CHAPTER II

SALES TAX/VAT

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EXECUTIVE SUMMARY

Appreciable increase in tax collection	As indicated at para 1.1.2 of Chapter-I in 2011-12, the collections of taxes from Sales Tax increased by 21.17 *per cent* and Central Sales Tax decreased by 2.55 *per cent* over the previous year.
Very low recovery by the Department on observations pointed out by us in earlier years	During the period 2006-07 to 2010-11, we had pointed out non/short-levy, non/short-realisation, underassessment/loss of revenue, incorrect exemption, concealment/suppression of turnover, application of incorrect rate of tax, incorrect computation etc., with revenue implication of ₹ 1,506.91 crore in 6,794 cases. Of these, the Department/ Government had accepted audit observations in 2,694 cases involving ₹ 406.39 crore but recovered only ₹ 5.78 crore in 185 cases. The recovery position in respect of accepted objections was very low at 1.42 *per cent* during the five year period.
Results of audits conducted by us in 2011-12	In 2011-12, we test-checked the records of 227 offices of the Commercial Taxes Department and noted preliminary audit findings involving underassessments of tax and other irregularities of ₹ 304.20 crore in 1,780 cases. The Department had accepted under assessments and other deficiencies of ₹ 42.98 crore in 735 cases, of which 52 cases involving ₹ 17.43 crore were pointed out in audit during the year 2011-12 and the rest in the earlier years. An amount of ₹ 35.43 lakh was realised in 37 cases during the year.
What we have highlighted in this chapter	In this chapter we present the results of a Performance Audit conducted on "VAT Audits and Refunds" involving tax effect of ₹ 49.39 crore and illustrative cases involving ₹ 30.21 crore. These cases were selected from observations noticed during 2011-12 in our test check of records relating to the Commercial Taxes Department as well as those which came to notice in earlier years but could not be included in previous years' reports, where we found that the provisions of the Acts/Rules were not observed. It is a matter of concern that similar omissions were pointed out by us repeatedly in the Audit Reports for the past several years, but the Department had not taken corrective action. We are also concerned that though these omissions were apparent from the records which were made available to us, the CTOs and Assistant Commissioners failed to detect them.

With reference to the Performance Audit, we observed that there were systemic deficiencies in the planning and execution of VAT audits as well as compliance deficiencies. Major deficiencies are summarized below

- There were substantial arrears of VAT audits planned;
- There was no monitoring mechanism whereby the status of audits authorised and completed could be verified;
- The files were not being transferred to jurisdictional offices soon after completion of audits, and we found delays in transmission of files ranging from three months to three years;
- There had been poor utilisation of audit module of VATIS package in the VAT audit process;
- Prescribed procedures and instructions issued by Commissioner of Commercial Taxes(CCT) were not adhered to with regard to selection of dealers for VAT audits;
- The top dealers with high turnover were not selected for audit since inception of APVAT Act in 2005;
- Authorisation of same dealer was entrusted to many audit officers for the same or converging audit periods and there was no coordination between the divisional officer who authorises the audit and the jurisdictional CTO who is responsible for cancellation of registration of dealers.
- Refunds were granted without finalising the tax liability and beyond the powers of the Assessing authority.
- Excess refunds were granted due to incorrect determination of taxable turnovers, incorrect exemption, non levy of penalty/interest etc.

Our conclusion The Department needs to improve the internal control system and initiate necessary corrective action to recover the non/short levy of tax, interest, penalty etc., pointed out by us, more so in cases where it has accepted our contention.

- The Department should focus on quality, rather than quantity of VAT audits, by adopting a risk-based approach which involves planning of fewer VAT audits but higher revenue collection (for which the auditing officers should be held accountable). They should also ensure a set of comprehensive and standardised guidelines for selection of dealers for VAT audits, so as to minimise discretionary and arbitrary selection; this must be invariably enforced in

all jurisdictions. The audit module in VATIS should be designed and implemented to facilitate automatic selection, based on these guidelines. Implementation of such standardised guidelines should be monitored, and failure penalised. If necessary, a specified percentage of VAT audits (10 *per cent* or so) can be selected by the DC, using his judgment based on specified parameters.

