T) Rules, every dealer, who in the course of inter-state trade or commerce sells goods to a registered dealer located in other State shall be liable to pay tax under this Act at the rate of four *per cent* (three *per cent* with effect from 1 April 2007 and two *per cent* with effect from 1 June 2008), provided the sale is supported by declaration in form 'C'. Otherwise tax shall be calculated at double the rate in case of declared goods and at the rate of 10 *per cent* or at the rate applicable to sale of such goods within the State, whichever is higher in case of goods other than declared goods. With effect from 1 April 2007 respective State rate is applicable to all goods.

We noticed (between September 2009 and August 2010) during the test check of the assessment files of 17 circles[33] that in 26 cases inter-state sales valued at ₹ 37.96 crore were not supported by declaration in the prescribed 'C' Forms. The AAs while finalising the assessments between September 2007 and March 2010 for the years 2004-05 to 2008-09, levied tax at a concessional rate. This resulted in short levy of tax of ₹ 83.48 lakh.

After we pointed out the cases, the Department stated (August 2011) that assessments were revised in three cases and file was submitted for revision in one case. The AAs while accepting (between January 2009 and June 2010) the audit observations in five cases stated that assessments would be revised. In the remaining cases, the AAs replied that the matter would be examined.

2.12.14 Conclusion

The review revealed several deficiencies in the printing and custody of declaration forms and several compliance deficiencies in the acceptance of declaration forms governing inter-state sales. These included absence of a system for ascertaining the genuineness and correctness of declaration forms submitted by the dealers for claiming concessions and exemptions of tax on account of inter-state sales/stock transfers through cross verification of transactions from the States concerned, absence of a system for blacklisting dealers and absence of a reliable database of concessions and exemptions and the revenue foregone. The computerisation efforts in this area of Tax Administration revealed lack of security/access controls along with absence of security features thereby exposing the system to risk and misuse.

[33] Adoni-II, Chilakaluripeta, Hyderabad (Begum Bazaar, Jeedimetla, Jubilee Hills Khairatabad, Malakpet, Nampally, Vanasthalipuram, Vengalrao Nagar), Jadcherla, Kodad, Mahaboobnagar, Mahabubabad, Narsampet, Puttur and Tirupati-II.

2.12.15 Recommendations

It is recommended that the Government may

- ***prescribe norms for conducting periodical cross verification of inter-state transactions related to sales/purchases/branch transfers/ consignment transfers with original records maintained in other States and implement the same;***

- ***create a reliable database of the concessions and exemptions allowed to dealers by establishing a management information system to facilitate a systematic review and effective monitoring of the concessions and exemptions;***

- ***set up a system for blacklisting dealers found utilising fake/invalid declaration forms;***

- ***implement all aspects of the access controls and information security policy so as to enable effective functioning of online issue of statutory forms;***

- ***provide commodity validation in the software i.e., the form should be given for the commodity for which the dealer is registered in the registration certificate (Software should be integrated with CST Registration Certificate). Ensure the dealer validation of other states (through TINXSYS) from whom the local dealer purchases the goods;***

- ***keep a specimen copy in the TINXSYS website duly mentioning/ displaying the security features of the forms of all the States for taking action on prima facie evidence; and***

- ***continue with the system of physical cross verification of declaration forms parallel to the web based checking until the electronic system of other States becomes fully operational.***

2.13 Audit observations on Returns/Assessments

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.

2.14 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, ITC claimed therein and full payment of tax payable for such tax period.

We noticed (between July 2009 and November 2010) during the test check of monthly returns in 14 circles[34] that during the period from April 2005 to March 2010, 21 dealers declared VAT of ₹ 29.12 lakh instead of ₹ 102.04 lakh on the turnovers relating to cement poles, electrical goods, motor transformers, insulators, paints, stone ballast, etc., due to application of incorrect rate. This resulted in under declaration of VAT of ₹ 72.92 lakh as detailed below:

(₹ in lakh)

Name of the circle/year of assessment	Commodity / item No./ Schedule	Rate applicable/ applied (%)	Tax leviable/ levied	Short levy of tax	Observation
Guntakal 2009-10	Electrical stamping Lamination Schedule V	12.5/ 4	6.13/ 1.96	4.17	Under the APVAT Act electrical stamping and lamination are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 4.17 lakh. AA stated (September 2010) that matter would be examined.

[34] Bheemunivaripalem, Guntakal, Hindupur, Hyderabad (Keesara, Malakpet, Vanasthalipuram), Kurnool-I, Mangalagiri, Nandyal-I, Peddapuram, Rajam, Seetharamapuram, Tirupati and Vizianagaram (East).

