

EXECUTIVE SUMMARY

Tax collection	In 2010-11, the collection of taxes on sales, trade, etc. which stood at ` 20,234.69 crore, had increased by 28 <i>per cent</i> over the previous year.
Absence of Internal Audit Wing	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. After we had recommended in 2009-10 to Government to expedite the setting up of an IAW, the same was re-established with effect from June 2011.
Insignificant recovery by the Department of observations pointed out by us in earlier years	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 ` 202.97 crore in 61 paragraphs. Of these, the Government/ Department had accepted audit observations in 50 paragraphs involving ` 49.80 crore and had since then recovered only ` 13.54 crore which was 27 <i>per cent</i> of the recovery involved.
Results of audit conducted by us in 2010-11	We conducted a test check of the records of 64 VAT offices and 12 offices of commercial taxes covering Entry tax, Entertainment tax, Agricultural Income tax and Betting tax during the year 2010-11, which revealed under-assessments of tax and other irregularities involving ` 159.67 crore in 408 cases. Of these, the Department accepted 60 cases involving ` 3.41 crore and recovered ` 8.56 crore in 316 cases which were pointed out by us in earlier years.
What we have highlighted in this chapter	In this Chapter we present a Performance audit on ‘ Cross verification of Declaration Forms in Inter-State trade and Commerce ’ involving ` 3.96 crore and a few illustrative cases involving ` 75.30 crore selected from observations noticed during our test check of records conducted during 2010-11 relating to assessment, levy and collection of taxes on sale, trade, etc. in the CTD, where we found that the provisions of the Acts/Rules were not observed.
Our conclusion	<p>The Department needs to improve the internal control system including strengthening of internal audit so that weaknesses in the system are addressed and omissions of the nature detected by us are avoided in future.</p> <p>There was no system of regular Cross verification of Declaration Forms used in Inter-State Trade to ascertain the genuineness of the forms before allowing the concessional rates of taxes on Commodities traded/transferred. Cross verification through the TINXSYS website was ineffective as</p>

	<p>upto-date information was not available and most of the details were incorrect or incomplete.</p> <p>It also needs to initiate immediate action to act upon the recommendations on the Performance Audit on 'Cross verification of Declaration Forms in Inter-State trade and Commerce' and to recover the un-realised tax, undercharge of tax, etc pointed out by us, more so in those cases where the Department has accepted our contention.</p>
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CHAPTER-II: TAXES ON SALES, TRADE, ETC

2.1 Tax administration

The levy and collection of Value Added Tax (VAT) and Sales tax are governed by the Karnataka Value Added Tax Act, 2003 (KVAT Act), the Central Sales Tax Act, 1956 (CST Act), the Karnataka Sales Tax Act, 1957 (KST Act) and the rules made thereunder. The Commercial Taxes Department (CTD) is under the administrative control of the Finance Department and headed by the Commissioner of Commercial Taxes (CCT). The CCT is assisted by the 14 Additional Commissioners (Ad Com) and Joint Commissioners (JCCTs) Minor Acts, Enforcement, Vigilance and there are 13 Divisional VAT Offices (DVO) in the State each headed by JCCT and 13 JCCT (Appeals) and 148 Audit Offices headed by Deputy Commissioners (DCCT) and Assistant Commissioners (ACCT). At the field level, VAT is being administered through 95 Local VAT Offices (LVOs) and VAT Sub Offices (VSOs) headed by ACCTs and Commercial Tax Officers (CTOs) respectively. The computer cell of the CTD is headed by an Ad Com.

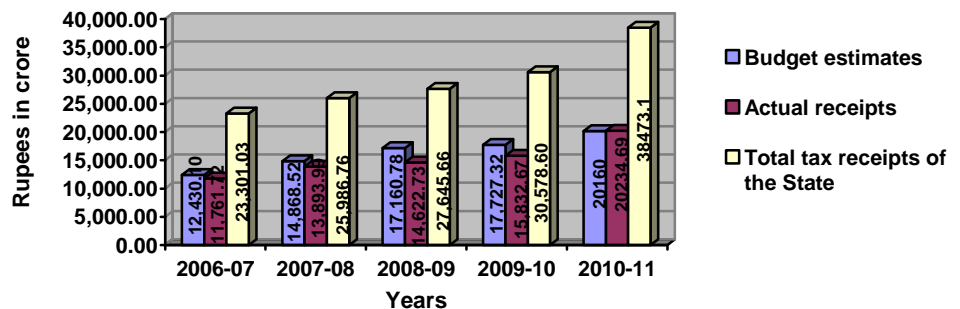
2.2 Trend of receipts

Budget Estimates (BEs) and actual receipts from taxes on sales, trade etc. during the years 2006-07 to 2010-11 along with the total tax receipts during the same period is exhibited in the following table and graphs.

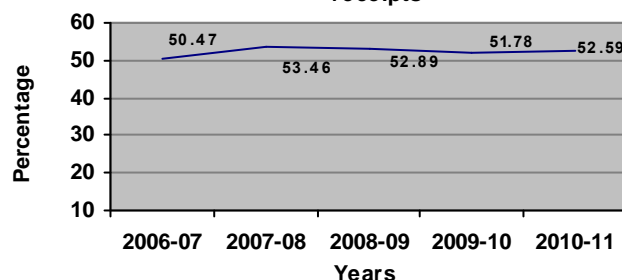
(` in crore)

Year	Budget estimates	Actual receipts	Variation excess(+)/shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
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
2010-11	20,160.00	20,234.69	(+) 74.69	(+) 0.37	38,473.12	52.59

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



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



The percentage of actual receipts of VAT to the total tax receipts ranged between 50.47 and 53.46 *per cent* during five year period from 2006-07 to 2010-11.

2.3 Analysis of arrears of revenue

The arrears of revenue as on 31 March 2011 amounted to ` 3,193.21 crore. The following table depicts the position of arrears of revenue during the period 2006-07 to 2010-11, as furnished by the CTD.

(` in crore)

Year	Opening balance of arrears	Amount collected during the year	Percentage of collection to opening balance of arrears
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
2010-11	3,750.79	320.49	8.54

The CTD stated that the arrears include ` 1,024.73 crore pertaining to deferred tax amount. Of the remaining ` 2,168.48 crore, ` 393.34 crore were stayed by court orders, ` 108.05 crore is pending before Board of Industrial and Financial Reconstruction (BIFR), ` 176.35 crore under liquidation process, ` 82.54 crore covered by revenue recovery certificates, ` 184.07 crore covered by court recovery, ` 160.59 crore held under payment verification and ` 39.99 crore was under write off proposal. The balance ` 1,023.55 crore was under recovery by the Department.

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, when it was 11.43 *per cent*.

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

2.4 Cost of VAT per assessee

The number of assessees, cost of collection, and the cost of VAT per assessee during 2006-07 to 2010-11 were as follows:

(Amount in `)

Year	Number of assessees	Cost of VAT collection	Cost of VAT collection per assessee
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
2010-11	4,03,639	92,86,95,000	2,301

2.5 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 2008-09, 2009-10 and 2010-11 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
	(` in crore)			
2008-09	16,259.37	81.62	0.50	0.83
2009-10	16,546.34	84.46	0.51	0.88
2010-11	21,252.97	92.87	0.44	0.96

2.6 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 ` 202.97 crore in 61 paragraphs. Of these, the Government/Department had accepted audit observations in 50 paragraphs involving ` 49.80 crore and had since recovered ` 13.54 crore. The details are shown in the following table:

(` in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ¹	Number	Amount
2006-07	14	23.47	14	11.12	03	2.30
2007-08	19	77.54	14	25.64	14	8.13
2008-09	09	7.41	07	1.72	06	1.36
2009-10	09	15.29	09	10.79	07	1.32
2010-11	10	79.26	06	0.53	06	0.43
Total	61	202.97	50	49.80	36	13.54

As seen from the above table, the recovery made by the Department was 27.19 per cent of the revenue involved in the total accepted cases.

