

CHAPTER-II: TAXES ON SALES, TRADE, ETC

2.1 Tax administration

The levy and collection of Value Added Tax (VAT) is governed by the Karnataka Value Added Tax Act, 2003 (KVAT Act) and the rules made thereunder. The Commercial Taxes Department (CTD) is under the administrative control of the Finance Department and is headed by the Commissioner of Commercial Taxes (CCT) who is assisted by the Additional Commissioners at headquarters. There are 13 Divisional VAT Offices (DVO) in the State headed by Joint Commissioners and 148 Audit Offices headed by Deputy Commissioners and Assistant Commissioners. At the field level, VAT is being administered through 95 Local VAT Offices (LVOs) and VAT Sub Offices (VSOs) headed by Assistant Commissioners and Commercial Tax Officers respectively.

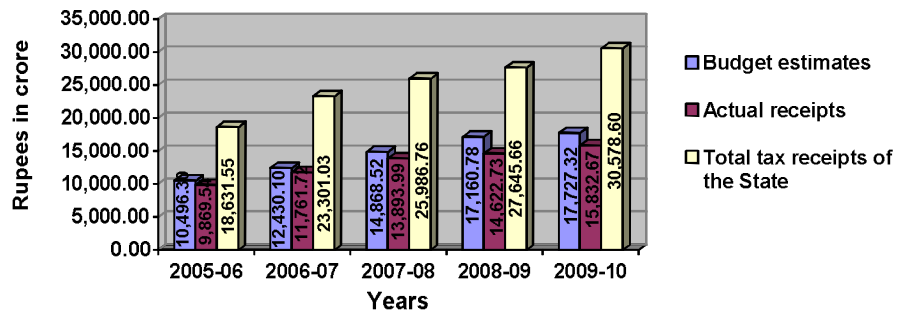
2.2 Trend of receipts

Budget Estimates (BEs) and actual receipts from VAT during the years 2005-06 to 2009-10 along with the total tax receipts during the same period is exhibited in the following table and graphs.

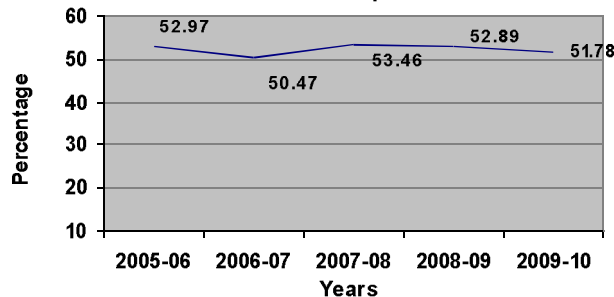
(Rupees in crore)

Year	Budget estimates	Actual receipts	Variation Excess(+)/ Shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
2005-06	10,496.30	9,869.54	(-) 626.76	(-) 5.97	18,631.55	52.97
2006-07	12,430.10	11,761.72	(-) 668.38	(-) 5.38	23,301.03	50.47
2007-08	14,868.52	13,893.99	(-) 974.53	(-) 6.55	25,986.76	53.46
2008-09	17,160.78	14,622.73	(-) 2,538.05	(-) 14.79	27,645.66	52.89
2009-10	17,727.32	15,832.67	(-) 1,894.65	(-) 10.69	30,578.60	51.78

Graph 1 : Budget estimates, Actual receipts and Total tax receipts



Graph 2: Percentage of Actual receipts vis-a-vis Total tax receipts



It is seen from the graphs that the variation between the actual receipts as compared to the BEs was less than seven *per cent* during the periods from 2005-06 to 2007-08. However, the variation increased to (-) 14.79 *per cent* in 2008-09 and (-) 10.69 *per cent* in 2009-10. The percentage of actual receipts of VAT in the total tax receipts ranged between 51.78 and 53.46 *per cent* during the five year period from 2005-06 to 2009-10. The Department has not furnished the reasons for variation of the actual receipts as compared to the BEs, although it was called for (September 2010).

2.3 Analysis of arrears of revenue

The arrears of revenue as on 31 March 2010 amounted to ₹ 3,750.79 crore. The Department reported (October 2010) non-availability of information of arrears of revenue pending for more than five years. The following table depicts the position of arrears of revenue during the period 2005-06 to 2009-10, as furnished by the CTD.

(Rupees in crore)			
Year	Opening balance of arrears	Amount collected during the year	Percentage of collection to opening balance of arrears
2005-06	2,916.64	211.28	7.24
2006-07	2,873.89	328.58	11.43
2007-08	4,297.18	358.33	8.34
2008-09	3,985.13	395.02	9.91
2009-10	4,164.96	316.76	7.61

The percentage of collection of arrears to the opening balance of arrears was less than 10 *per cent* for all the years except during the year 2006-07, which was 11.43 *per cent*.

The details of the amount collected or written off during the year was not furnished by the Department, as such we could not ascertain the correctness of the balances.

We recommend that the Department take effective measures for improving the collection of arrears of revenue.

2.4 Assessee profile

The Department reported that 4,16,265 dealers were registered as on 31 March 2010. Of these, 3,05,714 dealers were required to file returns during the year 2009-10. They further reported that only 2,05,887 dealers had filed returns during the year and that notices had been issued to all the non-filers.

Under the KVAT Act, every registered dealer is required to furnish returns in the prescribed form and pay the tax due on such return within 20 days after the end of the preceding month or any other tax period. However, it is seen from the above that the Department reported that only 3,05,714 dealers were required to file returns as against 4,16,265 registered dealers.

2.5 Cost of VAT per assessee

The number of assessees, cost of collection, and the cost of VAT per assessee during 2005-06 to 2009-10 were as follows:

(in Rupees)

Year	Number of assessees	Cost of VAT collection	Cost of VAT collection per assessee
2005-06	3,27,230	62,23,07,000	1,902
2006-07	3,42,458	60,60,46,000	1,770
2007-08	3,80,135	74,30,28,000	1,955
2008-09	4,01,817	81,61,95,000	2,031
2009-10	4,16,265	84,45,67,000	2,029

It is seen from the above that there is no significant variation in the cost of collection of VAT per assessee.

2.6 Arrears in assessment

The details of assessments pending at the beginning of the year, additional cases which became due for assessment during the year, cases disposed of during the year and cases pending at the end of each year during 2005-06 to 2009-10 as furnished by the CTD are mentioned below:

Year	Opening Balance	Cases due for assessment during the year	Total	Cases disposed of during the year	Cases pending at the end of the year	Percentage of 6 to 4
1	2	3	4	5	6	7
2005-06	5,83,427	4,72,386	10,55,813	2,82,894	7,72,919	73.21
2006-07	7,72,919	11,416	7,84,335	5,14,161	2,70,174	34.31
2007-08	2,70,174	42,503	3,12,677	1,29,130	1,83,547	58.70
2008-09	1,83,547	38,015	2,21,562	78,538	1,43,024	64.55
2009-10	1,43,024	83,865	2,26,889	45,490	1,81,399	79.95

It is seen from the above that the finalisation of assessments remained consistently low except in 2006-07 when the finalisation of assessments was high.

We recommend that the Department take appropriate steps to conclude the pending assessments early in the interest of revenue.

2.7 Cost of collection

The gross collection in respect of taxes on sales, trade etc, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2007-08, 2008-09 and 2009-10 along with the relevant all India average percentage of expenditure on collection to gross collection for the respective preceding years were as follows:

Year	Gross collection	Expenditure on collection	Percentage of cost of collection to gross collection	All India average percentage for the preceding year
	(Rupees in crore)			
2007-08	15,036.11	74.30	0.49	0.82
2008-09	16,259.37	81.62	0.50	0.83
2009-10	16,546.34	84.46	0.51	0.88

The above table indicates that the percentage of cost of collection to gross collection was less than the all India average percentage for all the three years.