(₹ in lakh)

Name of the circle/year of assessment	Commodity / item No./ Schedule	Rate applicable/ applied (%)	Tax leviable/ levied	Short levy of tax	Observation
Hindupur 2009-10	Laminated photos Schedule V	12.5/ 4	0.79/ 0.24	0.55	Under the APVAT Act laminated photos are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 0.55 lakh. AA stated (May 2010) that matter would be examined
Keesara (Hyderabad) 2009-10	Weigh bridges Schedule V	12.5/ 4	1.20/ 0.38	0.82	Under the APVAT Act Weigh bridges are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 0.82 lakh. AA stated (June 2010) that assessment file is under process of VAT audit and result would be intimated.
Malakpet (Hyderabad) 2006-07	Poultry cages Schedule V	12.5/ 4	47.59/ 15.23	32.36	Under the APVAT Act Poultry cages are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 32.36 lakh. The AA stated (July 2010) that matter would be examined.
Vanasthali-puram (Hyderabad) 2008-09	Electrical goods Entry 39 of Schedule IV	4/2	1.69/ 0.85	0.84	Under entry 39 of Schedule IV, electrical goods are taxable at the rate of four *per cent*. The AA incorrectly levied tax at the rate of two *per cent*. This resulted in short levy of tax of ₹ 0.84 lakh. The AA stated (January 2010) that matter would be examined
Mangalagiri 2009-10 Vanasthali - puram 2008-09	Empty bottles entry 90 of Schedule IV	4/nil	4.94/ nil	4.94	Under entry 90 of Schedule IV, empty bottles are taxable at the rate of four *per cent*. In two cases, the AAs incorrectly exempted the sale turnover of empty bottles. This resulted in non-levy of tax of ₹ 4.94 lakh. The AAs stated (between January and May 2010) that matter would be examined.
Kurnool-I 2005-06	Oxygen gas Schedule V upto 30.4.2006 (12.5%) thereafter under entry 100 of Schedule IV (4%).	12.5 /4	1.67/ 0.53	1.14	Under the APVAT Act oxygen gas was taxable at the rate of 12.5 *per cent* upto 30 April 2006. The AA incorrectly levied tax at the rate of four *per cent*, This resulted in short levy of tax of ₹ 1.14 lakh. The AA stated (August 2009) that the assessment file would be submitted to DC (CT) Kurnool along with audit objection for revision.

(₹ in lakh)

Name of the circle/year of assessment	Commodity / item No./ Schedule	Rate applicable/ applied (%)	Tax leviable/ levied	Short levy of tax	Observation
Nandyal 2008-09 & 2009-10	Recharge cards Schedule V	12.5/ nil	4.74/ nil	4.74	Under the APVAT Act recharge cards are taxable at the rate of 12.5 *per cent*. In two cases, the AA incorrectly exempted the sale turnover of recharge cards. This resulted in non-levy of tax of ₹ 4.74 lakh. In one case, the AA stated (November 2010) that notice was issued and in another case, it was stated (July 2009) that matter would be examined.
Peddapuram 2008-09	Tri cycles entry 13 of Schedule IV	4/nil	1.16/ nil	1.16	Tricycles are taxable at the rate of four *per cent* under entry 13 of schedule IV of the APVAT Act. The AA incorrectly exempted the sale turnover of tricycles. This resulted in non-levy of tax of ₹ 1.16 lakh. The AA stated (July 2009) that the matter would be examined.
Seetharama puram 2009-10	Paints (Red oxide)	12.5/4	1.11/ 0.35	0.76	Under the APVAT Act, Paints (Red oxide) are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 0.76 lakh. The AA stated (June 2010) that as per G.O.Ms.No.381, Revenue dt. 9-4-86, Red oxide was eligible for concessional rate of tax @ 4% as confirmed by the APSTAT in the case M/s Dogra Colour Industries Vs. State of AP (1998 27APSTJ36), which was not repealed in the APVAT Act. The reply is not acceptable as there was no separate entry under Schedule IV of the APVAT Act for red oxide and hence application of 12.5 *per cent* tax was in order.
Tirupati-II 2009-10	Motor transformers Schedule V of APVAT Act	12.5/4	4.59/ 1.47	3.12	Under the APVAT Act Motor transformers are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 3.12 lakh. The AA replied (August 2010) that matter would be examined and detailed reply would be sent to audit in due course.

(₹ in lakh)

Name of the circle/year of assessment	Commodity / item No./ Schedule	Rate applicable/ applied (%)	Tax leviable/ levied	Short levy of tax	Observation
AO(DCTO)ICP Bheemunivari palem 2008-09	Boiler components Schedule V	12.5/4	6.24/ 2.00	4.24	Under the APVAT Act colour TVs, Insulators, washing machines, Machinery etc., are taxable at the rate of 12.5 *per cent* and four *per cent*. The AA incorrectly levied tax at the rate of four *per cent* and lesser than four *per cent*. This resulted in short levy of tax of ₹ 8.13 lakh. The AA replied (February 2010) that the assessments would be revised and intimated to audit.
	Colour TVs Schedule V	12.5/4	1.34/ 0.43	0.91	
	Insulators Schedule V	12.5/4	1.03/ 0.33	0.70	
	Tyres and Tubes Schedule V	12.5/4	1.13/ 0.36	0.77	
	Washing Machines Schedule V	12.5/1.6	1.34/ 0.17	1.17	
	Machinery Schedule IV	4/0.35	0.37/ 0.03	0.34	
Rajam 2008-09 2009-10	Cement poles Schedule V of APVAT Act @ 12.5%	12.5/4	12.27/ 3.92	8.35	Under the APVAT Act cement poles are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 8.35 lakh. The AA stated (November 2010) that matter would be examined.
Vizianagaram (East) 2005-06	Stone Ballast Schedule V of APVAT Act @ 12.5%	12.5/4	2.71/ 0.87	1.84	Under the APVAT Act stone ballast are taxable at the rate of 12.5 *per cent*. The AA incorrectly levied tax at the rate of four *per cent*. This resulted in short levy of tax of ₹ 1.84 lakh. The AA stated (August 2010) that matter would be examined.
	Total		**102.04/ 29.12**	**72.92**	

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

2.15 Excess claim of input tax credit

In terms of Section 13(5) of the APVAT Act, no Input Tax Credit (ITC) shall be allowed on sale of exempted goods (except in the course of export), exempt sales and transfer of exempted goods outside the State otherwise than by way of sale. As per Section 13(6), ITC for transfer of taxable goods outside the State otherwise than by way of sale shall be allowed for the amount of tax in excess of four *per cent*.