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

2.7 Working of Internal Audit Wing

Internal Audit Wing (IAW) is intended to examine and evaluate the level of compliance with the rules and procedures so as to provide a reasonable assurance on the adequacy of the internal control. Effective internal audit system both in the manual as well as computerised environment is a pre-requisite for the efficient functioning of any Department. However, consequent to introduction of VAT with effect from 01 April 2005, the Department abolished the Internal Audit Wing leaving it vulnerable to the risk of control failure.

After we pointed out, the Department replied (October 2011) that an IAW was re-established in the Department with effect from June 2011.

2.8 Results of Audit

¹ Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

We conducted a test check of the records of 64 VAT offices and 12 offices of commercial taxes covering Entry tax, Entertainment tax, Agricultural Income tax and Betting tax during the year 2010-11, which revealed under-assessments of tax and other irregularities involving ` 159.67 crore in 408 cases, which fall under the following categories.

(` in crore)

Sl. No.	Category	Number of cases	Amount
	Taxes on Sales, Trade, etc.		
1.	Cross verification of Declaration Forms in Inter-State trade and Commerce (A Performance Audit)	1	3.96
2.	Incorrect exemption as sale in the course of export/import	16	72.26
3.	Non/short levy of output tax	64	21.15
4.	Incorrect/excess allowance of input tax credit	63	8.88
5.	Incorrect/excess refund carried forward	27	3.85
6.	Non/short payment of tax	74	14.38
7.	Incorrect allowance of tax deducted at source	17	22.57
8.	Non/short levy of penalty	64	5.83
9.	Non/short levy of interest	44	2.58
10.	Non-forfeiture of tax collected in excess	3	0.92
11.	Other irregularities	5	1.97
	Total	378	158.35
	Entry Tax		
13.	Non/short realisation of entry tax/penalty	3	0.05
	Entertainment Tax		
13.	Non/short realisation of entertainment tax/penalty	7	0.73
	Agricultural Income Tax		
14.	Non/short levy of interest and penalty	14	0.34
	Luxury Tax		
15.	Non/short levy of tax, interest/penalty	3	0.06
	Betting Tax		
16.	Non/short levy of tax, interest/penalty	3	0.14
	Grand Total	408	159.67

During the course of the year 2010-11, the Department accepted 60 cases involving ` 3.41 crore and recovered ` 8.56 crore in 316 cases which were pointed out by us in earlier years.

A Performance Audit on ‘**Cross verification of Declaration Forms in Inter-State trade and Commerce**’ involving ` 3.96 crore and a few illustrative cases involving ` 75.30 crore are mentioned in the following paragraphs.

2.9 Performance Audit on “Cross verification of Declaration Forms in Inter-State trade and Commerce”

Highlights

We found that the Department had not devised a proper and effective mechanism for printing/reviewing the existing stock of the Declaration Forms and the pace of issue of Declaration Forms before printing of new Forms. There were 3,150 ‘C’ Forms in stock since 2008-09, and though 1,60,000 ‘H’ forms were held in stock since 2005-06, additional 32,000 ‘H’ forms were got printed during 2008-09 when only 8,000 forms were issued up to 2009-10, leaving a closing stock of 1,84,000 forms as at the end of 31 March 2011 and thus clearly printed forms were in excess of requirements.

(Paragraph 2.9.5.1)

Very high percentage of error records (50 to 100 *per cent*) on the TINXSYS website, coupled with an incomplete database, defeated the purpose of the website for verification of the State’s Inter-State transactions.

(Paragraph 2.9.5.4)

We noticed that 79 *per cent* of the Central Sales Tax (CST) assessments were pending finalisation as on 31 March 2010, with only 21 *per cent* assessments being completed (1,55,682) as against 7,44,338 cases due for assessments, leaving a balance of 5,88,656 cases for the period 2005-06 to 2009-10. Incomplete assessments had a huge risk of tax escapement due to non-verification of claims of concessional tax on declaration forms.

(Paragraph 2.9.5.6)

We noticed that the Dealer Ledger and Demand, Collection and Balance Register/G2 Register was not maintained either in manual form or in electronic mode. The CTD had not maintained position of arrears under CST separately.

We found that there were 2,462 cases of short/non-filing of declaration/statutory forms. Though tax together with interest aggregated to ` 147.40 crore was levied, these amounts were not booked and taken as arrears of tax .

(Paragraph 2.9.5.7)

We found that the Department had not put in place any mechanism for cross verification of the Declaration Forms furnished by the dealers of the State effecting Inter-State transactions with the concerned States.

(Paragraph 2.9.5.8.1)

We noticed that in four LVOs, 36 ‘C’ forms for a turnover of ` 68.19 lakh which had originated from Nagpur, Maharashtra were not issued by those Sales Tax authorities. Five State dealers had shown Inter-State sales turnover

of ` 12.26 lakh for the year 2007-08 covered by 'C' forms which were not issued to the purchasers whose details were mentioned therein. The tax recoverable on such fake forms was ` 6.95 lakh besides penalty leviable. We found escapement of turnover of ` 8.17 crore involving a tax of ` 69.96 lakh in 20 'C' forms filed by 17 dealers in five LVOs.

(Paragraph 2.9.6)

We noticed that in four LVOs, Declarations Forms 'C', in support of Inter-State sale involving a turnover of ` 90.05 lakh though incomplete, were accepted in respect of eight dealers wherein the tax of ` 7.25 lakh was leviable by disallowing these forms.

(Paragraph 2.9.7.1)

We noticed that Intra-State sales valued at ` 75.58 lakh were done by wrongful utilisation of 12 'C' forms resulting in escapement of tax of ` 6.97 lakh while Inter-State sales valued at ` 5.76 crore were not found supported by 'C' forms. Incorrect Grant of concessional rate of tax on the form 'C' covering transactions of more than one quarter resulted in short levy of tax of ` 18.19 lakh. Inter-State sales on Forms 'C' exceeded the turnover mentioned in their Monthly and Annual Returns of 11 dealers with reference to the forms filled by them by ` 1.20 crore resulting in escapement of tax of ` 4.46 lakh.

(Paragraphs 2.9.7.2 to 2.9.7.5)

In 10 LVOs we noticed exemption from payment of tax on stock transfer without verification of the Declaration Forms which were pertaining to more than one month. The tax leviable on these irregular forms was ` 61.36 crore. A tampered 'F' Form involving tax effect of ` 1.21 crore was incorrectly accepted. The matter needs investigation

(Paragraph 2.9.8)

We found that though three assessments of two dealers for the years 2005-06 to 2007-08 were concluded, the demand notices were not served on the dealers, resulting in non-demand of tax of ` 2.33 crore.

Further in one case the AA omitted to demand and levy interest and penalty thereon of ` 69.32 lakh.

(Paragraph 2.9.9)

The 'Online Issue of Declaration Forms System' was deficient for want of adequate validation controls to prevent issue of more than one Form against an invoice, upgradation to real time presentation system and cancellation of approved forms for any reason.

(Paragraph 2.9.11.1)

2.9.1 Introduction

The Central Sales Tax Act, 1956 formulates principles for determining when a sale or purchase of goods takes place in the course of Inter-State trade or Commerce or outside a State or in the course of import into or export from India. It provides for the levy and collection of taxes on sale of goods in the course of Inter-State trade or Commerce. Though the rates are determined under the Central Law, the taxes are administered and collected by the State Government. Accordingly, every dealer, who in the course of Inter-State trade or Commerce, sells to a registered dealer, goods of the classes, specified in the registration certificate of the purchasing dealer, shall be liable to pay tax at the concessional rate of tax (four *per cent* upto 31-03-2007, three *per cent* w.e.f. 01-04-2007 and two *per cent* w.e.f. 01-06-2008) of such turnover, provided that the sales are supported by valid and complete declarations in Form 'C'. The tax payable by any dealer on his Inter-State sales turnover not supported by declaration in Form 'C' was at the rate of 10 *per cent* or at the rate of tax to sale or purchase of such goods inside the appropriate State under the Sales tax law of the State whichever was higher up to 31 March 2007. With effect from 1 April 2007, it shall be at the rate applicable to sale or purchase of such goods under the sales tax law of that State.