2.8 Analysis of collection

The break-up of the total collection at the pre-assessment stage and after regular assessment of taxes on sales, trade, etc. during the year 2009-10 and corresponding figures for the preceding four years as furnished by the CTD is mentioned below:

(Rupees in crore)

Year	Amount collected at pre-assessment stage	Additional demand created after regular assessment, including penalty	Amount refunded	Net collection ¹ furnished by the Department	Percentage of 3 to 2
1	2	3	4	5	6
2005-06	11,490.13	137.82	363.00	11,326.30	1.20
2006-07	14,144.61	103.45	604.36	13,690.72	0.73
2007-08	16,011.73	151.75	508.34	15,669.83	0.95
2008-09	17,290.72	137.11	801.98	16,628.55	0.79
2009-10	18,445.85	248.86	713.16	18,132.54	1.35

It is seen from the above that the percentage of additional demand after regular assessment to the amount collected at pre-assessment stage was less than one *per cent* for all years except during 2005-06 and 2009-10 when it was at 1.20 and 1.35 *per cent* respectively. Further, it is also seen that the net collection figures amounts reported by the Department for all the years has not been worked out correctly.

2.9 Impact of audit reports

During the last five years, through our audit reports, we had pointed out non/short levy, incorrect exemption, non/short levy of interest/penalty, etc with revenue implication of ₹ 149.45 crore in 63 paragraphs. Of these, the Government/Department had accepted audit observations in 55 paragraphs involving ₹ 68.29 crore and had since recovered ₹ 16.87 crore. The details are shown in the following paragraph:

(Rupees in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ²	Number	Amount
2005-06	12	25.74	11	19.02	09	3.83
2006-07	14	23.47	14	11.12	03	2.30
2007-08	19	77.54	14	25.64	12	8.09
2008-09	09	7.41	07	1.72	06	1.33
2009-10	09	15.29	09	10.79	07	1.32
TOTAL	63	149.45	55	68.29	37	16.87

As seen from the above table, the recovery made by the Department is only 24.70 *per cent* of the amount involved in the total accepted cases.

We recommend that the Government take measures to ensure expeditious recovery of revenue in respect of the accepted cases.

¹ These figures are at variance from the figures included in the Finance Accounts of the respective years.

² Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

2.10 Working of internal audit wing

The objective of an Internal Audit Wing (IAW) is to have a deterrent and reforming effect in the direction of prevention of mistakes and to play a corrective role by pointing out mistakes and ensuring remedies without loss of time. IAW in CTD was functioning up to 2004-05. On introduction of VAT, the IAW was abolished leaving it vulnerable to the risk of control failure.

Mention of the absence of the IAW was made in the paragraph No.2.2.15 of the Comptroller and Auditor Generals' Audit Report (Revenue Receipts) 2008-09. The report has not been discussed by the PAC; however, the Department reported in October 2010 that they had taken a decision to form an IAW at the central office and necessary orders in this regard were being issued.

2.11 Results of audit

We conducted a test check of the records of 96 VAT offices during the year 2009-10, which revealed underassessments of tax and other irregularities involving ₹ 81.38 crore in 531 cases, which fall under the following categories:

(Rupees in crore)			
Sl. No.	Category	Number of cases	Amount
1.	Information Technology (IT) Audit of VATSoft in Commercial Taxes Department (A review)	01	7.09
2.	Non/short levy of output tax	120	19.54
3.	Incorrect/excess allowance of input tax credit	67	17.75
4.	Incorrect allowance of tax deducted at source	23	16.43
5.	Non/short payment of tax	69	7.14
6.	Incorrect/excess carry forward of refund	60	5.95
7.	Non/short levy of interest	75	3.17
8.	Non/short levy of penalty	70	1.40
9.	Non-forfeiture of tax collected in excess	11	1.10
10.	Other irregularities	35	1.81
	Total	531	81.38

During the course of the year 2009-10, the Department accepted underassessments of tax amounting to ₹ 1.43 crore in 53 cases pointed out in audit in earlier years and of that, recovered ₹ 90.81 lakh in 49 cases. Further, in respect of sales tax, the Department recovered an amount of ₹ 1.37 crore in 56 cases, which were pointed out in earlier years.

A Review on 'IT Audit of VATSoft in Commercial Taxes Department' involving ₹ 7.09 crore and few illustrative cases involving ₹ 8.20 crore are mentioned in the following paragraphs.

2.12 IT Audit of VATSoft in Commercial Taxes Department

Highlights

Software developed for implementation of VAT by the CTD through a private agency for ₹ 7.09 crore was discontinued for various reasons resulting in infructuous expenditure.

(Paragraph 2.12.5.1)

The CTD did not clearly spell out the basic objectives for computerisation. Further, the Department assigned development of the application system to NIC without formalising the terms of engagement.

(Paragraph 2.12.5.2)

No system audit was conducted by the CTD either during development stage or after the completion of the implementation. Consequently, adherence to system development standards, documentation, and incorporation of detective controls could not be ensured.

(Paragraph 2.12.5.3)

There was no approved policy regarding acquisition and periodic up gradation of hardware resources, disposal of e-waste, period of retention and subsequent disposal of source documents etc. Disposal of hard disks and other media without removing data has the potential risk of recovery and misuse of vital data of the CTD by unauthorised persons.

(Paragraph 2.12.6.2)

Network security was inadequate due to co-existence of LAN and internet connections in the computer nodes without firewall protection, non-disabling of USB ports and absence of clear policy for installation of security patches led to inadequate network security.

(Paragraph 2.12.6.4)

The Department does not have a clearly documented and approved policy statement comprehensively covering all aspects of logical security. 65 login IDs were provided without capturing the names of the employees to whom it is assigned and in 201 cases same employees were using more than one login ID, in some cases with different user privileges.

(Paragraph 2.12.6.5)

A large number of uncorrected error returns were found in the database, including 4,138 returns where the tax credit brought forward from previous return was shown in excess by ₹ 448.75 crore.

(Paragraph 2.12.7.1)

There were weak input controls as a result of which the dealers claimed ITC on purchases from invalid/deregistered dealers resulting in excess claim of ITC of ₹ 2.03 crore.

(Paragraph 2.12.7.1)

Non-mapping of Business Rules relating to 'revised' return led to acceptance of belated returns.

(Paragraph 2.12.7.1)

Inadequate application controls resulted in double accounting of 405 cheques involving ₹ 3.07 crore.

(Paragraph 2.12.7.1)

Even after a lapse of five years of computerisation there was continued dependence on manual processes for all administrative decisions like processing of refund claims, refunds under industrial incentive scheme, etc.

(Paragraph 2.12.9.1)

2.12.1 Information System set up

The Computer cell of the CTD is headed by Joint Commissioner of Commercial Taxes (Computer cell). Value Added Tax Software (VATSoft) developed by National Informatics Centre (NIC) is in operation from 2 August 2006. It uses Oracle 8i RDBMS at back end and ASP.Net with C# language for front end application. The data centre located at the Head office, Bangalore is connected to the Local Area Network (LAN) of all divisions, LVOs and VSOs through Very Small Aperture Terminals (VSAT) and leased lines. Online data base has been distributed in 50 locations across the state and the data is being replicated on a weekly basis to the central server located at Head Office/Data centre. Major modules in VATSoft are registration of dealers, returns submission, tax collection, tax deduction at source (TDS), statutory forms and for generating various management information system (MIS) reports.