As per sub-rules (7), (8), (9) of Rule 20 of APVAT Rules, a VAT dealer making taxable sales, exempted sales and exempt transactions of taxable goods shall restrict his ITC as per the formula prescribed i.e., A x B/C, where A is the input tax for common inputs for each tax rate, B is the taxable turnover and C is the total turnover.

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 claimed.

2.15.1 We noticed (between December 2009 and December 2010) during the test check of monthly returns in three LTUs[35] and 14 circles[36] that for the period from April 2005 to March 2010, in 19 cases, the sale transactions of the dealers involved taxable sales, exempt sales and exempt transactions. These exempt sales and exempt transactions were on account of sale of exempted goods (Schedule–I) and consignment sales/branch transfers respectively. We saw that the returns had not been scrutinised as mandated under the Act and resultantly the input tax was not restricted as per the formula prescribed. This resulted in excess claim of ITC of ₹ 5.91 crore.

After we pointed out the cases, the Department stated (August 2011) that assessment was revised in one case and orders would be passed in another case. The AAs replied (between March and November 2010) that show cause notices were issued/would be issued in four cases. In another case, the AA stated (May 2010) that ITC was restricted in Departmental audit upto July 2009. The reply is not acceptable as the objection relates to the period from August 2009 to March 2010. In another case, the AA contended (July 2010) that ITC would be restricted at the time of audit of accounts of the assessee. The reply is not acceptable as returns are to be scrutinised as per Section 20(3)

[35] Chittoor, Hyderabad (Begumpet) and Nellore.
[36] Adoni-II, Hyderabad (Ferozguda, IDA Gandhinagar, Keesara, Vidyanagar), Sangareddy, Secunderabad (Marredpally, SD Road), Special Commodities Circle, Tenali (Gandhi Chowk), Vijayawada (M.T Street), Visakhapatnam (Dwarakanagar, Gajuwaka, Kurupam Market).

of the Act. In the remaining cases, final replies have not been received (October 2011).

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

2.15.2 Incorrect claim of input tax credit on ineligible items

According to Section 13(1) of the APVAT Act, ITC shall 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 are for use in the business of the VAT dealer. As per Section 13(4) of the APVAT Act, read with Rule 20(2)(q) with effect from 1 May 2009, an assessee is not entitled to claim ITC on furnace oil. Further, as per Rule 20(2)(i), any input used in construction or maintenance of any buildings including factory or office buildings, is not eligible for ITC unless the dealer is in the business of executing works contracts and has not opted for composition.

We noticed (between August 2009 and August 2010) during test check of monthly returns/audit assessments in eight circles[37] that during the period from 2007-08 to 2009-10 in nine cases, the dealers who were not works contractors had claimed ITC of ₹ 31.11 lakh on purchase of cement, steel, electrical material, paints, furnace oil etc. These dealers used the above goods in construction of office and factory buildings or in the furnaces or boilers of their factories, processing units etc., and thus they are not eligible for ITC. This resulted in excess claim of ITC of ₹ 31.11 lakh.

After we pointed out the cases, in one case, the AA stated (September 2009) that the excess input tax would be restricted. In another case, the Commissioner contended (September 2011) that the dealer produced documentary evidence for ITC for the period from May 2009 to March 2010 and the dealers had purchased butter. The reply is not acceptable as the assessee is eligible to claim ITC at four *per cent* only if he had purchased butter, whereas the dealer had claimed ITC of 12.5 *per cent* on furnace oil in addition to four *per cent* ITC on butter. In another case, the AA contended (March 2010) that the audit was conducted as per the provisions of the Act duly allowing the ITC claim. The reply of the Department is not acceptable as the material used for construction and maintenance of any building including factory or office building is not eligible as per the APVAT Rules. In the remaining cases, the AAs stated that the matter would be examined.

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

[37] Gudur, Hyderabad (Nampally, Special Commodities Circle, Srinagar Colony), Nandyal-II, Rajahmundry (Aryapuram, Alcot Gardens) and Visakhapatnam (Gajuwaka).

2.16 Short levy of interest on belated payments of Sales Tax deferment

According to 'Target 2000 sales tax incentive scheme' promulgated by the Government in 1996, sales tax incentive of deferment of tax is available for the products manufactured by the industrial units to the extent of incentive limit as mentioned in the Final Eligibility Certificate (FEC).

After the introduction of the APVAT Act, 2005 with effect from 1 April 2005, sales tax holiday/ exemption incentives sanctioned to industrial units were converted into sales tax deferment with the remaining period of availment being doubled without change in monetary limit of the incentive sanctioned. Further as per G.O.Ms.No.503 dated 8 May 2009, repayment of deferred sales tax shall commence after the end of the period of availment. In case of non-remittance of deferred tax on the due dates, interest at the rate of 21.5 *per cent* per annum is liable for payment.