- The Department should ensure effective monitoring of completion of VAT audits by specifying timelines (say 1 or 2 months), after which the VAT audited files must be mandatorily transferred to the respective jurisdictional offices. If the Department believes that the assessing officers are under excessive time pressure to complete VAT audits in timely manner, they may consider setting up a dedicated VAT audit wing (as is being followed by Tamil Nadu for VAT and by AP itself for Registration and Stamps).

- VAT-audited cases should be subject to a random check (based on a statistical sample), and poor quality VAT audits should result in penal action. The Department may also consider interaction with the Vigilance & Enforcement Department to discuss systemic trends of tax evasion, so as to plug leakage of revenue and also enrich the approach to VAT audits.

During the Exit Conference, the Commissioner had given certain assurances on implementation of the recommendations made by audit which would be verified in future audits.

2.1 Tax Administration

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

2.2 Trend of Receipts

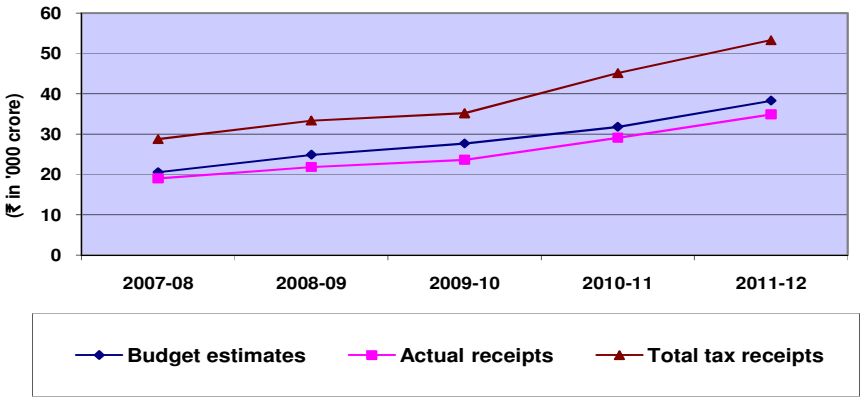
Actual receipts from VAT/CST during the last five year period from 2007-08 to 2011-12 along with the total tax receipts during the same period is exhibited in the following table and graphs:

Table 2.1 - Trend of receipts

(₹ in crore)

Year	Budget estimates	Actual receipts	Variation excess (+)/ shortfall (-)	Percentage of variation	Total tax receipts of the State	Percentage of actual VAT receipts vis-a-vis total tax receipts
2007-08	20,568.00	19,026.49	(-) 1,541.51	(-) 7.49	28,794.05	66.08
2008-09	24,887.28	21,851.66	(-) 3,035.62	(-) 12.20	33,358.29	65.51
2009-10	27,685.00	23,640.21	(-) 4,044.79	(-) 14.61	35,176.68	67.20
2010-11	31,838.00	29,144.85	(-) 2,693.15	(-) 8.46	45,139.55	64.57
2011-12	38,305.60	34,910.01	(-) 3,395.59	(-) 8.86	53,283.41	65.52

Graph 2.1: Budget estimates, Actual receipts and Total tax receipts



The total tax receipts of the state have been following an increasing trend for the last five years as is with the receipts of taxes on sales, trade etc. The percentage of the revenue contribution to the total tax receipts by the receipts of taxes on sales, trade etc. has been almost stable within a range of 65 *per cent* to 67 *per cent*.