2.12.2 Audit Objectives

We conducted the review with a view to assess whether:

- the system meets the requirements of the KVAT Act and is synchronised with the business rules/needs of the Department,
- the implementation of the system was preceded by systematic planning and adequate assessment of operational requirements and needs,
- proper input, validation and process control existed in the system to ensure that the data captured was authentic, reliable, complete and accurate,
- the database provides sufficient, complete, reliable and authorised information for management action,
- the physical and logical access controls are sufficient to guard against unauthorised access and modification of data, and
- adequate security controls and disaster recovery plan exists.

2.12.3 Scope and methodology of audit

We conducted a review of VATSoft covering major modules such as registration, returns, collection, statutory forms, dealer ledger, tax deducted at source, etc., between September 2009 and March 2010. We also analysed database backup as at the end of October 2009 using Computer Aided Audit Tools - Interactive Data Extraction and Analysis (IDEA) and Structured Query Language (SQL) besides front end analysis with test data. Further, we also selected cases in the system through statistical sampling using IDEA and cross checked the same with source documents and manual records.

2.12.4 Acknowledgement

We acknowledge the co-operation of the CTD in providing necessary information and records for audit including access to systems. We held an Entry Conference with the CCT in September 2009, wherein the scope of audit, methodology and audit objectives were explained. We held an Exit Conference with the Principal Secretary (Finance) and the CCT in July 2010, wherein the audit findings were discussed. The Principal Secretary stated all necessary action would be taken to set right the deficiencies in application software as pointed out by audit and strengthening the software.

Audit Findings

2.12.5 Planning and System Development

Our review of system development processes revealed the following:

2.12.5.1 Planning for Computerisation

IT planning involving clear spelt-out objectives, specifications, documentation and testing before implementation of IT systems is an important general control.

The Government of Karnataka initially appointed M/s. Crown Agents, London (CA) in August 2001 to provide technical assistance to the CTD for the implementation of KVAT Act. The softwares, VAT Information Processing System (VIPS) and VAT Registration

Number System (VRN) developed by CA at a cost of ₹ 7.09 crore were put to use by the CTD on introduction of VAT with effect from 1 April 2005. However, attributing inadequate support in maintenance of the software, the CTD terminated the agreement with CA and discontinued the usage of VIPS and VRN. Subsequently, the work of Software development and support was entrusted to NIC in January 2006 and VATSoft, developed by NIC was introduced from August 2006.

After we pointed out the failure of the exercise of VIPS and VRN developed by CA at a cost of ₹ 7.09 crore, the Department stated in the exit conference that the whole exercise was a learning experience for the Department and such mistakes are prone to occur in any software development process. The Department after running VIPS and VRN for more than one year had found that the software was incomplete and unsatisfactory. Further, independent evaluation of the same by e-Governance Secretariat also pointed out that the software had many practical problems, some of which could not be corrected.

Thus the fact remains that the software initially developed, failed to achieve its intended purposes resulting in infructuous expenditure of ₹ 7.09 crore.

2.12.5.2 Documentation of Objectives and User Requirements

The CTD did not clearly spell out the basic objectives for computerisation. Further, the Department assigned development of the application system to NIC without formalising the terms of engagement through a contractual agreement clearly identifying the deliverables and laying down a schedule for delivery of each module. As a result there was no prioritisation of tasks and functions were being incorporated as and when requirements were being

noticed. Further, the software developer failed to incorporate the necessary input, processing, detective and authorisation controls and table level relations required for an effective accounting system, as brought out in the succeeding paragraphs.

2.12.5.3 Audit of systems

Information System (IS) audit during the SDD phase is an important preventive and detective control to ensure efficient and effective delivery of services and achievement of objectives of computerisation.

We noticed that no system audit was conducted by the CTD either during development stage or after the completion of the implementation. Consequently, adherence to system development standards, documentation and incorporation of detective controls could not be ensured.

After we pointed out the above, the CCT stated that although no IT audit of the software was conducted, all developments under the project will get verified by the professional third party IT auditors.

➤ **Audit Trail:**

A standard audit trail provides for recording and monitoring of database activity.

An audit trail involving logging of activities, regular review of the same in accordance with an established schedule, provision for automatic exception reporting etc. has not been provided, rendering it impossible to monitor any unauthorised access to the system or modification of data by the end users, particularly in a scenario where system administrator level functions are outsourced with super-user privileges.

➤ **Registration module:**

Registration module of VATSoft deals with capturing the details furnished by the dealers in the application form prescribed in this regard under the KVAT Act and registering them by generating Tax payers Index Number (TIN) after processing the application on the basis of inspection of business premises by the Commercial Tax Inspectors (CTI). The module also processes the application for deregistration of dealers.

➤ **Incomplete/invalid data:** We noticed a few system deficiencies due to which the mandatory data required to be captured was not captured as mentioned below:

- In 785 cases, names of registered dealers and in 198 cases, business addresses of registered dealers were not captured.
- The field for capturing Permanent Account Number (PAN) and trade name contained invalid entries in many cases. Further, for 1,93,761 dealers out of the total of 4,03,311 current registered dealers (as of October 2009), PAN was not captured.

- The database of commodities dealt by individual dealers is incomplete, having commodity details of 2,37,930 dealers only out of a total 5,04,241 dealers available in the dealer registration database.

➤ **Duplicate Registration:** We observed that controls to avoid duplicate registration of dealers were not in place. As a result, in 919 instances, the same dealer was issued duplicate TIN. Of these, 64 had not been de-registered at the time of audit.

After we pointed out the instances the Department issued a circular based on which field offices have undertaken to initiate deregistration processes in the above cases.

System Design Issues

2.12.6 General Controls

2.12.6.1 Third Party Management

The duties, responsibilities, privileges and tenure limitations of system administrator are not defined and assigned. In absence of this, the privileges of system administrator in respect of database, though not defined in the contract are currently being enjoyed by several employees of different third party organisations viz. M/s. InfoTech Explorer India (Pvt) Ltd., (IEIPL) and M/s. Indian Computers Corporation (ICC), who were engaged by the Department for '*running the applications*' and '*hardware maintenance and antivirus definitions*' respectively. In this scenario, where there is considerable reliance on the third party for determining and reviewing the application, there is considerable risk of dilution of authority and accountability besides compromise of the integrity and confidentiality of the CTD data.

The Department stated that a decision was taken to take services of three professionals from NIC and they are going to migrate to centralised network architecture, the capacity of the servers is likely to be enhanced and the server would be moved to the State data centre and all the issues like physical access control, disaster recovery and business continuity, etc. would be addressed at that stage.

2.12.6.2 IT Asset Management

Effective IS Management requires all aspects of asset management to be addressed through clearly defined and documented policies approved at the highest level.

We observed that there was no approved policy regarding acquisition and periodic upgradation of hardware resources, disposal of e-waste, period of retention and subsequent disposal of source documents etc. Disposal of hard disks and other media without removing data has the potential risk of recovery and misuse of vital data of the CTD by unauthorised persons.

The CCT accepted that they have not designated a system administrator and stated that they would seek the services of three technical personnel from NIC

as System Administrator, Data Base Administrator and Network Specialist. With regard to IT asset management and e-waste management the Department agreed to devise a policy, after the appointment of the technical personnel.

2.12.6.3 Physical Access and Environmental Controls

The servers are kept in a room which is occupied by outsourced service engineers and employees of the CTD. There is no control to restrict physical access to the servers. The room is paneled with fire susceptible materials. However, neither are the servers protected in fire proof cabinets nor are fire extinguishing devices provided in the room.