We noticed (February 2011) during the test check of the monthly returns of AC (LTU) Secunderabad that in case of one industrial unit, deferment period had been completed and the instalment of tax deferred had become due for payment in February/ March 2010 against which the payment was made in October and November 2010 respectively. For the delay of eight months in payment of instalments of deferred tax of ₹ 68.92 lakh, the AA levied interest of ₹ 0.85 lakh instead of ₹ 9.88 lakh resulting in short levy of interest of ₹ 9.03 lakh.

After we pointed out the case, the AA stated that show cause notice would be issued to the dealer.

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

2.17 Under declaration of VAT due to incorrect exemption

Bio-fertilisers and surgical implants are taxable at four *per cent* under respective entries 19/111 of schedule IV to the APVAT Act. Recharge coupons, SIM cards, ice cream, kova are not specified in I to IV and VI schedules to the APVAT Act and hence these goods fall under schedule V and are liable to VAT at the rate 12.5 *per cent* with effect from 1 April 2005 and at the rate of 14.5 *per cent* with effect from 15 January 2011.

We noticed (between July 2009 and November 2010) during the test check of monthly returns in 10 circles[38] from the VAT returns for the period from July 2006 to March 2010 that 11 dealers had

[38] Ananthapur, Bhongir, Hyderabad (Agapura, Nacharam), Jagitial, Machilipatnam, Narasaraopet, Puttur, Suryaraopet and Vijayawada (Marwadi Temple Street).

incorrectly declared the sale turnover of ₹ 4.46 crore relating to 'bio-fertilisers, recharge coupons, surgical implants, SIM cards, ice cream, kova' etc., as exempted turnover. The reasons for exempting the turnover were not forthcoming from the returns/other records made available to audit. The incorrect exemption of taxable turnover resulted in under declaration of tax of ₹ 27.40 lakh. This was not detected by the Department, as they did not scrutinise the returns.

After we pointed out the cases, the AAs stated (between July 2009 and November 2010) that the issue has to be verified by audit in one case; the matter is pending before the Hon'ble High Court of AP for adjudication in one case and the assessment file was submitted to DC (CT) concerned for verification in one case. In the remaining cases, the AAs stated that the matter would be examined.

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

2.18 Non-declaration of tax on industrial inputs

According to Section 4(4) of the AP VAT Act, every VAT dealer, who in the course of his business, purchases any taxable goods from a person or dealer not registered as a VAT dealer or from a VAT dealer in circumstances in which no tax is payable by the selling dealer, shall be liable to pay tax at the rate of four *per cent* on the purchase price of such goods, if after such purchase, the goods are used as inputs for goods which are exempt from tax under the Act.

Sale of electricity is exempted from levy of tax under the APVAT Act.

We noticed (between September and October 2009) during the test check of the returns of CTO-Mangalagiri that the dealer purchased taxable goods i.e., biomass waste and chemicals from an unregistered dealer and utilised them in the process of generation of electricity. However, the tax on purchase of biomass waste and chemicals was not declared and paid as prescribed in Section 4(4). This resulted in non-declaration of purchase tax of ₹ 16.70 lakh on a turnover of ₹ 4.18 crore at the rate of four *per cent*.

After we pointed out the case, the AA stated that the assessee purchased chemicals from local dealers and out of state dealers and had shown the turnovers as exempted purchases. The reply is not acceptable, as it is evident from the return/statement of purchases furnished by the dealer that he purchased biomass waste and chemicals from unregistered dealers without payment of tax. Hence he is liable to pay tax on the purchase turnover under section 4(4).

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

2.19 Non-payment of VAT by Rice Millers

As per Section 2(7) of the APVAT Act, a casual trader means a person who whether as principal, agent or in any other capacity, carries on occasional transactions of a business nature involving the buying, selling or distribution of goods in the State, whether for cash or for deferred payment, or for commission, remuneration or other valuable consideration. The definition of 'Dealer' as defined under section 2(8) of the Act also includes a casual trader and is liable for payment of tax on every sale of goods in the State at the scheduled rates applicable to goods. The commodity 'Rice' is taxable at four *per cent* under entry 85 of Schedule-IV to the Act.

According to the orders of Government of Andhra Pradesh issued in 1983, the Yanam rice millers of Union Territory of Puducherry were permitted to purchase paddy in AP and sell the levy rice to Food Corporation of India (FCI), Andhra Pradesh (AP) region and to effect free market sale at a percentage as determined in the levy policy, on par with the rice millers of AP. The Government of AP thereby treated the Yanam rice millers on par with the rice millers in AP for all practical purposes. Thus the millers of Yanam have been purchasing paddy in AP and selling the resultant milled rice in AP by supplying to FCI and also effecting sale in open market. In accordance with the levy policy, the FCI has been making payment for levy rice procured by them from rice millers of Yanam for levy rice purchases made within the State of AP inclusive of the element of VAT. Therefore, the traders of Yanam are liable to pay tax as 'casual trader' on their sale of rice to FCI in AP State.