2.3 Cost of collection

Gross collection of Commercial Taxes Department, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2009-10, 2010-11 and 2011-12 along with the relevant all India average percentage of expenditure on collection to gross collection for the previous year are given below:

Table 2.2 - Cost of collection

(₹ in crore)

Head of revenue	Year	Gross collection	Expenditure on collection of revenue	Percentage of cost of collection to gross collection	All India average percentage for the previous year
Taxes/VAT on sales, trade etc.	2009-10	23,640.21	215.88	0.91	0.88
	2010-11	29,144.85	261.98	0.90	0.96
	2011-12	34,910.01	282.63	0.81	0.75

Although the percentage of cost of collection to gross collection decreased by 0.09 *per cent* during the year 2011-12 over the previous year, it is still higher than the All India average percentage of cost of collection of the previous year.

2.4 Impact of Local Audit

During the last five years, we had pointed out non/short levy, non/short realisation, underassessment/loss of revenue, incorrect exemption, concealment/suppression of turnover, application of incorrect rate of tax, incorrect computation etc., with a revenue implication of ₹ 1,506.91 crore in 6,794 cases. Of these, the Department/Government had accepted audit observations in 2,694 cases involving ₹ 406.39 crore and had since recovered ₹ 5.78 crore. The details are shown in the following table:

Table 2.3 - Impact of local audit

(₹ in crore)

Year	No. of units audited	Objected		Accepted		Recovered	
		No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
1	2	3	4	5	6	7	8
2006-07	227	1,264	389.08	548	122.22	14	0.24
2007-08	209	980	196.63	141	80.26	43	1.02
2008-09	198	1,282	267.95	776	43.90	21	1.19
2009-10	210	1,646	279.61	647	72.46	64	2.83
2010-11	223	1622	373.64	582	87.55	43	0.50
Total	**1,067**	**6,794**	**1,506.91**	**2,694**	**406.39**	**185**	**5.78**

The insignificant recovery of ₹ 5.78 crore (1.42 *per cent*) as against the money value of ₹ 406.39 crore relating to the accepted cases during the period 2006-07 to 2010-11 highlights the failure of the Government/Department machinery to act promptly to recover the Government dues even in respect of the cases accepted by them.

2.5 Working of Internal Audit Wing

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

2.6 Results of Audit

Test check of the records of 227 offices of the Commercial Taxes Department during 2011-12 relating to VAT, revealed underassessments of tax and other irregularities with preliminary audit findings involving ₹ 304.20 crore in 1,780 cases, falling under the following categories:

(₹ in crore)

Sl. No.	Category	No. of cases	Amount
1	Performance audit on "VAT Audit and Refunds"	1	49.39
2	Under declaration of VAT on works contract	230	23.94
3	Excess claim of input tax credit	408	27.17
4	Under declaration of VAT due to incorrect exemption	159	20.53
5	Non/short levy of interest/penalty	148	10.57
6	Application of incorrect rate	18	0.98
7	Other irregularities	816	171.62
Total		**1,780**	**304.20**

During 2011-12, the Department accepted underassessments and other deficiencies of ₹ 42.98 crore in 735 cases, of which 52 cases involving ₹ 17.43 crore were pointed out in audit during 2011-12 and the rest in earlier years. An amount of ₹ 28.60 lakh was realised in 33 cases during the year 2011-12.

After the issue of draft paragraphs, the Department reported (November 2012) recovery of ₹ 6.83 lakh in respect of four cases.

Performance Audit on "VAT Audits and Refunds" involving ₹ 49.39 crore and a few illustrative audit observations involving ₹ 30.21 crore which came to notice in the course of test audit of records during the year 2011-12, as well as those which came to notice in earlier years but could not be included in previous years reports, are mentioned in the following paragraphs.