Central servers, in which the entire data of VATSoft is generated from various local servers is backed up on weekly basis and the local servers for LVOs -010, 010 Addl., 030, 030 Addl. are kept side by side in the same room rendering them susceptible to the same IT security/environmental hazards.

2.12.6.4 Inadequate Network Security Controls

Adequate network security controls are required to protect against unauthorised access, malwares, etc.

Several computer nodes in the internal LAN (Intranet) of the Department have parallel access to the internet as well. However, no firewall was installed to isolate and protect the internal network and/or to log internet use. USB ports in the terminals in the Department were not disabled. Data from web based applications of the Department like '*e-filing*' and payment reconciliation, data obtained from banks through electronic data interchange are ported into the internal network of the Department through removable media like pen drives. Also, the Department had not established a program for installation of various security patches issued by the makers of the operating system after testing for compatibility. Hence, no protection was available against external intrusions, malicious programs or spy wares and unregulated internet use. We noticed that there were several instances of virus attacks, one of which was serious enough to cause shut down of servers throughout the state for more than two weeks during the month of July 2009.

After we pointed out the above, the CCT replied that the data centre would be refurbished considering all IT security aspects and all servers shifted to professionally managed state data center, mirroring the NIC data centre in Hyderabad and steps would be taken to disable USB ports and other removable media. It was also stated that the absence of security in IT system is due to lack of expertise and domain knowledge. However, the induction of technical personnel would resolve the issues.

2.12.6.5 Logical Access Control Policy

Logical access controls in application software are essential to identify users and restrict privileges.

The Department does not have a clearly documented and approved policy statement comprehensively covering all aspects of logical security. Usernames, passwords, user groups and designations of all the end users are stored in a system table.

Privileges to view this table are available to outsourced third party engineers. In a scenario where passwords are not stored in encrypted format, access to the passwords of all users to third party users who also have administrator privileges of back-end data modification limits the ability of the Department to ensure data integrity and confidentiality.

Further, we observed that 65 login IDs were provided without capturing the names of the employee to whom it was assigned and in 201 cases same employees were using more than one login ID, in some cases with different user privileges. In 103 cases the same login ID was assigned to different users and in 301 cases employees' usernames and passwords were the same. Automatic shutdown after specific number of failed login attempts was not provided.

➤ Processing of dishonored transactions:

We noticed the following deficiencies in processing of dis-honoured transactions.

In the tax collection module, each transaction, initially shown as 'processed' is altered to 'Treasury/Bank realised' or 'bounced' as the case may be on entry of realisation particulars. The system also provides for closure of dishonored transactions on receipt of payment, by removing the entry from the current database to 'history'.

- As at the end of November 2009, there were 22,703 cases of dishonored cheques involving ₹ 94.78 crore as per the database. However, while exercising the provision for closure of dishonored transactions, the receipt of payment and removal of the corresponding entry from the current database to 'history' are not coupled automatically.

This makes it possible for a user to 'close' a transaction even without receipt of repayment for the bounced amount. Out of 17,515 entries in 'history', corresponding payment details of 6,036 cheques for an amount of ₹ 16.62 crore were not found in the tax collection database.

- Due to system design deficiencies, dishonored cheques were not linked with its subsequent payment. All repayments are entered as original transactions rendering it impossible to incorporate further system level controls to watch repayment of individual transactions, ensure their correct accounting and levy interest thereon as per the provisions of the KVAT Act. There were 14,410 dishonored cheques/payments in the current tax collection database against which no corresponding repayment information is available.

- Inadequacy of system designs with regard to dishonored payments has led the LVOs to depend entirely on manual procedures like maintenance of 'cheque bounce register'. On cross verification of a statistically drawn sample of the above cases with field records, we observed subsequent payments received and realised in lieu of bounced cheques were accounted against different tax periods in the database in 73 per cent cases. In a few instances however, repayment was called for after our pointing out the same.

2.12.7 Application controls

2.12.7.1 Input and processing controls

Proper input, validation, authorisation and processing controls should be in place to ensure that all relevant information is captured and that the data is complete, valid, accurate and properly authorised.

Our review of input and processing controls in the various modules of the application system revealed the following deficiencies.

➤ Currency and Adequacy of Security Deposit:

The KVAT Act, 2003 prescribes the collection of security deposit from the dealers seeking registration under the Act.

We observed that in 10,174 cases the system contains even 'null' values in the field provided for security deposit amount. In 2,14,935 cases, the amount entered is less than the minimum prescribed amount of ₹ 1000 (₹ 0 in

2,12,772 cases).

- The types of security deposit instrument (bank guarantee, postal order, NSC, other and cash) were allotted codes 1 to 5 respectively. However, the type was not recorded in 2,226 cases and recorded as '0', in 2,618 cases causing ambiguity in the available data.
- In 92,598 cases, the security deposit instrument had expired by 31 October 2009, including 82,402 cases where it had expired even prior to 1 April 2005, i.e., the date of introduction of VAT. However there was no system prompting to ensure the renewal of the instrument.
- In 84,058 cases, the effective date of registration recorded was prior to the date of application itself. In 1,238 cases, the effective date of registration was recorded as prior to the date of introduction of VAT (01 April 2005).

From the above data and inconsistencies/abnormalities etc we infer that either the input controls were absent or were ineffective due to lack of proper validation checks.

After we pointed out the above, the CCT replied that the mistakes occurred due to porting of data from VIPS and VRN. However, the Department is planning to introduce on-line registration, e-filing and e-payment to overcome the deficiencies. Further, appropriate input controls would be introduced to

capture the mandatory data and NIC would be requested to provide necessary prompts and report to enable the LVOs to monitor the processing of data.

➤ **Return submission module:**

The Return submission module of VATSoft application deals with input of monthly returns filed by the dealers in Form VAT 100, which has provision for capturing gross/net turnover, exemptions, tax calculations, etc. Also, dealers whose turnover for the preceding year was less than ₹ 2 crore and/or ₹ 16 lakh during the month, shall furnish dealer-wise extract of purchase register along with the returns. The returns submitted by dealers are to be verified by the LVO for arithmetical accuracy and if he is satisfied regarding the correctness of the return, it would be accepted which constitutes deemed assessment under the KVAT Act.

➤ On entry of data, the application system exercises preliminary checks on the return and prompts for errors. Also, based on the checks performed the return is tagged correct/complete or incorrect/incomplete. A return is not finally 'posted' and remains open for corrections until all inconsistencies are resolved.

We noticed that the percentage of the returns tagged as incorrect and kept open without obtaining correct returns for the years 2006-07 to 2009-10 was very high as mentioned in the following table:

Year	Total number of returns filed	Number of error returns	Percentage of error returns
2006-07	12,30,381	6,60,112	53.65
2007-08	14,67,552	5,98,645	40.79
2008-09	15,95,482	4,92,522	30.87
2009-10 (up to February 2010)	14,68,728	3,80,898	25.93

The huge number of outstanding incorrect returns indicates that the Department is not in a position either to take remedial measure for correcting returns or data of returns is not being updated. We also noticed that the error returns include 4,138 returns where the tax credit brought forward from the previous return was shown in excess by ₹ 448.75 crore.

➤ **Weak input controls:** We observed that there were weak input controls as a result of which dealers claim ITC on purchases from invalid/deregistered dealers, the completeness of the purchases were not checked with respect to the ITC claimed etc. as evident by the following:

- The purchase statements filed with 1,392 returns contained 24,392 invalid TINs of the selling dealers.
- In 425 cases the purchase statements submitted by the dealers contained the TIN of dealers who were deregistered at the time of purchase.
- In 90,586 cases, ITC claimed in monthly return was in excess of that declared in the purchase statements by ₹ 2.03 crore.