We noticed from the cross verification (May 2011) of the information received from the FCI, AP region (February 2011) with the records of DC (CT) Kakinada that during the period from 2005-06 to 2009-10, 11 millers of Yanam sold rice valued at ₹ 253.26 crore to FCI, A.P. region. Though the cost of rice procured by the FCI was inclusive of VAT, the millers did not remit the tax to the Government of AP though collected by them. Irregular retention of the VAT on the turnover of ₹ 253.26 crore worked out to ₹ 10.13 crore. Besides, penalty was also leviable.

After we pointed out the cases (May 2011), the Department issued (June 2011) notices of assessment to the millers for payment of VAT.

We referred the matter to the Department and Government (October 2011); their reply is awaited.

2.20 Under declaration of tax on "loose liquor" under the APVAT Act

Under Section 4(9) of the APVAT Act, with effect from 24 November 2005, not withstanding anything contained in the Act, every 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 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. Thus with effect from 24 November 2005, loose liquor served in bars and restaurants is taxable under Section 4(9).

From 1 May 2009, every dealer being a star hotel having a status of three star and above and other dealers whose annual total turnover is ₹ 1.50 crore or above shall pay tax at the rate of 12.5 *per cent* on taxable turnover. Further, every dealer being a hotel whose star rating is less than three star and other dealers whose annual total turnover is less than ₹ 1.50 crore shall pay tax at the rate of four *per cent* on the taxable turnover and they are not eligible for Input Tax Credit (ITC).

The High Court of Andhra Pradesh held {M/s Manasa enterprises Vs CTO Nacharam (49STJ 2009)} that 'loose liquor' served in bars and restaurants fall under Section 4(9) of the APVAT Act, and it is different from 'liquor bottled and packed' falling under item 1 of Schedule VI which is not liable to tax at second and subsequent points. The Commissioner of Commercial Taxes issued a circular No. 1-111(4) 537/2010 dated 25 January 2010 to levy tax on sale of loose liquor in Bar and Restaurants with effect from 24 November 2005 and the same was kept in abeyance by another circular dated 22 February 2010.

2.20.1 We noticed (between April and December 2010) during the test check of the returns of 43 circles[39] that in 96 cases, the sale of loose liquor was shown as exempt sale by the dealers in the VAT returns filed by them for the period from December 2005 to March 2010. The AAs did not enforce the

[39] AC(LTU) Visakhapatnam, Bodhan, East Godavari (Kakinada, Ramachandrapuram) Eluru, Guntur (Lalapet), Hyderabad (Ashok nagar, Basheerbagh, Barkatpura, Begumpet, Ferozguda, Gowliguda, IDA Gandhinagar, Jubilee hills, Keesara, Madhapur, Malakpet, Mehdipatnam, Musheerabad, Narayanaguda, Punjagutta, Saroornagar, Somajiguda, Vengalraonagar, Vidyanagar), Jagitial, Karimnagar, Kamareddy, Mangalagiri, Nalgonda, Nizamabad-II, Nellore-II, Ongole, Puttur, Secunderabad (General Bazaar, Marredpally, SD Road), Tirupati-I, Vijayawada (Benz circle, Krishna Lanka), Visakhapatnam (Dwarakanagar), Vizianagaram (East) and Warangal (Ramannapet).

amended provisions of the Act with effect from 24 November 2005 and they did not raise the demand by levying tax as per Section 4(9). The Department should have ensured the implementation of the amended provisions of the Act from the effective date. Further, the orders of the CCT of February 2010 keeping the amended provisions of the Act in abeyance appears to be without the requisite authority to do so. This resulted in under declaration of VAT of ₹ 19.67 crore on a taxable turnover of ₹ 207.04 crore.

After we pointed out the cases, the Department accepted (November 2010) the audit view and stated that an amendment to the Act is under consideration keeping the commodity "loose liquor" outside the purview of the VAT.

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

2.20.2 We noticed (between March and October 2010) during the test check of the monthly returns of four circles[40] that in six cases, the dealers i.e. hoteliers/caterers etc., had computed their taxable turnover during May 2009 to March 2010 as ₹ 10.91 crore instead of ₹ 15.80 crore by claiming 40 *per cent* exemption which was not applicable from May 2009 onwards. In another case, pertaining to CTO, Kurupam Market, the dealer declared tax at four *per cent* on his taxable turnover of ₹ 44.48 lakh instead of declaring tax at 12.5 *per cent* on 60 *per cent* of the taxable turnover during the period April 2008 to March 2009. This resulted in overall under declaration of tax of ₹ 62.71 lakh.

After we pointed out the cases, the AAs stated (between March and November 2010) that in four cases show cause notices were issued. In the remaining three cases, the AAs stated that the matter would be examined.

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

2.21 Non-levy of interest

According to Section 22(2) of the APVAT Act, if any dealer fails to pay the tax due on the basis of monthly return submitted by him under the Act, within the time prescribed he shall pay, in addition to the amount of such tax, interest calculated at the rate of one *per cent* per month for the period of delay from such prescribed date for its payment.

We noticed (July 2010) during the test check of the assessment files of Somajiguda circle that in one case, the accounts of the dealer for the years 2006-07 to 2009-10 were examined by the AA in February 2010 and it was found that there was an under declared tax of ₹ 26.57 lakh. The same was collected in March 2010. The AA did not levy interest of ₹ 5.01 lakh for the delay in payment of tax.