Exemption from levy of tax are also provided under the Act on production of specified Declaration Forms for deemed exports (Form 'H'), stock transfer to outside the State by a dealer to his any other business place or his agent or his principal (Form 'F').

Further, under the CST Act, no tax shall be leviable on a subsequent sale effected by transfer of documents of title to goods, during a movement of such goods from one State to another occasioned by an inter-State sale subject to the production of the prescribed certificates (Form 'E-I' or 'E-II') obtained from the selling dealer coupled with declarations in Form 'C' issued by the subsequent purchasing dealers.

2.9.2 Audit Objectives

We conducted the Performance Audit to assess whether:

- There exists a foolproof system for custody and issue of the declaration forms;
- Exemption/concession of tax granted by the assessing authorities (AAs) was supported by the original declaration forms;

- There was a system for ascertaining genuineness of the forms for preventing evasion of tax;
- There was a system of uploading the particulars in the TINXSYS website and the data available there is utilised for verifying the correctness of the forms;
- Appropriate steps were taken on receipt and detection of fake, invalid and defective (without proper or insufficient details) forms; and
- There exists an effective and adequate internal control mechanism.

2.9.2.1 Audit Criteria

We adopted the following criteria in the Performance Audit:

1. The Central Sales Tax Act, 1956
2. The Central Sales Tax (Registration and Turnover) Rules, 1957
3. Karnataka Value Added Tax (KVAT) Act, 2003
4. Notifications issued by Government of India from time to time
5. Notification issued by Government of Karnataka

2.9.3 Scope and methodology of audit

We conducted the Performance Audit on Cross verification of Declaration Forms (C&F) in Inter-State trade and Commerce during the period November 2010 to August 2011 with a view to assess the correctness in accounting, printing, receipt, issue and utilisation of the Declaration Forms by 12 offices of the CTD (Eight LVOs and Four AOs) during the years 2007-08 to 2009-10. We collected 10,783 Declaration Forms and verified these forms with the records of CTD of 13 States through our Accountants General/Pr. Accountants General of the concerned States. The details are mentioned in the following table.

Forms	C	F	Total
Number of Forms	42,690	1,121	43,811
Number of form on which verification report received	10,415	368	10,783

We received 7,452 Declaration forms for cross verification from other States:

Forms	C	F	Total
Number of Forms	5,706	1,746	7,452
Discrepancies found	Nil	Nil	Nil

We also test checked the assessments concluded under the CST Act, the results of the test check are also included in the Performance Audit.

2.9.4 Acknowledgement

We acknowledge the co-operation of the CTD in providing necessary information and records for audit including access to Information systems. Our findings as a result of test check of the records and system were reported to the CTD during the period December 2010 to August 2011. We held an Entry conference in December 2010 with the Principal Secretary, Finance

Department (FD), wherein the scope of audit, methodology and audit objectives were explained to the Department. Exit conference was held in December 2011 and our findings were discussed with the Principal Secretary, Finance Department and the CCT. The replies received during the exit conference and at other points of time have been appropriately commented in the relevant paragraphs of the Audit Report.

Audit findings

System deficiencies

2.9.5.1 Maintenance of accounts of receipts and use of declaration forms Printing, custody and issue of declaration forms

The CTD introduced on-line issue of Form 'C' with effect from 25 April 2009 and on-line filing of monthly return with effect from 01-04-2010. Consequent to this, the stock and issue registers lost its relevance as the same need not be maintained manually by the issuing authority.

Prior to introduction of on-line issue of Form 'C', all forms i.e., 'C', 'F' and 'H' were being obtained by the CCT from the State Government press and supplied to the divisions for distribution amongst the circle offices under their jurisdiction. Declaration forms are issued to the registered dealers by circle offices to enable them to issue prescribed declaration forms to other registered dealers for purposes specified in their registration certificate in order to avail exemption from levy of tax or to pay concessional rate of tax. Dealers had to submit periodical utilisation certificate to the circle office concerned for the declaration forms received and utilised by them, and the same is to be properly recorded by the Assessing Officer. No declaration form was to be issued by the circle office to the dealers till accounts of the utilisation of forms issued earlier to the dealer was submitted.

The details of opening stock of declaration forms, got printed during the year, issues and closing balance, as furnished by the CTD during the period 2005-06 to 2009-10 are mentioned in the following table:

Year Form	Opening stock			New forms printed			Issued during the year			Closing stock		
	C	F	H	C	F	H	C	F	H	C	F	H
2005-06	4937	25	160000	0	0	0	3370	8	0	1567	17	160000
2006-07	1567	17	160000	16563	5000	0	17150	2447	0	980	2570	160000
2007-08	980	2570	160000	15000	0	0	3440	840	0	12540	1730	160000
2008-09	12540	1730	160000	0	0	32000	9390	150	0	3150	1580	192000
2009-10	3150	1580	192000	0	0	0	0	0	8000	3150	1580	184000
2010-11	3150	1580	184000	0	0	0	0	390	0	3150	1190	184000

It can be seen from the above table that:

- i. The Department had 3,150 'C' Forms held in the closing stock since 2008-09, for which the CTD had not issued any directions for disposal of these forms.
- ii. Though 1,60,000 'H' forms were held in stock since 2005-06, additional 32,000 'H' forms were got printed during 2008-09 and only

8,000 forms were issued up to 2009-10 leaving closing stock of 1,84,000 forms as at the end of 31 March 2011 indicating therein that the forms were printed in excess of the requirement.

This indicates that the Department had not devised a proper and effective mechanism for printing/reviewing the existing stock of the Declaration Forms and the pace of issue of Declaration Forms before proceeding for printing of additional forms.

After this being pointed out by us, the Department in the Exit conference accepted the fact that Declaration Forms were got printed in excess, which are now redundant.

2.9.5.2 Receipts and Issue

The receipt and issue of the aforesaid Declaration Forms are accounted for in separate stock registers by the division and circle offices indicating receipt and issue of various declaration forms. When the forms are issued to the dealer, the signature of the dealer as a token of receipt is to be obtained in the register. Every registered dealer to whom any declaration form is issued by the appropriate authority shall maintain complete account of every such form. The dealer has to furnish utilisation certificate to the competent authority showing the name of dealer to whom the form is issued, bill number and date and description of goods with value.

We noticed that the physical verification of statutory forms held at Head office, Divisions and assessment circles were not conducted by the CTD during our audit period.

After we pointed out, the CTD had issued instruction to the newly established internal audit wing to conduct regular physical verification of statutory forms.

2.9.5.3 Computerisation of the CTD- On-line issue of Declaration Forms

The CTD was computerised on introduction of VAT with effect from 1 April 2005. The VATSoft developed by National Informatics Centre (NIC) was made operational initially for registration of dealers and generating TIN, receipt and acknowledgement of returns and payments, capturing and analysing the contents of return for their correctness, accounting for payments, etc. On-line issue of C forms was made operational with effect from 25 April 2009. Currently the CTD is functioning in computerised environment which includes on-line filing, e-payment, on-line updation and issue of declaration forms, etc.

2.9.5.4 Tax Information Exchange System

2.9.5.4.1 TINXSYS is a centralised exchange of all Inter-State dealers spread across the various States and Union territories of India. TINXSYS will help the CTDs of various States and Union Territories to effectively monitor Inter-State trade and Commerce.

2.9.5.4.2 TINXSYS could be used by any dealer to verify the counterpart dealer in any other State. Apart from dealer verification, CTDs could use TINXSYS for verification of the Statutory Forms issued by other State CTDs

and submitted to them by the dealers in support of claim for concessions or exemptions. TINXSYS would also provide MIS and Business Intelligence Reports to the CTDs to monitor interstate trade movements and enable Empowered Committee (EC) of State Finance Ministers to monitor the trends in Inter-State trade. TINXSYS would be used as an effective centralised tool for verification and monitoring of interstate trade in post VAT scenario.