2.7 Performance Audit on "VAT Audits and Refunds"

2.7.1 VAT Audits

2.7.1.1 Importance of VAT Audits

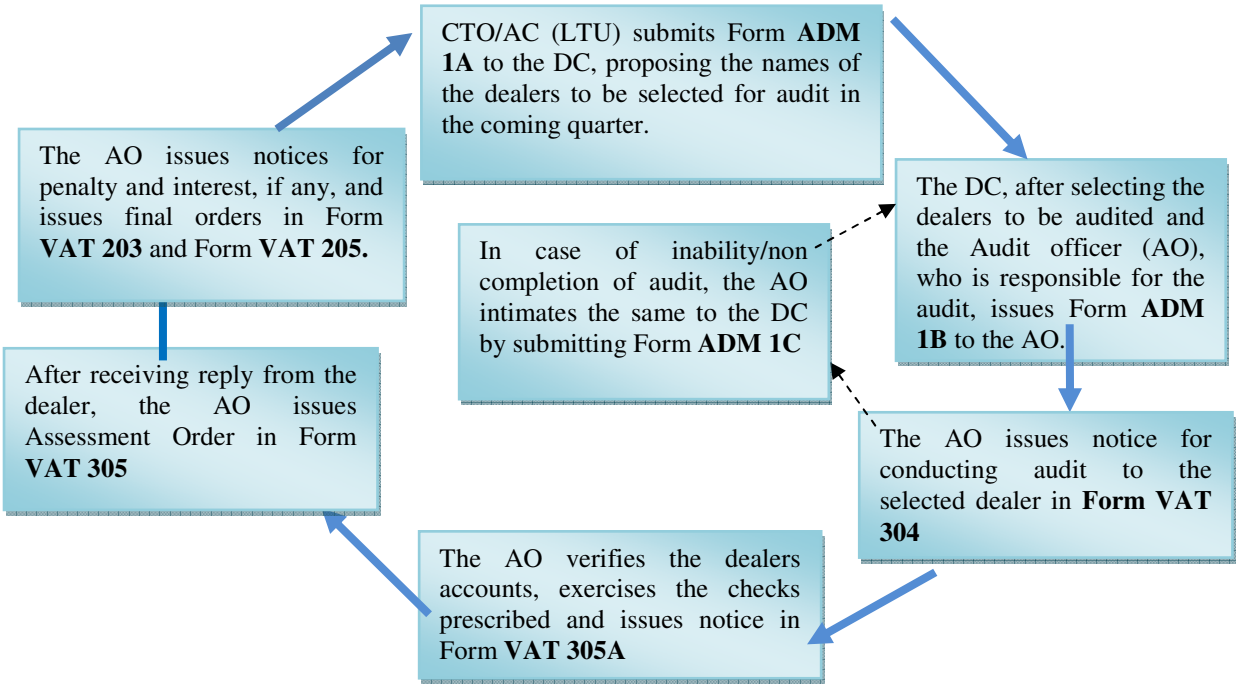
The APVAT Act, 2005 was introduced in April 2005 to replace the APGST Act 1957. The new Act aimed at a hassle-free system for the dealers to declare the tax on self-assessment basis, subject to random scrutiny or audit by the Department.

The two systems of annual assessment and inspection under the repealed APGST Act 1957 were replaced by the system of audit in the APVAT 2005, which includes both the functionalities of assessment and inspection. Audit is one of the four important pillars of VAT administration, the other three being Registration, Returns and Refunds. As per Rule 25(5) of the APVAT Rules, 2005, the returns submitted by the registered dealers are to be scrutinized for their correctness by the prescribed authority. As the self-assessment (in monthly return form VAT 200) will be deemed assessed if no assessment is conducted in four years after its due date, VAT audit and the resultant assessment is crucial to ensure revenue realisation in smooth manner and in bridging the gap between the tax due and the tax declared by the assessee.

2.7.1.2 Authorisation and conduct of audit

The VAT audit of dealers within the Division is authorised by the Deputy Commissioners (DC) to officers not below the rank of Deputy Commercial Tax Officer in a jumbling manner as prescribed in the VAT Audit Manual, 2005.