[40] Hyderabad (Begumpet, Mehdipatnam, Nampally and Somajiguda).

After we pointed out the case, the AA stated that the matter would be examined.

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

2.22 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 preceding 12 months exceeds ₹ 40 lakh up to 30 April 2009 shall be liable to be registered as VAT dealer. From 1 May 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 (between May 2009 and May 2010) during the test check of monthly returns in the 18 circles[41] that though the turnovers of 44 TOT dealers exceeded ₹ 10 lakh in preceding three month period between July 2005 and 30 March 2009, the AAs did not convert these dealers into VAT dealers. The turnovers that exceeded the threshold limits in these cases worked out to ₹ 15.03 crore on which VAT was leviable by registering these dealers as VAT dealers. Thus the dealers were liable to pay VAT of ₹ 1.06 crore on this turnover. The dealers had not applied for registration nor were they registered by the AAs. This resulted in short realisation of revenue of ₹ 1.06 crore towards VAT. Besides penalty of ₹ 26.54 lakh was also leviable. We noticed that in absence of a monitoring mechanism in the Department to watch the registration of the TOT dealers who may have crossed the threshold limit for registration as dealers under the APVAT Act, the dealer continued business without being registered with the Department.

After we pointed out the cases, the Department/AAs stated (between May 2009 and August 2011) that show cause notices were issued/would be issued to the dealers in 12 cases. In respect of five other cases, the AAs stated (November 2009 and March 2010) that action would be initiated to collect the tax due. In another case, the Department stated (August 2011) that the case was pending with the Joint Commissioner (Legal) for review and that final outcome of the case was awaited. In another case, the AA contended that the turnover for quarter ended June 2008 exceeded ₹ 10 lakh and not ₹ 40 lakh

[41] Anantapur-II, Bhongir, Hyderabad (Basheerbagh, Fathenagar, Hyderguda, Malakpet, Nizamshahi Road), Khammam-II, Kadapa (Rajam), Narasaraopet, Paravathipuram, Peddapuram, Secunderabad (General Bazaar), Srikakulam, Warangal (Narasampet), West Godavari (Palakol), Visakhapatnam (Dwarakanagar and Kurupam Market).

and hence the dealer is registered as VAT dealer with effect from 1 April 2009. The reply is not acceptable as the dealer was liable to be registered as VAT dealer from 1 August 2008 since his turnover had exceeded ₹ 10 lakh in the preceding three months period. In another case, the AA contended that the turnover of the dealer has not exceeded ₹ 40 lakh during the period 2007-08. The reply is not acceptable in view of the fact that though the turnover in the 12 preceding months had not exceeded ₹ 40 lakh, it exceeded ₹ 10 lakh in January 2008 for the preceding three months period of October 2007 to December 2007. Hence, the dealer was liable for VAT registration. In the remaining cases, the AAs stated that the matter would be examined.

The Government may consider putting in place a mechanism for prompt identification of the TOT dealers who have crossed the threshold limit and their registration as VAT dealers.

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

2.23 Non-levy of penalty

Under Section 53(1) of the APVAT Act, where any dealer has under declared tax, and where it has not been established that fraud or wilful neglect has been committed and where the under declared tax is (i) less than 10 *per cent* of the tax, a penalty shall be imposed at 10 *per cent* of such under declared tax (ii) more than 10 *per cent* of the tax, a penalty shall be imposed at 25 *per cent* of such under declared tax. Further, under Section 53(3) of the APVAT Act, any dealer who has under declared tax and where it is established that fraud or wilful neglect has been committed, he shall be liable to pay penalty equal to the tax under declared. Further, under Section 51 of the APVAT Act, where a dealer who fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, he shall be liable to pay tax and a penalty of 10 *per cent* of the amount of tax due.

According to Section 57(4), if any person collects tax in excess of the amount of tax due, any sum so collected shall be forfeited to the Government and in addition he shall be liable to pay a penalty of an amount equal to the amount of tax so collected. Further, under Section 55(2) of the APVAT 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.

We noticed (between May 2009 and August 2010) during the test check of 14[42] circles that the accounts of 16 VAT dealers for the period from April 2005 to March 2010 were examined by the departmental officers and under declared tax of ₹ 1.30 crore was assessed on account of excess claim of input tax, suppression of turnover, false tax invoice, excess collection of taxes from the purchasers etc. The AAs however did not levy the penalty of ₹ 46.90 lakh on the under declared tax. Further, in two cases, the dealers failed to pay monthly tax within the time prescribed for its payment. But the AAs did not levy

[42] Guntur (Patnam Bazaar), Hyderabad (Afzalgunj, Nampally, Ramgopalpet, Somajiguda, Srinagar colony), Karimnagar-II, Nellore-I, Rajahmundry (Aryapuram), Rajahmundry, Siddipet, Secunderabad (Mahankali Street) and Visakhapatnam (Dwarakanagar, Kurupam Market).

penalty of ₹ 8.89 lakh for belated payment as shown in the following table:

(₹ in lakh)