2.9.5.4.3 Ineffective TINXSYS

As and when the Commercial Tax Department uploads the data of the statutory forms to the TINXSYS, the website provides the details of information of Data Extracted by the Department and the error data details in the form of messages (included in the details). As could be seen from the TINXSYS, the detailed information of data extracted, the number of error records are very high on each and every occasion of uploading of forms.

We downloaded (7-06-2011) the data relating to the 'C' & 'F' forms uploaded for the month of November 2010 on 31-05-2011 by CTD from the TINXSYS website and found that the percentage of error records ranged from 50 per cent to 100 per cent as mentioned in the following table:

Sl. No.	Type of Data	Extracted records	Correct records	Error Records	Percentage of error records
1	Dealer Business Information	8870	4435	4435	50
2	C forms issued	178138	88091	90047	51
3	C forms utilisation	357360	87010	270350	76
4	C form Invoice details	1816125	443169	1372956	76
5	C forms received	1074	NIL	1074	100
6	F forms issued	1810	892	918	51
7	F form invoice details	7253	NIL	7258	100
8	F forms received	108	NIL	108	100

We noticed that, on every occasion of uploading of information of statutory forms, the percentage of error records varied from 50 to 100 per cent. The existence of large number of error records in the TINXSYS, and non-availability of latest information of statutory forms, the cross verification of the data by the other States virtually would not fetch the required results and purpose of cross verification by the CTDs of other States would become ineffective thereby defeating the intended purposes of the web site. The CTD of Karnataka had not taken any action to correct the error records right from the inception of the TINXSYS website to till date.

The TINXSYS was, thus, totally ineffective as large number of error records/data exist, which hampers the cross verification and defeated the very purpose for which it was established.

2.9.5.4.4 Deficiencies noticed in updating/non-availability of Declaration Form details in TINXSYS

We found the following deficiencies in the updation of TINXSYS system:

- Even though the data availability statistics at the TINXSYS website shows the last updated date as 31-05-11 for the State of Karnataka, forms issued

after 01-12-2010 were not traceable on the website. This indicates a data updation lagging behind by more than 6 months.

- Ten declaration forms drawn from ISSUE TABLE of VATSoft Database issued during the financial year 2009-10 (prior to 31-11-2010) were also not traceable in the TINXSYS site. These are given below:

Sl. No.	TIN to whom issued	Type	Series	Form No.	Date of issue
1	29790077420	C	KA-C/01	951932	4/28/2009
2	29500247960	E1	E	137132	11/11/2009
3	29390146122	F	3	602000	2/16/2010
4	29960061467	C	TCK-R	2616304	5/14/2010
5	29910034189	C	G-21	695603	5/15/2010
6	29170128104	H	F1	150501	5/27/2010
7	29060085533	F	KA-F/01	312031	6/18/2010
8	29290787056	F	KA-F/01	97195	6/30/2010
9	29560075364	F	KA-F/01	97222	7/1/2010
10	29310117066	F	H	706605	9/17/2010

The reasons for non-updating or uploading of these forms to TINXSYS are not forthcoming.

2.9.5.4.5 The following lack of controls and related issues were also noticed in connection with the updating of data on TINXSYS.

- It was observed that no input controls are available in the system to ensure that serial numbers of the declaration forms are entered in the standard/uniform format in the statutory form issue database. Several entries in incorrect/non-uniform format (“0012393-97”, “hI” instead of “H1”, “ka-c/01” instead of “KA-C/01”) are noticed in the statutory form issue database. Since this table gets directly uploaded to TINXSYS, the site will fail to respond to queries based on entry of serial numbers and show the forms as untraced. This undermines the utility of the site and makes it ineffective in achieving its intended purpose.
- It is also observed in many cases that the selling dealer information available in the database of statutory form utilisation, had failed to upload into TINXSYS.
- The belated and delayed uploading of the details of statutory forms to the TINXSYS defeats the very purpose for which the web site was established.

2.9.5.5 ‘Copy’ function in statutory forms issued on-line not disabled

Under on-line issue of statutory forms, the dealers submit requests for Declaration Forms on-line on the basis of inter-State purchases effected. After verification and approval by the CTD, the forms are issued online, which the dealers can take print outs and submit to their respective inter-State sellers. It was observed that as the online format of the statutory forms are not in the ‘pdf’ format and the ‘copy’ function in the format of form provided on-line was not disabled, the system permits the dealer to copy the form on to any word processing application and take unlimited number of copies with suitable alterations in form number, date, dealer name, purchase invoice/bill particulars, amount, etc. Deficiency of this control may lead to a proliferation of bogus

forms in the absence of automatic online mechanisms for authentication of forms between all participating States.

2.9.5.6 Non-finalisation of VAT and CST Assessments

The Government of Karnataka implemented the KVAT Act with effect from 1 April 2005. Under the KVAT Act, every dealer shall be deemed to have been assessed to tax based on the return filed by him.

In this scenario, we are of the opinion that there is a potential risk of dealers claiming concessional rate of tax or exemption from levy of tax in their CST returns without filing the mandatory declaration forms. The potential risk of misclassifying local sale as Inter-State sale to claim exemption/concessional rate of CST against the liability to pay tax at higher rates under the KVAT Act cannot be ruled out. These kind of evasions could not be detected and corrected unless scrutiny assessments are concluded by the Department or the mechanism prescribed for filing utilisation details of declaration forms are duly monitored.

Under the CST Act, scrutiny assessments were to be taken up and completed for every year. As per the information furnished by the CTD, total number of 1,55,682 assessments (about 21 *per cent*) only were concluded as against 7,44,338 cases due for assessments, leaving a balance of 5,88,656 cases (about 79 *per cent*) for the years 2005-06 to 2009-10. The year wise pendency position is mentioned in the following table:

Year	Number of cases due for assessments	Assessments concluded	Percentage of completion of assessments	Pending assessment cases	Percentage of pending assessments
2005-06	1,08,736	40,951	37.66	67,785	62.34
2006-07	1,18,405	68,522	57.87	49,883	42.13
2007-08	1,10,844	17,223	15.53	93,621	84.47
2008-09	1,68,178	16,303	09.69	1,51,875	90.31
2009-10	2,38,175	12,683	05.32	2,25,492	94.68
Total	7,44,338	1,55,682	21	5,88,656	79

The above table would reveal that the percentage of assessments concluded each year from 2006-07 to 2009-10 was declining despite the increase in number of dealers under CST each year.

The details of additional revenue generated and collected from the CST assessment concluded from 2005-06 to 2009-10 were as mentioned in the following table:

(` in lakh)				
Year	Assessments completed	Additional demand for revenue raised in the assessment orders	Additional revenue collected	Percentage of collection
2005-06	40,951	2,713.58	746.27	27.50
2006-07	68,522	14,131.11	10,286.85	72.79
2007-08	17,223	8,449.33	6,056.93	71.68
2008-09	16,303	32,217.73	5,317.27	16.50
2009-10	12,683	12,229.07	4,827.35	39.47
Total	1,55,682	69,740.82	27,234.67	39

From the above table it is obvious that substantial additional revenue was raised by the Department on conclusion of assessments. Hence, timely

conclusion of the remaining 5,88,656 cases pending for assessment would result in substantial tax revenue to the Government.

After we pointed out, the CTD issued circular instructions to all the Divisional VAT Officers (DVOs) to take out the pendency of CST assessments from 2005-06 to 2009-10 through Comprehensive Audit System (CAS) for early completion of assessments.

In the Exit conference CCT mentioned that separate action is being taken to reduce the pendency in assessments.

2.9.5.7 Correctness of the arrears of revenue under CST and KVAT – Non-maintenance of records

The Karnataka Commercial Taxes Manual (KCT Manual) prescribed maintenance of various demand registers to watch recovery of arrears of tax.

We noticed that the internal control mechanism of the Department is very weak as the Department had not devised a mechanism or system to watch the assessments, collection, remittances and refunds under CST or VAT as evidenced by the absence of maintenance of the Dealer Ledger and Demand, Collection and Balance Register/G2 Register either in manual as prescribed in the KCT Manual or in electronic mode. The CTD had not maintained position of arrears under CST separately.