On verification of a sample of these cases in the field units, it was observed that 89 per cent of such mistakes occurred due to incomplete or incorrect data

entry. However, in the balance cases where there was actual incorrect claims of ITC, the Department had initiated action subsequent to audit.

➤ Invalid tax periods: In 64 instances, returns were recorded as pertaining to incorrect tax periods such as 13th and 16th month of the year (eg. '200713', '200716') indicating absence of validation control of input data.

➤ VATSoft provides for relegating the previous return filed for a tax period to 'history' when revised/corrected returns are filed for that tax period and only the most recent return is maintained in the current database of returns. However, we noticed that the control was not effective in view of the following:

- In 13,763 instances, more than one 'original' return for the same period is available in the current database. We observed on a test check of source documents maintained in the LVOs that either the same return can be re-entered or a subsequent *corrected/revised* return can be entered as an 'original' return at the time of transfer of jurisdiction of the records from one office to another, when transfer of registration data was effected immediately and that of return and payment data was delayed.

As a consequence the application system represents exaggerated liabilities or credits. Further, any system controls established in conformity with statutory provisions in the case of revised returns could be bypassed in such instances and provisions related to belated filing of original returns would become erroneously applicable.

- We further observed 253 'revised' returns in the 'live' database showing a corresponding 'revised' return itself in 'history'. This indicates the possibility that a dealer could file a 'revised' return without filing a corresponding 'original' return.

➤ **Non-mapping with business rules in respect of 'revised' and 'correct' returns:**

Under the KVAT Act, a dealer may file revised return *within* six months from the end of the relevant tax period on any omission or incorrect statement in the return coming to his notice.

Out of 57,201 revised returns filed for the period up to August 2009, 8,016 returns were delayed beyond six months. Since the system was not mapped with the business rules, it accepted the returns that were submitted belatedly, which should have been rejected.

Under the KVAT Rules, LVO shall issue a notice in form VAT 150 requiring a dealer to submit a 'complete' or 'correct' return in the case of any apparent deficiency noticed, within 10 days from the issue of the notice.

Even though the system provides for the generation of VAT 150, no controls are established to relate the filing of 'correct' returns with the issue of the notice. This design deficiency in the system makes it incapable to ensure timely filing of 'correct' returns as also to prevent filing of 'revised' returns as 'correct' returns.

After we pointed out the above, the CCT stated that there was no systematic method of tackling the error returns in the Department; however NIC would be requested to provide necessary input and processing controls. Further, by amending the KVAT Rules the filing of purchase and sales details would be made mandatory for claiming ITC, and e-filing would reduce the data errors.

➤ **Tax collection module:**

The Tax Collection Module provides for acknowledging, recording, reconciling the cheques realised with reference to bank/treasury scroll number and accounting the payments made by dealers in discharge of their liabilities of tax, interest, penalty etc as declared in tax returns or arising from audit, inspection etc. The module also has to monitor dishonoured cheques and the subsequent payment thereagainst. Our analysis of data revealed inadequate/absence of controls to ensure correct accounting, prevent double accounting of transactions, consolidate individual dealer ledger accounts and process dishonoured transactions resulting in continued dependence on manual processes.

➤ **Acknowledgement for receipt of payments:** The module lacks controls that mandate acknowledgement of every instance of payment and to ensure all acknowledged payments are necessarily accounted. Thus, on the one hand, the system fails to provide assurance that all payments received are entered without fail and on the other, fails to ensure that all particulars of the payment are entered correctly.

- We noticed that issue of computer generated acknowledgement slips were not mandatory and were not coupled with the subsequent entry of payment data in the system. We found that against the total number of 17,77,847 payments received, only 1,30,518 acknowledgement slips were generated by the system. We also noticed that 54,440 acknowledgements (of which 1,197 related to discharge of VAT liability of ₹ 4.35 crore), given for respective TIN and tax period were not traceable to the tax collection database.
- We further observed on analysis of the tax collection database that there were 3,622 instances where cheque numbers were entered but the amount of the cheque was entered as “0”. The tax liability as per the returns in these cases was ₹ 40.78 crore. Of these, in 177 cases there was no subsequent presentation of cheque or payment to discharge declared tax liability amounting to ₹ 49 lakh.

➤ **Duplication of Cheques:** The tax collection module of the application system lacks controls to prevent double entry of cheques. We observed that 405 cheques involving ₹ 3.07 crore were accounted twice in tax collection table for the period from April 2008 to September 2009, i.e. each tax payment appears in the credit of more than one dealer, or twice in the credit of the same dealer, or simultaneously in the credit of a dealer as well as in the LVO

suspense³ concerned. Thus, the tax collection figure of the data base is overstated, undependable and unreliable.

➤ The application system does not provide controls that enable the administration to ensure that all liabilities declared are promptly and correctly discharged. We observed that as per the data available in the system, an amount of ₹ 136.28 crore in respect of 10,275 cases was paid short as against the tax liability declared in Form VAT 100, (of which in respect of 5,030 cases the difference between liability and discharge was more than ₹ 1,000 in each case). Manual documents maintained in the field offices revealed that in several instances, the amounts received had been wrongly accounted against subsequent tax periods and in a few cases actual default was undetected by the LVOs concerned.

➤ **Dealer Ledger:** The VATSoft Application System provides for a dealers ledger that represent the values of ‘demand’, ‘collection’ and ‘balance’ (DCB) against each dealer. We observed that no relational integrity is established to ensure representation of all registered dealers and updation of all instances of demand and collections from details entered in registration, returns, payments and other modules for presentation of a consolidated position of the balance for all dealers.

- As against over 5 lakh dealers registered under the KVAT Act, we observed that the module contained ledger only in respect of 67,254 dealers. Further the ‘balance’ field for these dealers showed ‘null’ values while 6,05,312 entries had ‘null’ values for both ‘demand’ and ‘collection’ fields. The field for entry of tax period contains invalid entries like ‘0’, ‘99999’ etc.
- In the absence of DCB, any additional demand raised in reassessment of any dealer could not be traced in the system. Also any short payment of tax than the net tax liability declared in the returns cannot be watched for their recovery.

➤ **Entry of realisation information:** The front end window of the VATSoft application system enables case workers to enter, verify and approve the payments made by various dealers as well as to reconcile the realisation of the same by entering the bank or treasury scroll numbers.

- The privileges of entry of payment information and reconciliation of the same with bank/treasury reports are not segregated. The same case worker who entered the payment information is able to reconcile the same.
- There is no system level referencing available between actual scroll numbers issued by the banks or treasuries. Hence a particular instance of payment can be reconciled by entering any random number and date for scroll number and date of realisation. Though users at the level of Assistant Commissioner of Commercial Taxes (ACCT) are enabled to

³ LVO suspense is a ledger provided in VATSoft for LVOs to temporarily account for unrecognised payments to be transferred in favour of the dealer concerned after identification.

modify payment entries even after reconciliation, supervision over entry of realisation particulars is not made mandatory at the application system level. Even after the ACCT has modified and limited the amount of cheque to the bank realised amount, it is still possible for a case worker to reduce the amount using treasury reconciliation module of the application system.

- Moreover, though the front end of the application system prevents the entry of an amount higher than the cheque amount realised, we observed that back end data contained 1,112 instances where realised amount was higher than cheque amount.

After we made the above observations, the CCT stated that the NIC would be asked to prepare a comprehensive dealer wise and office wise DCB module with appropriate controls; e-payment system with accounting and that reconciliation procedures are being evolved with consent of AG (A&E), which would eliminate most of the mistakes.