<table>
<tr><th>Sl. No.</th><th>Name of the Circle</th><th>Audit observation</th><th>Under decal-red Tax/</th><th>Penalty leviable /levied</th><th>Non/short levy of penalty</th></tr>
<tr><td>1</td><td>Six Circles[43]</td><td>The Departmental officers examined the accounts of eight dealers and detected under declared tax on account of incorrect computation of turnover, excess claim of ITC etc., where the offence is not wilful under Section 53(1) of the APVAT Act. The penalty leviable at 25%/10% of the under declared tax was either not levied or levied short by the AAs.</td><td>106.73</td><td>26.68/
4.59</td><td>22.09</td></tr>
<tr><td colspan="6">In one case the AA (Srinagar Colony circle) contended that it had not been established that under declaration of tax was due to fraud or wilful neglect. The reply is not acceptable as the dealer claimed excess input tax credit, which resulted in under declaration of tax that was detected by the AA. Levy of penalty is mandatory under the provisions of Section 53(1) of the APVAT Act in case of under declaration of tax, whether the under declaration is wilful or not. Hence penalty at 25 per cent is leviable in this case under Section 53(1). In the remaining six cases the AAs stated that the matter would be examined and report furnished to audit.</td></tr>
<tr><td>2</td><td>Six Circles[44]</td><td>The Departmental officers examined the accounts of six dealers and detected under declared tax on account of suppression of turnover, non-accountal of sales etc. Where the offence is wilful by the dealers under Section 53(3) of the Act, the penalty leviable is 100% of the under declared tax. This penalty was either not levied or short levied by the AAs.</td><td>23.19</td><td>23.19/
5.37</td><td>17.82</td></tr>
<tr><td colspan="6">The AA (Patnam Bazaar) accepted the observation involving ₹ 0.72 lakh in one case and stated that penalty of ₹ 0.72 lakh was levied. In the remaining five cases, the AAs stated that the matter would be examined.</td></tr>
</table>

[43] Karimnagar-I, Nampally, Nellore-I, R.G.Pet, Somajiguda, and Srinagar Colony.
[44] Afzalgunj, Aryapuram, Dwarakanagar, Patnam Bazar, Rajahmundry and Somajiguda.

(₹ in lakh)

<table>
<tr><th>Sl. No.</th><th>Name of the Circle</th><th>Audit observation</th><th>Under decal-red Tax/</th><th>Penalty leviable /levied</th><th>Non/short levy of penalty</th></tr>
<tr><td>3</td><td>Two Circles[45]</td><td>We saw that two dealers failed to pay tax of ₹ 88.93 lakh due on the monthly returns submitted by them on the dates prescribed for payment, and they paid the same with a delay of 11 days to 68 days. The AAs did not levy penalty of 10 per cent of the amount of tax due under Section 51(1) of the Act, for belated payment of tax due.</td><td>88.93 (Tax due)</td><td>8.89/ NIL</td><td>8.89</td></tr>
<tr><td colspan="6">In one case, the AA stated (March 2010) that the penalty would be collected after verification and in another case, it was stated that the matter would be examined.</td></tr>
<tr><td>4</td><td>Srinagar Colony</td><td>The dealer collected excess tax of ₹ 8.15 lakh from the purchasers in contravention of the provisions of the Act. We saw that the AAs levied penalty of ₹ 2.06 lakh equal to 25 per cent of the tax under Section 53(1) instead of penalty leviable under Section 57(4) of the Act.</td><td>8.15 (Excess collecti-on of tax)</td><td>8.15/ 2.06</td><td>6.09</td></tr>
<tr><td colspan="6">The AA stated that penalty was levied at the rate of 25 per cent, as there was no wilful mistake to evade tax. The reply is not acceptable, as the dealer had collected tax at the rate of 12.5 per cent not contemplated in the Act and had remitted only four per cent tax to the Government, which amounts to wilful act of evasion and excess collection of tax for which penalty contemplated is under section 57(4) of the Act.</td></tr>
<tr><td>5</td><td>Mahankali Street</td><td>The AA detected the false purchase invoices from the dealer, who wilfully claimed ITC on their basis. The AA levied penalty equal to 25 per cent of tax shown on the false invoice instead of 200 per cent applicable in terms of Section 55(2) of the Act.</td><td>0.52</td><td>1.03/ 0.13</td><td>0.90</td></tr>
<tr><td colspan="6">Department replied (August 2011) that demand was raised and collection was under process.</td></tr>
</table>

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

[45] Visakhapatnam (Kurupam Market) and Siddipet.

2.24 Incorrect exemption on invalid declarations

As per Rule 10(b), read with proviso under Rule 12(1) of CST (R and T) Rules, 1957, each declaration in form 'H' shall cover transactions of export sales, which take place in a quarter of a financial year between the same two dealers. Therefore, a single declaration issued to cover transactions of export sales for more than one quarter is 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.

Rule 12(10)(b) of CST (R and T) Rules, that lays down provisions relating to the issue and use of forms, stipulated that, the conditions specified for Form 'C' shall *mutatis mutandis* apply to certificate in Form 'H'.

We noticed in the test check of the assessment files (between July 2009 and July 2010) of AC (LTU) Anantapur and seven circles[46] that the AAs while finalising the assessments in 32 cases between August 2007 and March 2010 for the years 2005-06, 2006-07 and 2007-08 incorrectly exempted the export sales of dry chillies, granite, iron ore etc., valued at ₹ 155.27 crore supported by 'H' forms covering transactions of more than one quarter. Further, in one case, the AA exempted the export sales of potash feldspar valued at ₹ 7.60 lakh effected on 10 June 2006, whereas the documentary evidence revealed that the goods were actually exported on 8 June 2006 i.e., prior to the invoice date. Hence, the transaction is invalid and the turnover should have been taxed. The tax involved in these cases was of ₹ 15.87 crore on a total turnover of ₹ 155.39 crore as inter-state sales not covered by forms.