We also noticed in seven² LVOs that as per the assessments concluded there were 2,462 cases of short/non-filing of declaration/statutory forms. In respect of these cases differential tax together with interest aggregated to ` 147.40 crore were levied and demand notices were served to the concerned dealers. However, these amounts were not booked and taken as arrears of tax under CST. This includes demand notices issued under CST for ` 52.19 crore for the assessment years 2005-06 and 2006-07 to M/s. Hindustan Aeronautics Limited.

Though the demand notices were issued in these cases between January 2009 and March 2010, follow up actions for recovery of these demands were not forthcoming from the records. As a result the position of arrears of revenue stated by the CTD being not only inaccurate, but also there was no effective action for recovery of these amounts from the dealers concerned, which is a matter of serious concern.

After we pointed out, the CTD stated in October 2011 that circular instructions were issued in June 2011 to update arrears position within three months and submit the same to Commissionerate for follow-up action.

2.9.5.8 Absence of a system of cross verification of declaration forms

² LVO: 010, 090, 110, 120, 130, 140 and 045.

As the declaration forms filed by the dealers provide them with concession/exemption from levy of tax, filing of fake or inflated value in declarations by the dealers is a potential risk. Therefore, cross verification of the declaration forms by the State/s in which the forms were received with the originating State of those forms is an effective internal control to check this risk.

2.9.5.8.1 During the course of the Performance Audit we found that the Department had not put up any mechanism to cross verify the declaration forms furnished by the dealers of the State effecting inter-State transactions with the concerned States. No statistical information indicating the details for cross verification of Declaration Forms filed by the dealers in the LVOs with the concerned originating State was made available to us.

2.9.5.8.2 We noticed that in cases of loss of forms due to theft, fire mishaps, etc. the Department issues gazette notifications to invalidate such forms and news paper advertisement are also given. However, the gazette notification alone would not serve the purpose as the invalidated forms if issued by any dealer would be getting the benefit of tax exemption/concession in the State to which they were issued. Hence it is important to communicate to all the other States regarding the cancellation of those forms. Effective measures taken if any, by the Department to prevent the misuse of such cancelled declarations though called for has not been received (January 2012).

2.9.5.8.3 The CTD received requests from various other States for the cross verification of “suspected” declaration forms. We noticed that in such cases, except for forwarding the letter to the concerned LVOs, the Department had not watched the progress of verifications of such forms. We also noticed from some of the correspondence between the office of the AdCom (I&C) and LVOs that the AdCom (I&C) fixed the time frame to furnish the detail by the LVOs. However the details were not furnished by the LVOs promptly and thus did not adhere to the time frame.

Compliance deficiencies

2.9.6 Irregularities based on cross verification of details of Declaration Forms

We noticed the following types of irregularities from the cross verification of details of Declaration Forms received from CTD of other States through our State Accountants General/Pr. Accountants General.

2.9.6.1 In four³ LVOs, nine State dealers filed 36 ‘C’ forms for a turnover of ` 68.19 lakh for the period 2005-06 and 2006-07, which had originated from Nagpur, Maharashtra. Our cross verification with the concerned authorities in Nagpur revealed that these Forms were not issued by those Sales Tax

³ LVOs 120, 090, 130, 110.

authorities. These transactions involving tax effect of ` 5.79 lakh required verification.

In the Exit conference the CCT stated that these cases would be verified and details would be furnished by the end of December 2011.

2.9.6.2 Five State dealers had shown Inter-State sales turnover of ` 12.26 lakh for the year 2007-08 covered by 'C' forms. Our cross verification of these forms with the concerned States revealed that those 'C' forms were not issued to the purchasers whose details were mentioned therein. As such, the transactions required verification for escapement of tax of ` 1.16 lakh.

2.9.6.3 In seven cases 'C' forms were filed by the dealers in support of their claim of Inter-State sales of various commodities for ` 28.75 lakh effected to purchasers in Uttarakhand and Jammu & Kashmir during the year 2007-08. Accordingly tax at a concession rate of 4 *per cent* was paid by the dealer which was accepted by the AAs. However, our cross verification revealed that the registration certificate of the dealers in the respective States to whom the goods were stated to have been sold did not cover the goods sold. Thus the inter-State transactions involving tax effect of ` 2.73 lakh required verification.

2.9.6.4 In one case, 'C' forms filed by a dealer in support of his claim of Inter-State sales of parts and accessories of motor vehicles for ` 29.23 lakh effected during the year 2006-07 to a purchaser in Uttar Pradesh dealing with beverages and soft drinks. Accordingly tax at a concession rate of 4 *per cent* was paid by the dealer and was accepted by the LVO-130. However, our cross verification revealed that the registration certificate of the dealer in respective State to whom the goods were stated to have been sold did not cover those goods. The transaction required verification for escapement of tax of ` 2.49 lakh.

2.9.6.5 In 20 'C' forms filed by 17 dealers in five⁴ LVOs in support of their Inter-State sales turnover of ` 8.87 crore, our cross verification with the concerned States revealed that the respective purchasers declared purchase turnover of ` 70.02 lakh only. Thus, escapement of turnover of ` 8.17 crore involving a tax of ` 69.96 lakh required verification.

2.9.7 Deficiencies noticed in the Assessments

2.9.7.1 Acceptance of incomplete declaration forms

⁴ LVOs 90, 110, 120, 130 and 10.

CST Act, 1956 provides that concessional rate of tax under the Act shall not be applicable unless a dealer claiming such concession furnishes to the prescribed authority a declaration duly filled and signed by the Registered dealer in support of the inter-State transaction made by him. Thus incomplete Declaration Forms are liable to be rejected for the purpose of concessional rate of tax.

We noticed that four⁵ LVOs, accepted Declarations Forms 'C' in support of inter-State sale involving a turnover of ` 90.05 lakh for the years 2005-06 to 2007-08, in respect of eight dealers. Our scrutiny of the Declaration Forms revealed that the forms did not contain prescribed particulars such as date of issue, to whom issued, registration numbers, etc. These forms were liable to be rejected and concessional rate of tax

claimed by the dealer was not admissible but the LVO failed to detect the omissions resulting in short levy of tax of ` 7.25 lakh.

2.9.7.2 Misuse of 'C' Form

Under the CST Act, a dealer shall not be entitled to a concessional rate of tax unless he produces the Declaration forms in support of his inter-State sale.

In case a dealer furnishes a false Declaration for claiming concessional rate of tax, he shall after being heard, be liable to simple imprisonment or with a daily fine which may extend to ` 50 for every day during which the omission continues under section 10 of the CST Act 1956

We noticed from the Monthly Returns and Annual Returns filed by two dealers in two⁶ LVOs that the dealers had made intra-State sales valued at ` 75.58 lakh by utilising 12 'C' forms for the year 2006-07 and 2007-08. This was evident from the fact that these 'C' forms were issued to the dealers

in Karnataka by the dealers registered in Karnataka. However the LVOs while accepting the returns submitted by the dealers and raising the demands (March and August 2009) did not detect the omissions. The issue of the Declaration Forms involving tax of ` 6.97 lakh needs investigation as detailed in the following table:

⁵ LVOs 10, 90, 120 and 130.

⁶ LVOs 110 and 130.

(` in lakh)

Sl. No.	C Form No.	Assessing authority	Authority by whom issued	Year	Turnover	Differential rate of tax	Short levy of tax
1.	TCK R 4301654	LVO 110	LVO 035	2006-07	4.19	8.5	0.36
2.	TCK R 4961935	LVO 110	LVO 110	2006-07	8.04	8.5	0.68
3.	TCK R 4959415	LVO 110	LVO 120	2007-08	5.91	9.5	0.56
4.	TCK R 4959416	LVO 110	LVO 120	2007-08	4.82	9.5	0.46
5.	TCK R 4301655	LVO 110	LVO 035	2007-08	3.19	9.5	0.30
6.	KAC/01 236498	LVO 110	LVO 120	2007-08	18.96	9.5	1.80
7.	4704602	LVO 130	LVO 140	2006-07	3.74	8.5	0.32
8.	4704603	LVO 130	LVO 140	2006-07	5.08	8.5	0.43
9.	4704499	LVO 130	LVO 140	2007-08	13.99	9.5	1.33
10.	4704498	LVO 130	LVO 140	2007-08	5.65	9.5	0.54
11.	4717768	LVO 130	LVO 060	2007-08	0.77	9.5	0.07
12.	4704497	LVO 130	LVO 140	2007-08	1.24	9.5	0.12
Grand total					75.58		6.97

Further, the penalty for misuse of Form 'C' was also leviable under the Act.