Procedure for VAT Audits



2.7.2 Refunds

Under section 15(1) of the Act, the Government may, if it is necessary to do so in the public interest and subject to conditions imposed, by a notification, provide for grant of refund of tax paid to any person on the purchases effected by him and specified under the notification. The input tax credit (ITC) in excess of liability or input tax paid on purchases used in exports will be refunded to the dealer subject to refund audit to be conducted. The refund audit is conducted on similar lines as audit of VAT dealers. The excess of tax shall be refundable within a period of 90 days from the date of claim, lest Government is liable to pay interest.

2.7.3 Trend of revenue (VAT Audits)

Analysis of the total revenue from VAT and additional revenue from VAT audits during the period from 2006-07 to 2010-11[1] was as under:

Table 2.4 - Trend of revenue (VAT Audits)

(₹ in crore)

Year	VAT	No. of audits completed	Additional revenue on VAT audits			Percentage of additional revenue demanded to total sales tax
			Demand	Collection	Balance (cumula-tive)	
2006-07	14,222.67	18,011	458.06	88.96	369.1	3.22
2007-08	17,593.41	17,225	1,133.08	321.47	1,180.71	6.44
2008-09	20,596.47	18,693	997.55	308.84	1,869.42	4.84
2009-10	22,278.14	22,254	727.70	228.82	2,368.30	3.27
2010-11	27,443.24[2]	25,935	903.85	307.53	2,964.62	3.29

Note: The demand of additional revenue includes levy of tax on telecom companies on sale of Recharge Cards, which was struck down by the AP High Court in September 2011. The demand may also include issues which are sub judice, the details of which are awaited from the Department.

As seen from the above table, although the number of audits completed show an increasing trend from the year 2007-08 onwards, the additional revenue generated showed a decreasing trend from 2007-08 up to 2009-10, after which there was a marginal increase in 2010-11. The increasing trend of arrears of additional revenue indicated either poor collection efforts on part of the Department or the doubtfulness of the demands raised as a result of VAT audits or both.

1 Source of figures - Commissioner of Commercial Taxes.

2 Of this, petroleum products and liquor constituted 50 per cent (₹ 13,697.75 crore) of the total revenue collection from VAT (Petroleum products – ₹ 8,226.30 crore and liquor – ₹ 5,471.45 crore). These products are taxed at the first point of sale i.e., by the PSU oil companies and Andhra Pradesh State Breweries Corporation Limited.

2.7.4 Trend of Refunds

The trend of refunds issued by the Department is as below:

Table 2.5 - Trend of refunds

(₹ in crore)

Year	No. of cases[3]	Category			Total
		Govt. notification[4]	Exports	Excess ITC/ Excess tax paid	
2008-09	130	56.40	55.89	22.09	134.38
2009-10	124	46.27	39.62	42.33	128.22
2010-11	179	67.57	82.61	97.46	247.64

As seen from the figures above, refunds showed an increasing trend in 2010-11. Refunds for exports also increased in that year.

2.7.5 Audit Approach

2.7.5.1 Audit Objectives

We conducted a Performance Audit on 'VAT Audits and Refunds' to assess

- whether there exists an adequate, efficient and effective system of planning for VAT audits (including criteria for selection and allotment of VAT Audits) as well as execution, reporting and monitoring of VAT Audits;
- whether VAT audits conducted pointed out deficiencies in respect of key risk areas, such as excess claims of Input Tax Credit(ITC), works contracts, VAT deferment, purchase tax etc.;
- whether there exists an adequate, efficient and effective system of processing and authorisation of refund claims;
- whether refunds authorised focus on specific areas of the return which gave rise to the refund, e.g., payment of interest, exports, excess ITC and cases of excess ITC due to lower rate of tax on output compared to inputs etc., and
- whether the Department effectively monitors the conduct of VAT audits and refunds of tax.

[3] Cases where amount refunded was more than ₹ 10 lakh.

[4] The major refunds through the Government notification are to GMR Rajiv Gandhi International Airport Limited and Krishnapatnam Port.