➤ **TDS Module:**

Dealers authorised to make TDS are required to submit monthly returns in Form VAT 125 showing amount of tax deducted and particulars of remittance of the same.

➤ We noticed that there is no mechanism in the application system to watch the submission of monthly returns by TDS authorities. Of the 3,761 TDS authorities, entries for monthly returns were not available in the module in respect of 2,960 authorities.

➤ In 35 cases, names/details of entities submitting Form VAT 125 for deduction of tax at source are neither captured in the dealer database nor in the database of TDS authorities. This limits the ability of the system to correlate TDS deduction claims by registered dealers with admissions made by the respective TDS authorities.

➤ We also observed that a sum of ₹ 1,575.91 crore had been claimed as TDS by various VAT dealers in their monthly returns filed which were allowed by the LVOs. Against this, TDS details of ₹ 221.76 crore and remittance details of ₹ 164.48 crore only was available in the module leaving an unaccounted excess TDS credit of ₹ 1,411.43 crore.

After we pointed out the above, the CCT stated that system control for TDS payments was not developed; however, an amendment to introduce Deducting Authority Number (DAN) would be made for all TDS authorities which would enable monitoring of TDS payments.

➤ **Statutory Forms Module:**

The VATSoft application system provides for recording the issue and receipt of statutory forms and their utilisation particulars filed by the dealers.

We observed that system level controls to prevent issue of statutory forms to the non-CST dealers and to dealers who failed to file utilisation particulars of forms issued previously were not enabled in the system. In 1,713 instances we found that statutory forms were issued to dealers who had not opted for CST registration. Further, in many cases forms were shown as issued even

without entry of information regarding utilisation reports of previous forms. For example, as per system data, a dealer (TIN 29110464630) was issued C-forms on two instances, first on 6 February 2007 and then again on 20 February 2007 without any information on utilisation of forms issued earlier. Subsequently the dealer is seen to have got deregistered on 29 August 2007. At the time of deregistration also the dealer has not submitted utilisation reports.

After we pointed out the above, the CCT stated that the issue of all statutory forms would be made online and an officer would be designated to conduct cross verification of the same.

2.12.7.2 Output Controls

➤ Unreliable MIS

VATSoft provides for various MIS Reports such as registration, payments, refunds, returns defaulter, commodity wise dealers, etc.

➤ We found that the MIS report on commodity wise dealers was not accurate. For instance the MIS report on dealers dealing in edible oil in “LVO 010” also yielded names of textile dealers, electrical goods dealers etc. We also found that the names of some dealers are repeated in the same list.

➤ Report on turnovers of the above dealers for the period April 2008, in respect of edible oil which is taxable at 4 *per cent* yielded the total sales turnover of the dealers including their turnover in other commodities which were taxable at 12.5 *per cent*.

After we pointed out the above, the CCT stated that the above inaccuracy was due to the dealer dealing in multiple commodities and in order to overcome the problem e-returns with electronic tax calculator module is being developed.

2.12.8 Backup and recovery issues

2.12.8.1 Absence of Disaster Recovery (DR) and Business Continuity (BC) Plan

Clearly formulated, tested and approved DR and BC Plans are essential to restore business operation within pre-determined time in the event of any disaster.

We noticed that the CTD has no DR and BC Plan. Though weekly uploading of data from distributed servers to the central server was being done, there was no provision for off-site back up of operating systems, application systems, database

management system, system documentation.

2.12.8.2 Media Library Management Controls

We observed that the Department had not defined media librarian functions nor had they assigned the duties of library management to any official. As a result, the Department does not have an up-to-date and fully inventoried media library containing backup copies of data, application programs, operating systems, DBMS etc. Periodic backups of data taken on magnetic

tapes/cartridges are kept in the same room along with the servers. In the absence of off-site storage, the servers and the backup are being subject to the same security risks. Further, the Department has not performed any restoration tests on media tapes till date.

2.12.9 Other Issues

2.12.9.1 Non-effectiveness of system in administration of VAT processes

➤ **Establishment of value chain:** We observed that even after a lapse of five years, the computerisation has not enabled the Department to effect a complete, automatic cross verification of sales and purchase transactions between the dealers or to establish a value chain as an essential prerequisite for prevention of VAT fraud, due to the following reasons.

- Incomplete data capture due to partial coverage of dealers under e-filing.
- Inadequate table level relational integrity between modules capturing purchase and sales details and monthly returns.
- Absence of facility in the application system to establish a complete value chain by correlating purchase and sales turnovers of individual dealers.

➤ **Refunds:**

Issue of refund orders is an important administrative function in the local VAT offices which involves detailed verification of returns, payments, previous claims etc.

The VATSoft does not provide for automatic computation or processing of refund claims. For instance, we observed that the module shows a refund of ₹ 48.42 lakh made to a dealer (TIN 29020209424) for the tax period January 2008. However, the module for monthly returns shows that the dealer had not declared any output tax or input tax credit for the entire period from May 2006 to December 2007 and thus the basis of the refund given needs verification. In 25 out of 5,000 test checked instances, we found that the dealers carried forward amounts to the subsequent monthly returns even after refunds of ₹ 45.31 lakh were issued. Error alerts available in the VAT returns module merely point out differences between amounts shown as carried forward in a return and that shown as brought forward from the previous return and do not make reference or furnish any information on refunds already granted. We also observed during the field study that the refund details could be updated only in respect of cases where the dealer claims refund arising out of excess ITC in the field provided. The system does not provide for processing of refunds but merely permits the entry of refunds already made manually. Further, the system does not permit even the entry of refunds arising out of excess advance tax payments, appeals, refunds under entry tax, etc. This has resulted in huge variance between actual refunds and the data available in the system as indicated below in a few of the test checked offices.

(Rupees in lakh)

LVO	Actual Refunds granted as per Refund Register		Refund Information as per computerised System		Difference	
	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
10	45	152.82	10	36.41	35	116.41
15	161	5,863.72	03	2.12	158	5,861.60
40	43	3,481.30	-	-	43	3,481.30
25	128	6,121.25	19	1,911.90	109	4,209.35
20	46	2,217.85	-	-	46	2,217.85

➤ **Refunds under industrial incentive scheme:** The module provided for the administration of tax exemption/deferment granted under industrial incentive scheme was not utilised by the CTD. The database contained only two dealers as against over 3,000 dealers who are benefited by the industrial incentive scheme. No table level reference is available between the module containing information on the monetary and time limits of individual claims and monthly returns, as a result of which it is impossible to keep a tag on consolidated claims made in the returns exceeding the permitted monetary limit or period as provided in the eligibility certificate issued by the CTD. Administration of this function is also done manually outside the application system in field offices.

After we pointed out the above, the CCT stated that with deployment of e-filing it would be mandatory for the dealers to furnish purchase and sales data. Further, the CCT admitted that the refund module was not fully automated and the VATsoft would be modified to capture data of refunds and industrial incentives.

2.12.9.2 Non/partial utilisation of the modules

The VATSoft was designed to capture the complete workflow of the Department in all spheres without any ambiguity. We noticed that the system was either not used or used only partially in respect of the following:

- All the Audited Accounts filed in Form VAT 240 were not fed into the system.
- Annual statements filed in Form VAT 115 were not entered into the system.
- Re-assessment orders, intelligence reports, debt and recovery management data are not being updated in the system.
- Photo capturing facility of the registration module not made use.
- Notices for non-filers, belated filers are not generated automatically.
- Additional demands, interest and penalty notices are not generated automatically.
- Manual system of acknowledgements for returns still exists.

Thus, the automated workflow as envisaged through the system was defeated and manual intervention and input errors made the data unreliable.