2.9.7.3 Non- production of 'C' Forms

In five⁷ LVOs we noticed from Monthly Returns and Annual Returns filed by 19 dealers made inter-State sales valued at ` 5.76 crore during the period 2005-06 to 2007-08. We found that neither these sales were supported by 'C' forms nor was the production of forms mentioned anywhere in the returns filed by the dealer. As such these sales were liable to be rejected for concessional rate of tax. However, we noticed that the LVOs did not notice the omission while issuing demand notices between December 2008 and September 2009 on the basis of the returns filed by the dealers.

Thus, grant of concessional rate of tax without production of C forms was incorrect resulting in short levy of tax of ` 49.36 lakh as detailed in the following table:

(` in lakh)

Sl No.	Year	Turnover involved	Rate of tax (percentage)			Short levy of tax
			Leviable	Levied	Differential	
1	2005-06 and 2006-07	325.33	12.5	4	8.5	27.65
2	2007-08	197.93	12.5	3	9.5	18.80
3	2005-06 and 2006-07	47.44	10	4	6	2.85
4	2007-08	5.60	4	3	1	0.06
Total		576.30				49.36

2.9.7.4 Incorrect Grant of concessional rate of tax on the form 'C' covered transactions of more than one quarter

Rule 12 of the CST (Registration and Turnover) Rules, 1957, provide that a Declaration Forms 'C' furnished by a dealer should not cover transactions of more than *one quarter* of a financial year between same dealers.

We noticed from the Declaration Forms and Monthly Returns submitted by the five dealers in support of their inter-State sale valued at ` 2.42 crore in four⁸

⁷ LVOs 010, 030, 110, 120 and 130.

⁸ LVOs 120, 110, 130 and 010.

LVOs that the Declaration Forms ‘C’ furnished by them during the period 2005-06 to 2007-08 covered transactions of more than *one quarter*. Hence the same were liable to be rejected. However, the LVOs while raising the demand (May to August 2009) for the unpaid amount on the basis of the returns filed by the dealers failed to detect the omission. This has resulted in short levy of tax of ` 18.19 lakh at the differential rates of tax as detailed below.

(` in lakh)

Sl No.	Year	Turnover involved	Rate of tax (percentage)			Short levy of tax
			Leviable	Levied	Differential	
1	2005-06 and 2006-07	96.46	12.5	4	8.5	8.20
2	2007-08	62.07	12.5	3	9.5	5.90
3	2005-06 and 2006-07	65.21	10	4	6	3.91
4	2007-08	18.27	4	3	1	0.18
	Total	242.01				18.19

2.9.7.5 Suppression of sales turnover

In five⁹ LVOs we noticed from the returns that the inter-State sales mentioned by 11 dealers in the Declaration Forms ‘C’ filed by them in support of their inter-State sale was in excess of the turnover declared by them in their Monthly and Annual Returns for the years 2005-06 to 2007-08 by ` 1.20 crore.

This indicates that the concerned LVOs while accepting and raising the demands on the basis of returns between 2008-09 and 2009-10 did not reconcile the figures mentioned in the Declaration Forms with the returns filed by the dealer. Thus sales valued ` 1.20 crore involving tax of ` 4.46 lakh for the periods from 2005-06 and 2007-08 escaped assessment. Besides, the dealers had suppressed the sales in their returns; interest and penalty was also leviable.

2.9.8 Incorrect grant of exemption of stock transfer turnover

Under the CST Act 1956 read with Rule 12(5) of the CST (Registration and Turnover) Rules, 1957, transfer of goods from one state to another “*other than by way of sale*” are exempted from levy of tax provided the turnover is covered by declaration in Form ‘F’. A single declaration Form ‘F’ requires to cover stock transfers pertaining to *one calendar month* of the year only.

2.9.8.1 In 10¹⁰ LVOs we noticed that while finalising the assessments under the CST Act for the assessment years 2005-06 to 2007-08, the AAs had accepted Declaration Forms ‘F’ for a turnover of ` 545.06 crore covering transactions for more than *one calendar month* in violation of the

⁹ LVOs 110, 090, 010, 130 and 120.

¹⁰ LVOs 140, 120, 10, 20, 71, 61, 45, 110, 35 and 90.

provisions of the Act. Thus, the allowance of exemption without verification of the Declaration Forms resulted in non-levy of tax of ` 61.36 crore.

2.9.8.2 We noticed in ACCT, LVO-061, Bangalore that the AA granted exemption of turnover on the basis of the Declaration Form 'F'. However, it was observed that in one Form filed for ` 12.06 crore during year 2005-06, though the validity of the form was for the month¹¹ of January 2005, it was tampered and the validity¹² was mentioned as January 2006. Acceptance of the tampered Form involving tax effect of ` 1.21 crore was incorrect. The matter needs investigation.

2.9.8.3 We noticed in four¹³ LVOs of Bangalore that six dealers had not filed Form 'F' for a turnover of ` 1.46 crore during 2005-06 to 2007-08. As such the dealers were liable to tax. But the LVO did not notice the omission and accepted the returns filed by the dealers. LVOs incorrectly raised demand (December 2008 and November 2009) by allowing exemption on stock transfers. The non-levy of tax at the rate of 12.5 per cent amounted to ` 18.26 lakh.

2.9.9 Non-issue of demand notices to the dealers

A demand notice indicating the amount payable and the date by which it should be paid is required to be issued in Form VAT 210 once the assessment is finalised by AA. In case of non-payment of the tax demanded, interest and penalty are leviable.

(i) Our test check of the CST assessment records ACCT, LVO-035, Bangalore revealed that in three assessments of two dealers for the years 2005-06 to 2007-08, the AA concluded the assessment (30 June 2011) and assessed tax, interest and penalty aggregating ` 2.33 crore but

the demand notices though prepared in Form VAT 210, were not served to the dealers. This has resulted in non-demand of tax of ` 2.33 crore.

(ii) We noticed during the test check of CST assessments in ACCT, LVO-035, Bangalore that while concluding the scrutiny assessment of a dealer for the years 2005-06 and 2006-07 the AA levied a tax of ` 1.24 crore for non-filing of 'C' forms and the demand notice issued in Form VAT 180. However, the AA omitted to demand and levy interest and penalty thereon. This has resulted in non-levy of interest and penalty of ` 69.32 lakh.

After we pointed out the above omissions the CCT stated that the concerned DVO has been instructed to finalise the issue and to personally supervise the compliance. A report on further action taken has not been received.

¹¹ from 1 January 2005 to 31 January 2005.

¹² from 1 January 2006 to 31 January 2006.

¹³ LVOs 10, 90, 110 and 120.

2.9.10 Defective system of information sharing

In the erstwhile KST regime, there was a system of forwarding the documents/information gathered at check post to the respective AAs for ensuring the correctness and proper accounting of such transaction by correlating with the returns and related records furnished by the dealers.

2.9.10.1 Further, it was also noticed that the reports of the Intelligence or Vigilance wing of the Department on random check of dealers conducted by them were also not made available to the AAs/LVOs in all the cases.