After we pointed out the cases, the Department replied (August 2011) that show cause notice issued (March 2011) in one case and revision was under process in 21 cases. The AAs replied in two cases (January 2010) that revised forms would be obtained. In three cases, it was contended (June 2010) by the AAs that issuance of a statutory form for a quarter is applicable to form 'C' only, but not to any other forms as per Rule 12(1) of CST (R&T) Rules and further Rule 12(10)(b) delegated power to State Governments for specific purposes, but not for issue of a quarterly 'H' form. The reply is not acceptable as Rule 12(10)(b) of CST (R&T) Rules, that lays down provisions relating to the issue and use of forms, stipulated that, the conditions specified for Form 'C' shall *mutatis mutandis* apply to certificate in Form 'H'. In the remaining cases, the AAs replied that matter would be examined.

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

[46] Chittoor-II, Guntur (Lalapet), Hyderabad (Nacharam, Saroornagar), Khammam-II, Piduguralla and Siddipet.

2.25 Non-levy of tax on Inter-State sales due to incorrect exemption

According to Section 8(2) of the CST Act, with effect from 1 April 2007, the rate of tax on sales in the course of Inter-State trade or commerce not covered by 'C' form shall be at the rate applicable to the sale or purchase of such goods inside the appropriate State under the sales tax law of that State.

Under entry 41 of Schedule I to the APVAT Act 'wheat bran' is exempt from tax. Hence the commodity is exempt under CST also.

"Wheat flakes" are taxable at the rate of 12.5 *per cent* under Schedule V to the APVAT Act, while sunflower bran and D bran fall under entry 87 of Schedule IV to the APVAT Act and are liable to tax at the rate of four *per cent.*

We noticed (between December 2009 and January 2010) during the test check of the assessment files of CTO-Afzalgunj that the AA while finalising the assessment in February 2009 for the year 2007-08, incorrectly exempted the inter-state sales turnover of ₹ 2.08 crore not covered by 'C' form, as sales of wheat bran which is exempt from tax. Our scrutiny of sales register of the dealer revealed that this turnover relate to Inter-State sale of wheat flakes, D bran and sunflower bran which are taxable goods. This resulted in non-levy of tax of ₹ 12.65 lakh.

After we pointed out the case, the AA stated that the matter would be examined.

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

2.26 Short levy of tax due to arithmetical error

Under the CST Act, tax is leviable on inter-state sale of goods at the rates prescribed in the Act.

We noticed (between October 2008 and September 2009) during the test check of the assessment files of three circles[47] that in three cases, the AAs while finalising the CST assessments in March 2008 and January 2009 for the period 2004-05 and 2005-06, worked out the tax as ₹ 4.80 lakh instead of ₹ 12.05 lakh due to arithmetical mistake. This resulted in short levy of tax of ₹ 7.25 lakh.

After we pointed out the cases, in one case, the AA stated (November 2008) that the mistake would be rectified. In the remaining two cases, the AAs stated that the matter would be examined.

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

[47] Hyderabad (IDA Gandhinagar, N.S. Road and Special Commodities Circle).

2.27 Incorrect computation of turnover

According to Section 2(s) of the APGST Act, 1957, turnover means the total amount set out in the bill of sale excluding the amount collected towards the tax or the tax due under the Act, whichever is less.

We noticed (January 2011) during the test check of records of AC (LTU), Abids Division in one case that an industrial unit was sanctioned (21 October 2002) sales tax deferment for 14 years from 2002 to 2016. It was mentioned in the FEC that the deferment of tax shall be allowed over the base turnover limit of ₹ 184.65 crore. We further noticed from the assessment files for the period 2002-03 to 2007-08 that the assessee included the sales tax component of ₹ 33.17 crore while arriving at the base turnover limit. As a result, the actual turnover i.e., value of goods produced was reduced to the extent of ₹ 33.17 crore. This resulted in short levy of tax of ₹ 1.59 crore.

After we pointed out the case, the AA stated that the matter would be examined.

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

2.28 Incorrect allowance of set-off of tax

Under the provisions of the APGST Act, and notifications issued there under, set-off can be allowed on sale of finished goods for tax paid on raw material used in manufacture of goods, provided the transactions at both ends take place within the State. In case of industrial units availing sales tax incentive, set off of tax paid on raw materials in a year should be allowed proportionately between (i) turnover upto base turnover limit and (ii) turnover above the base turnover.

We noticed (October and November 2009) during the test check of the assessment files of CTO-Special Commodities circle for the period 2004-05, that in one case where assessment was completed in March 2008 the set-off of tax of ₹ 1.12 crore paid on raw material during the year was adjusted to tax paid upto base production instead of proportionately adjusting to sale turnover upto base production and turnover over the base production. This resulted in excess exemption of tax of ₹ 62.85 lakh and short levy of tax to that extent.

After we pointed out the case, the AA stated that the matter would be examined.

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