After we pointed out the above, the CTD stated that poor connectivity of VSAT technology and distributed architecture resulted in poor monitoring and under utilisation of many modules, however, decisions are being taken towards better utilisation of modules.

2.12.10 Conclusion

Computerisation was undertaken with a view to enhance the efficiency of the organisation in implementing the KVAT Act, 2003, and the Rules thereunder. However, the CTD did not clearly spell the objectives for computerisation. The software (VIPS and VRN) initially developed through a private agency failed in its intended purpose resulting in infructuous expenditure of ₹ 7.09 crore. Even in VATSoft application system, the provisions of KVAT Act and Rules were not fully incorporated. Incomplete/invalid data was captured and no control were put in place to avoid duplicate registration of dealers. There was no policy regarding acquisition and periodical upgradation of hardware resources and disposal of e-wastes. There was no control to restrict physical access to the Servers. The passwords were not stored in encrypted format and names of the employees to whom passwords were assigned were not found in 65 cases. The number of error returns was very high. There was no mechanism in the application system to watch the submission of monthly returns by the authorities deducting tax at source. MIS report on commodity-wise dealer was not accurate. Though VATSoft was designed to capture the complete work flow of the Department in all spheres, it was either not used or was used partially in a number of fields. To overcome the deficiencies we recommend that the Government may consider the following recommendations.

2.12.11 Recommendations

We recommend that:

- the Department plan for implementing all the modules of VATSoft in order to reduce the manual maintenance of records;
- physical access controls be strengthened;
- password policy be revised, incorporating best practices in industry and fully implemented;
- necessary input and validation controls be built into the system to ensure that unauthorised, invalid, inaccurate and incomplete data is not fed into the system;
- automatic updation of Dealer Ledger module be established;
- CTD develop in-house expertise to enable effective management of IT. CTD may periodically review the adequacy of general, security and application controls for optimal utilisation of IT resources; and
- refund orders be generated through the VATSoft and the system of manually issuing refund orders may be discouraged.

2.13 Other audit observations

Scrutiny of assessment records of value added tax (VAT) and central sales tax (CST) indicated several cases of non-observance of provisions of Acts/Rules and notifications issued therein, suppression of sales/purchase turnover, non/short levy of tax/penalty/surcharge, incorrect adjustment of input tax credit (ITC), irregular concession/exemption, incorrect application of rate of tax, misuse of declaration forms etc. as mentioned in the succeeding paragraphs in this chapter. These cases are illustrative and are based on a test check carried out in audit. Such omissions on the part of assessing authorities are pointed out in audit each year, but not only do the irregularities persist; these remain undetected till an audit is conducted. There is need for the Government to improve the internal control system including strengthening of internal audit.

- **Non-observance of provisions of the Act/Rules**

The KVAT Act provides as under:

- *Section 4 for levy of output tax at prescribed rates;*
- *Section 10(2), 11, 14 and 17 for deduction of ITC subject to certain restrictions;*
- *Section 10(3) for net tax liability which shall be the amount of output tax less the input tax deductible;*
- *Section 10(5) for adjustment/refund of excess ITC for any other tax period;*
- *Section 9-A for tax deduction at source in respect of works contractors;*
- *Section 15 for composition of tax in lieu of net tax payable;*
- *Sections 35 and 36 for levy of interest for omission to pay tax;*
- *Section 35(4) for furnishing of revised returns within six months after the end of the relevant tax period; and*
- *Section 72(2) for levy of penalty for understatement of output tax/overstatement of ITC.*

Under the KVAT Act, every registered dealer is required to furnish returns in the prescribed form and pay the tax due on such return within 20 days after the end of the preceding month or any other tax period. Every dealer shall be deemed to have been assessed to tax based on such return filed by him. Where any prescribed authority has grounds to believe that any return furnished, which is deemed as assessed, understates the correct tax liability, it may re-assess such cases.

We noticed in test check of the records of 46 VAT offices that the above provisions were not fully followed by the concerned Assessing Authorities (AAs). This resulted in a number of discrepancies with non/short realisation of Government revenue amounting to ₹ 8.20 crore in 168 cases. The Department furnished replies in respect of 90 cases and accepted audit observations in 88 cases involving ₹ 3.70 crore and intimated recovery of ₹ 1.32 crore in 39 cases. The Department did not accept the audit contention in two cases for which suitable rebuttal has been made in the relevant paragraph. In respect of the remaining 78 cases final reply has not been received (January 2011).

2.13.1 Excess/incorrect allowance of input tax

17 VAT offices in five⁴ districts.

Input tax in relation to a registered dealer means the tax paid or payable on the purchase of any goods for use in his business.

We noticed between January 2008 and January 2010 that 28 assesseees had claimed ITC of ₹ 11.00 crore in 168 (166 deemed assessments and two reassessments) returns for tax periods between April 2005 and March 2009. The input tax admissible as per the provisions of the Act in these cases was ₹ 8.41 crore, which resulted in excess/ incorrect allowance of input tax of ₹ 2.59 crore. This was due to arithmetical errors, allowance of ITC on labour charges/ITC restricted goods, allowance of ITC without purchases, etc. A few illustrative cases are mentioned below:

(Rupees in lakh)				
Sl. No.	District/No. of dealers	Nature of objection	Input tax claimed/Input tax allowable	Amount of excess/incorrect input tax
1.	Bangalore/01	The input tax on purchase turnover of ₹ 73.84 lakh (at 12.5%) works out to ₹ 9.23 lakh. However, the dealer claimed ITC of ₹ 15.72 lakh during August 2007, due to arithmetical error.	15.72/9.23	6.49
2.	Bangalore/01	A dealer claimed ITC of ₹ 27.58 lakh for the month of March 2006 in his monthly return. Our scrutiny however revealed that he had made no purchases during the month of March 2006. As such his claim for the month was incorrect.	27.58/Nil	27.58
3.	Ramanagara/01	A dealer claimed ITC of ₹ 62.86 lakh during 2005-06 and 2006-07 on labour charges which was not admissible as no tax has been paid on such labour charges.	62.86/ Nil	62.86

After we pointed out the cases, the Department accepted audit observations in respect of 17 cases involving ₹ 1.41 crore and recovered ₹ 53.39 lakh in seven cases. We have not received final reply in the remaining cases (January 2011).

We reported the cases to the Government in June 2010; we have not received their reply (January 2011).

⁴ Bangalore, Belgaum, Chitradurga, Gulbarga, Ramanagara.

2.13.2 Underassessment of output tax/net tax

14 VAT offices in four⁵ districts.

Every registered dealer shall be liable to pay tax on his taxable turnover (output tax) at the rates specified in the relevant schedules to the Act. In respect of goods not specified in any of the schedules, tax is payable at the rate of 12.5 per cent. The net tax payable by a registered dealer in respect of any tax period shall be the amount of output tax payable by him less the input tax deductible by him.

We noticed between May 2008 and January 2010 that the taxable turnover of 30 assesseees for the tax periods between April 2005 and March 2009 amounted to ₹ 101.45 crore. The output tax/net tax liability worked out by audit amounted to ₹ 6.87 crore. However, the assesseees declared output tax/net tax liability of only ₹ 5.16 crore in their 198 (197 deemed assessments and one reassessment) monthly returns/annual statements. This was due to application of incorrect rate of tax, error in computation of the tax liability, claiming of incorrect exemption on taxable turnover, etc. This resulted in underassessment of output tax/net tax amounting to ₹ 1.72 crore.

After we pointed out the cases, the Department accepted audit observations in respect of 16 cases involving ₹ 57.75 lakh and recovered ₹ 95,614 in one case. We have not received final reply in the remaining cases (January 2011).