2.9.10.2 In one case it was noticed that a dealer transferred the goods to his factory situated in Tamil Nadu that the scrap materials were sent for conversion into HSD/TMT rods and claimed exemption from filing Forms 'F'. The contention of the dealer was accepted by the ACCT, LVO-090, Bangalore and "endorsement" was accorded exempting the dealer from filing the declaration forms. There was an intelligence report on this case insisting the need for filing the Declaration Forms 'F'. Further, while concluding the re-assessment under the CST Act, the dealer filed the declarations in Form 'F' in the office of the DCCT, AUDIT-33, Bangalore and the re-assessment concluded accordingly. The check post documents were not available to the LVO concerned as well as to the re-assessment authority. In the absence of information sharing between different wings of the Department, the LVO was not aware that the dealer filed Declaration Forms in the Audit Office and, the Audit Officer was not aware that the LVO had furnished such an "endorsement" granting exemption of turnover without declaration forms.

Thus, due to defect in the system of information sharing between Check Posts, intelligence wing and AAs, the assessment were finalised without considering the intelligence reports and Check Post documents/declaration. Better co-ordination among different wings of the Department is very essential to avoid such kind of mistakes/omissions.

2.9.11 Inadequate Controls

As mentioned earlier, on-line issue of 'C' forms was made operational in the State w.e.f. 25 April 2009. The following lack of Application, Input and Output controls in respect of on-line issue of 'C' forms was noticed during the course of the Performance audit.

2.9.11.1 A test check of the back end data tables of on-line issue of forms revealed that in 9969 instances the Department issued 'C' forms against the same purchase invoice, date and amount. This proves that the application system lacks necessary controls to prevent the dealer from obtaining more than "one" declaration form against a single inter-State purchase. This deficiency would also result in the module being unfit for both integration with other modules and upgraded into real time system in view of the following:

- The Statutory Form Issue Module represented an inflated figure in respect of Inter-State purchases effected by the dealers and failed to integrate with the Online Returns Module in case the dealer had presented a single transaction in his return.

- The System is unfit to be upgraded to real-time online statutory form presentation system that obviates the necessity of printing and physical submission of forms and does not detect any exaggerated Inter-State sales on part of the selling dealer.
- In case the dealer inadvertently represented an invoice in more than one form, under the manual system, there was facility of cancelling the form. Under the online system the dealer was deprived the opportunity of cancelling a form after its approval by the CTD. The system at present fails to distinctly establish the difference in status of a form that had been printed and actually been issued to the selling dealer as evidence of inter-State sale at concessional rate. Thus, it was construed that the present system may be unfit to be upgraded to a real-time presentation system.

2. 9.12 Conclusion

The Performance Audit revealed a number of deficiencies in the system of finalisation of assessments under the CST Act. Due to defect in the system of information sharing among check posts, intelligence wing, LVOs and AAs/Audit Officer, in many cases assessments were finalised without considering and cross verifying the facts and documents. There was no system of regular Cross verification of Declaration Forms by the assessing officers to ascertain the genuineness of the forms. Cross verification through TINXSYS is ineffective as up-to-date information is not available and most of the details were incorrect, incomplete and erroneous; and some of the States had not subscribed to the web site also. Internal control mechanism of the Department is very weak as evidenced by the absence of non-maintenance of various registers and records. In the absence of Internal Audit Wing, the Department remained unaware of the deficiencies. The prevailing mechanism to conduct and monitor the main areas of verification and scrutiny of returns, non-filing of returns, verification of declaration forms, collection of tax, re-assessment or audit of cases etc., are not adequate to ensure proper administration of tax under the CST Act and to prevent leakage of revenue.

2. 9.13 Recommendations

The Government may consider implementing the following recommendations for rectifying the system and compliance deficiencies:

- **Prescribe a system of carrying out regular cross verification of Declaration Forms and issuing guidelines of checks to be exercised before accepting the Declaration Forms for allowing concessional rate of tax or granting exemptions;**
- **Constituting an Inter-State Intelligence wing for cross verification of transactions;**
- **Cancellation of Declaration Forms due to loss in transit, theft, fire mishaps, etc. may be notified on the Departmental website also;**

- **Defects in on-line issue of forms may be corrected immediately,**
- **Errors in the TINXSYS data may be set right promptly and make the website effective for utilisation by all interested parties;**
- **Make the Internal Audit Wing functional and effective; and**
- **Strengthen internal control mechanism by maintaining the Dealer Ledger and DCB registers either manually or in electronic form.**

2.10 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 29 VAT offices that the above provisions were not fully followed by the concerned Assessing Authorities (AAs). The omissions and irregularities in 221 cases involve non/short realisation of Government revenue amounting to ` 75.30 crore. The Department has accepted audit observations in 84 cases involving ` 53.08 lakh and intimated recovery of ` 43.32 lakh in 38 cases. In respect of the remaining cases final reply has not been received (January 2012).

2.10.1 Excess adjustment of credit/refund amount

Eight LVOs and one Audit Office in Bangalore

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 January 2010 and November 2010 that 12 assesseees in their 13 returns filed for tax periods between April 2007 and April 2009, adjusted credit/refund amount of ` 50.98 lakh as brought forward from

earlier tax periods as against ` 19.51 lakh only due to them as credit/refund. This resulted in excess adjustment of credit/refund amount of ` 31.47 lakh.

After we pointed out the cases, the Government/Department accepted audit observations in respect of six cases involving ` 13.25 lakh and recovered ` 11.26 lakh in four cases. We have not received final reply in the remaining cases (January 2012).

2.10.2 Failure to demand tax

One VAT office in one¹⁴ district

¹⁴ Bangalore.

Under the Karnataka Value Added Tax Act 2003 (KVAT), every dealer whose total turnover in a year exceeds ` 40 lakh shall have his accounts audited by a Chartered Accountant or a Cost Accountant or a Tax Practitioner (Auditor) and shall submit to the prescribed authority a copy of the audited statement of accounts in Form VAT-240 and prescribed documents in the prescribed manner.

Form VAT-240 provides for the Auditor to fill a comparative statement of dealer's liability to tax and his entitlements for input tax/refund as declared in the tax returns and corresponding correct amount determined on audit. In case of difference between them, the Auditor may advise the dealer either to pay the differential tax together with the interest and penalty if any, or to claim refund due to him as the case may be.

We noticed in the office of the ACCT (LVO-035), Bangalore in May 2010 that in an audited statement of accounts filed by a dealer¹⁵ for the year 2008-09 in December 2009, the Auditor had brought out the following differences:

(` in lakh)

Particulars	Amount as per return in Form VAT 100	Amount determined on audit in Form VAT 240	Difference
Output tax payable under the KVAT Act 2003	1,239.55	1,318.97	79.42
Input tax deduction claimed under Section 10	594.47	588.95	5.52
		Total	84.94

However, neither the Auditor advised the dealer to pay the differential tax of ` 84.94 lakh together with interest and penalty as applicable nor was the differential tax paid by the dealer. The LVO concerned also failed to demand and collect the same on receipt of the Audited Statement of Accounts on 31 December 2009. The short levy of tax worked out to ` 1.05 crore as per details below:

(` in lakh)

Tax amount short declared and paid	84.94
Interest leviable under Section 36(2) of the KVAT Act, 2003 at 1.25 per cent per month (considering that the payment was due latest by 20.4.2009) for 11 months and 10 days upto 31 March 2010.	12.03
Penalty leviable at 10 per cent of output tax declared short by the dealer in the returns as the difference was more than 5 per cent of the actual liability to tax (5% of ` 13,18,97,109 = ` 65,94,855)	7.94
Total	104.91

We reported the case to the CCT in June 2010 and to the Government in June 2011; we have not received their reply (January 2012).

¹⁵

M/s Subhash Projects & Marketing Limited (TIN: 29270327190).

We recommend that the Department issue instructions to all Assessing officers to take action under VAT Rules on receipt of audited accounts and auditor's reports reconciling taxes paid as per Returns for short fall in payment of taxes.

2.10.3 Non/short levy of penalty on Shortfall in payment of taxes as per returns

Nine VAT offices in Bangalore and Hassan districts

Section 72(2) of KVAT Act provides that 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 February and December 2010 that in 94 returns filed by 21 dealers for tax periods between April 2005 and March 2009 output tax liability was understated and ITC aggregating ` 9.06 crore was overstated. Of these in 49 cases revised returns were filed by the dealers rectifying the errors in the original returns. In the remaining 45 cases errors were rectified by the

AAs through reassessments. However, in none of these cases the penalty due was demanded by the concerned AAs. This resulted in non-levy of penalty of ` 91.35 lakh.

After we pointed out the cases, the Government/Department accepted audit observations in respect of 37 returns of eight dealers involving ` 10.41 lakh and recovered ` 9.26 lakh in seven of them.

In respect of one case involving penalty of ` 8.82 lakh, the AA concerned stated that the dealer had filed the revised return within one month of filing the original return and paid the tax alongwith interest and hence penal provision under Section 72(2) cannot be applied as provided under Section 35(4) of the KVAT Act. The reply is not tenable as the dealer has furnished revised return under Section 35(4) of the KVAT Act and had understated his tax liability by more than 5 *per cent* as such he is liable to a penalty equal to 20 *per cent* of the amount for such tax understated.

In another case the AA concerned had levied and collected penalty of ` 1.79 lakh as against ` 4.79 lakh pointed out by us. We noticed that the AA had worked out the penalty incorrectly on the understated net tax liability of the dealer instead of on understated actual output tax liability.

We have not received final reply in the remaining cases (January 2012).

2.10.4 Excess/ Incorrect allowance of input tax

Four VAT offices in Bangalore district

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 April and August 2010 that six dealers had claimed ITC of ` 6.74 crore in 24 (deemed assessments) returns for tax periods between April 2008 and

March 2009. The input tax admissible as per the provisions of the Act in these cases was ` 6.50 crore, which resulted in excess/ incorrect allowance of input tax of ` 23.95 lakh as detailed below. This was due to arithmetical errors, allowance of ITC on labour charges/ITC restricted goods, allowance of ITC without purchases, etc.

Sl. No.	LVOs	Observation in brief	Excess credit availed (` in lakh)
1.	3 LVOs	The dealers had declared purchase turnover of ` 5.17 crore on which the ITC at 12.5 percent VAT paid worked out to ` 64.56 lakhs. However, the dealers concerned claimed ITC of ` 73.10 lakh in their returns due to arithmetical errors which were accepted by the LVOs resulting in excess claim of ITC.	8.53
2.	2 LVOs	The dealers had declared purchase turnover of ` 144.74 crore on which the ITC at 12.5 percent VAT paid worked out to ` 5.79 crore. However, the dealers concerned claimed ITC of ` 5.93 crore in their returns due to arithmetical errors which were accepted by the LVOs, resulting in excess claim of ITC.	14.50
3.	1 LVO	The dealers had declared purchase turnover of ` 1.10 crore and ` 27.80 lakh on which the ITC at 12.5 percent VAT paid worked out to ` 4.38 lakh and ` 3.47 lakh respectively. However, we noticed that the dealer had filed purchase statement only for ` 96.37 lakh (at 4 per cent) and ` 24.71 lakh (at 12.5 per cent). Hence the admissible ITC was only ` 6.94 lakh.	0.92
Total			23.95

After we pointed out the cases, the Government/Department accepted audit observations in respect of two returns of a dealer involving ` 4.34 lakh and recovered the entire amount. We have not received final reply in the remaining cases (January 2012).

2.10.5 Non-levy of interest

Seven VAT offices in three 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 January and December 2010 that while finalising 33 assessments (all reassessments) of 11 assesees for the tax periods between April 2005 and March 2009, an additional demand of ` 1.31 crore was raised.

However, interest of ` 18.67 lakh was not levied as detailed below:

(` in lakh)

Sl. No.	District (number of assesees)	Amount of tax involved	Non-levy of interest
1.	Bangalore (4)	86.84	7.73
2.	Dakshina Kannada (4)	24.96	8.50
3.	Raichur (3)	19.34	2.44
Total (11)		131.14	18.67

After we pointed out the cases, the Department accepted audit observations in respect of 32 assessments of 10 dealers involving ` 15.06 lakh and recovered ` 8.44 lakh in 18 assessments of eight dealers. We have not received final reply in the remaining case (January 2012).

2.10.6 Underassessment of output tax

Seven VAT offices and one Audit Office in Bangalore and Hassan 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*.

We noticed between February and August 2010 that the taxable turnover of nine dealers for the tax periods between April 2007 and March 2009 amounted to ` 1,319.36 crore. The assesees declared output tax liability of

only ` 164.52 crore in their 35 monthly returns/annual statements whereas the tax liability worked out to ` 164.69 crore. This was due to application of incorrect rate of tax, error in computation of the tax liability, error in declaring of taxable turnover, etc. This resulted in underassessment of output tax of ` 17.47 lakh as detailed in the following table:

Sl. No.	No. of returns	Observation in brief	Excess credit availed (` in lakh)
1.	3	In the re-assessment order concluded in May 2009 the AA omitted to levy output tax at 4 <i>per cent</i> on turnover relating to sale of REP licences of ` 97.14 lakh.	3.89
2.	15	Three dealers in their 15 returns declared tax liability at 4 <i>per</i>	7.17

Sl. No.	No. of returns	Observation in brief	Excess credit availed (` in lakh)
		cent on turnover of ` 84.36 lakh relating to sale of jelly, size stone and granite instead of at 12.5 per cent.	
3.	10	Three dealers in their 10 returns declared and paid output tax of ` 164.44 crore at 12.5 per cent on sale turnover of ` 1,315.86 crore instead of ` 164.48 crore due to arithmetical error.	4.11
4.	4	A dealer omitted to pay tax at the rate of 4 per cent on his purchases from un-registered dealers amounting to ` 33.76 lakh.	1.35
5.	3	A dealer in his three returns declared and paid output tax of ` 4.42 lakh at 4 per cent on sale turnover of ` 1.34 crore instead of ` 5.38 lakh due to arithmetical error.	0.95
	35	Total	17.47

After we pointed out the cases, the Government/Department accepted audit observations in four assessments of two dealers and recovered ` 5.19 lakh. We have not received final reply in the remaining cases (January 2012).

2.10.7 Short payment of tax

Four VAT offices in two¹⁶ districts

Every registered dealer shall be liable to pay tax in respect of any taxable sale of goods made by him after deducting the tax on the purchase of goods made by him, for use in the course of business.

We noticed between January and May 2010 that four assesseees in their returns filed between April 2008 and March 2009, had short paid the net taxes amounting to ` 9.95 lakh.

After we pointed out the cases, the Government/Department accepted audit observations in respect of three cases involving ` 4.83 lakh and recovered the entire amount. We have not received final reply in the remaining case (January 2012).

2.10.8 Incorrect acceptance of belated returns

A VAT office in Bangalore district

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 in July 2010 noticed that a dealer filed revised returns for tax period July 2008 in February 2009 and claimed reduction in tax liability amounting to ` 6.38 lakh. As per the provisions the dealer was eligible to file revised return only upto 31 January 2009 and hence the revised return was liable for rejection. However, it was accepted by

¹⁶ Bangalore, Raichur.

the LVO-075. Thus, acceptance of belated revised return resulted in irregular reduction of tax liability of ` 6.38 lakh which needs to be recovered.

We reported the case to the Department in August 2010 and to Government in June 2011; we have not received their reply (January 2012).

2.11 Incorrect exemption as sale in the course of export/import

Under the provisions of CST Act, the assesses are eligible to claim certain exemptions of turnovers such as Direct Export, High sea sales or In Bond sales, etc. on the basis of the documentary evidence or proof such as Bill of lading, customs invoices, high sea sales agreement copies, etc.

We noticed in five¹⁷ LVOs of Bangalore that exemptions claimed by 16 dealers on a turnover of ` 583.71 crore as Direct exports, Sale in the course of import or High sea sales, etc., during the years 2005-06 to 2007-08 were allowed. However the dealers had not filed the documentary

evidences in support of their claim for exemptions. The irregular/incorrect grant of exemption resulted in non-levy of tax at the rate of 12.5 *per cent* on turnover of ` 575.46 crore and at four *per cent* on ` 8.25 crore amounted to ` 72.26 crore.

¹⁷ LVOs 35, 130, 110, 90 and 120.