We reported the cases to the Government in June 2010; we have not received their reply (January 2011).

2.13.3 Non/short levy of interest

19 VAT offices in five districts.

Every dealer is liable to pay simple interest at the rate of 1.25 per cent per month on any amount of tax omitted to have been declared in a return and also for default in payment of tax wrongly collected. Further, interest shall also be demanded on additional tax liability determined on re-assessment.

We noticed between October 2008 and January 2010 that while finalising 328 assessments (165 deemed assessments and 163 reassessments) of 38 assesseees for the tax periods between April 2005 and March 2009, an additional demand of ₹ 11.42 crore was raised. However, interest of ₹ 1.38 crore was either not levied or

levied short as detailed below:

(Rupees in lakh)			
Sl. No.	District (number of assesseees)	Amount of tax involved	Non/short levy of interest
1.	Bangalore (34)	1,029.45	128.87
2.	Belgaum (01)	8.58	0.89
3.	Chamarajanagar (01)	12.19	0.36
4.	Kodagu (01)	3.32	1.31
5.	Mysore (01)	89.07	6.24
Total (38)		1,142.61	137.67

⁵ Bangalore, Bellary, Dakshina Kannada, Koppal.

After we pointed out the cases, the Department accepted audit observations in respect of 21 cases involving ₹ 69.51 lakh and recovered ₹ 50.69 lakh in 15 cases. We have not received final reply in the remaining cases (January 2011).

We reported the cases to the Government in June 2010; we have not received their reply (January 2011).

2.13.4 Excess adjustment of credit/refund amount

14 VAT offices in five⁶ districts.

Any dealer in whose case, on the basis of return filed for any tax period, the input tax deductible exceeds the output tax payable by him, such dealer may adjust the excess amount towards the tax payable by him for any other tax period.

We noticed between October 2008 and January 2010 that 25 assesseees in their returns filed for 33 tax periods (26 deemed assessments and seven reassessments) between June 2005 and September 2008, adjusted credit/refund amount of

₹ 2.48 crore brought forward from earlier tax periods as against ₹ 1.56 crore due to them as credit/refund. This resulted in excess adjustment of credit/refund amount of ₹ 92.33 lakh.

After we pointed out the cases, the Department accepted audit observations in respect of eight cases involving ₹ 32.51 lakh and recovered ₹ 1.80 lakh in one case. We have not received final reply in the remaining cases (January 2011).

We reported the cases to the Government in June 2010; we have not received their reply (January 2011).

2.13.5 Non/short levy of penalty

17 VAT offices in five districts.

A dealer who for any prescribed tax period furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five *per cent* of his actual liability to tax or his actual tax credit, as the case may be, shall after being given the opportunity of showing cause in writing against the imposition of a penalty, be liable to a penalty equal to ten *per cent* (20 *per cent* up to 31 March 2006) of the amount of such tax under or overstated.

We noticed between October 2008 and January 2010 that 32 assesseees had either understated the output tax liability or overstated the ITC amounting to ₹ 6.41 crore for 192 tax periods (101 deemed assessments and 91 reassessments) between April 2005 and March 2009. However, we observed that the AAs had either not levied

or levied short penalty of ₹ 76.59 lakh as detailed below:

⁶ Bangalore, Dakshina Kannada, Gulbarga, Haveri, Mysore.

(Rupees in lakh)			
Sl. No.	District (number of assessees)	Amount of tax involved	Non/short levy of penalty
1.	Bangalore (26)	516.57	62.51
2.	Belgaum (01)	49.99	5.00
3.	Chamarajanagar (02)	15.56	1.56
4.	Mangalore (02)	41.53	4.15
5.	Mysore (01)	16.88	3.37
Total (32)		640.53	76.59

After we pointed out the cases, the Department accepted audit observations in respect of 13 cases involving ₹ 19.51 lakh and recovered ₹ 13.71 lakh in eight cases. In two cases, the Department replied that penalty was not leviable as the net tax liability in the revised returns was not in excess of five *per cent* of that declared in the original return. However, we noticed that in one case, for the tax period December 2007, the assessee claimed ITC of ₹ 181.36 lakh as against eligible ITC of ₹ 58.01 lakh and for the tax period January 2008, he declared output tax of ₹ 331.66 lakh as against ₹ 390.49 lakh. In the other case, the assessee declared output tax of ₹ 80.99 lakh as against ₹ 116.33 lakh for the tax periods November 2007 and February 2008. As the understated output tax liability or overstated ITC in these cases was more than five *per cent*, the assessees were liable to penalty and hence the reply is not correct. We have not received final reply in the remaining cases (January 2011).

We reported the cases to the Government in June 2010; we have not received their reply (January 2011).

2.13.6 Loss of revenue due to acceptance of belated returns

Three VAT offices in two⁷ districts.

If any dealer, having furnished a return under the Act, discovers any omission or incorrect statement therein, he shall furnish a revised return within six months from the end of the relevant tax period.

We noticed between June and August 2009 that three assessees filed revised returns between May and December 2008 for 15 tax periods (deemed assessments) between April and November 2007 belatedly, with an average delay of five months, and were accepted by LVOs declaring less tax

liability than that declared in the original returns. Thus, acceptance of belated revised returns resulted in loss of revenue of ₹ 37.17 lakh.

After we pointed out the cases, the Department accepted audit observations in respect of two cases involving ₹ 7.83 lakh. We have not received final reply in the remaining cases (January 2011).

We reported the cases to the Government in June 2010; we have not received their reply (January 2011).

⁷ Bangalore, Bellary.

2.13.7 Incorrect adjustment of TDS

Five VAT offices in two⁸ districts.

The authority deducting the tax payable by a dealer in respect of any works contract executed for him in the State shall issue a certificate of TDS in Form VAT 156. A dealer adjusting the TDS against the net tax payable by him, in his return for any tax period, shall enclose the certificates of TDS to the return.

We noticed between April 2009 and November 2009 that six assesseees in their returns filed for 50 tax periods (deemed assessments) between October 2006 and March 2008, adjusted an amount of ₹ 33.57 lakh from output tax payable, as TDS from them. We observed that the required TDS certificates were not enclosed for the amount claimed as TDS and the returns were accepted by the concerned LVOs. Acceptance of

claim of TDS not supported by the prescribed certificate deprived the Government of revenue of ₹ 33.57 lakh.

After we pointed out the cases, the Government/Department accepted audit observations in respect of five cases involving ₹ 30.32 lakh and recovered ₹ 3.21 lakh in two cases. We have not received final reply in the remaining one case (January 2011).

2.13.8 Incorrect grant of exemption

Three VAT offices in two⁹ districts.

No deduction is admissible from the total consideration, in respect of a dealer engaged in works contract who had opted for composition of tax; exception being amounts paid to sub-contractor as consideration for execution of works contract, subject to production of document in proof that such sub-contractor is a registered dealer liable to tax under the Act and that the turnover of such amounts is included in the monthly returns filed by him.

We noticed between June 2008 and December 2009 that six assesseees, who opted for composition, filed 158 returns (deemed assessments) for tax periods between April 2005 and March 2008 and claimed exemptions towards labour charges, earthwork excavation charges, etc. involving a

turnover of ₹ 2.83 crore, which were accepted by the AAs. This resulted in short levy of tax of ₹ 11.32 lakh.

After we pointed out the cases, the Department accepted audit observations in all the cases and recovered ₹ 7.91 lakh in five cases.

We reported the cases to the Government in June 2010; we have not received their reply (January 2011).

⁸ Bangalore, Mangalore.

⁹ Bangalore, Mysore.