2.7.5.2 Scope and Methodology of Audit

We conducted the Performance Audit for the period from 2006-07 to 2010-11 between September 2011 and March 2012; this covered 13 circle[5] offices and seven[6] Divisions, which were selected based on higher number of VAT audits conducted and refund claims authorised. We also included relevant audit findings raised by the field parties during local audit of the remaining offices, as well as those commented in the Local Inspection Reports of these offices during earlier years.

2.7.5.3 Audit Criteria

The above objectives were benchmarked against the following sources of audit criteria:

- APVAT Act and Rules, 2005
- CST Act, 1956 and Rules 1957
- CST (AP) Rules 1956
- VAT Audit Manual, 2005[7] issued by the Government of AP and
- Orders/notifications issued by the Government/Department from time to time

2.7.5.4 Acknowledgement

We acknowledge the cooperation of the Commercial Taxes Department in providing necessary information and records to audit. We held an entry conference on 28 December 2011 with the CCT and other departmental officers, in which the Department was apprised of the scope and methodology of audit. The draft report was issued (August 2012) to the Government of Andhra Pradesh. Their response was awaited (January 2013).

An exit conference was held on 30 October 2012 wherein the main audit findings were discussed with Principal Secretary to Government (Revenue) and the CCT. The responses indicated during the Exit Conference have been duly considered, while finalising this Report.

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5 Anantapur-II, Bhimavaram, Eluru, Hyderabad (Hydernagar, Jubilee Hills, Malkajgiri and Srinagar Colony), Nandyala-II, Siddipeta, Tirupati-II, Vijayawada (Benz circle) and Visakhapatnam (Dabagardens and Dwarakanagar).

6 Anantapur, Eluru, Hyderabad (Abids, Punjagutta and Saroornagar), Nalgonda and Visakhapatnam.

7 The Department rescinded the earlier VAT Audit manual in the month of July 2011, and a revised manual was issued in June 2012 which was implemented from September 2012. The implementation of the revised manual will be scrutinised in future audits.

Audit findings

We have categorised the audit findings noted during the Performance Audit as below.

- System Deficiencies relating to VAT Audits;
- Compliance Deficiencies relating to VAT Audited cases; and
- Compliance Deficiencies relating to Refund cases.

System Deficiencies: VAT Audits

2.7.6 Planning of VAT Audits

2.7.6.1 Shortfall in completion of Audits

As per Para 4.9.2 of the VAT Audit Manual, 2005, the DC shall arrange for the computerized selection of the general audits based on the parameters prescribed in the manual. Further as per Para 4.8.2, the number of general audits and specific audits put together in a quarter shall not exceed 12.5 *per cent* of the number of total VAT dealers in the division.

The data relating to the number of registered dealers, number of audits to be completed/ completed, number of audits planned and shortfall in audits planned / completed during the period from 2006-07 to 2010-11, as furnished by the CCT Office, is given below:

Table 2.6 -Shortfall in Completion of Audits

Year	Total no. of registered dealers	Audits planned (percentage of total registered dealers)	Audits completed	Shortfall in completion of audit	Percentage of shortfall in completion
2006-07	1,97,250	36,895 (19)	18,011	18,884	51.18
2007-08	2,38,088	20,218 (08)	17,225	2,993	14.80
2008-09	2,69,153	23,082 (17)	18,693	4,389	19.01
2009-10	1,98,640	25,668 (13)	22,254	3,414	13.30
2010-11	2,16,110	29,837 (14)	25,935	3,958	13.08

As seen from the table, there were substantial arrears in completion of the planned audits in all the years, ranging from 13 to 51 *per cent*. Given the poor performance in completion of planned VAT audits, the targets for VAT audits set by the Department, appear to be unrealistic, nor are they commensurate with the additional collections resulting from such VAT audits.

2.7.6.2 Absence of VAT Audit monitoring registers

As per para 4.10 of the manual, the allocation of audit cases should be recorded on a computerized listing in divisional and circle offices with date of allocation, date of audit and date of finalisation. A watch register is to be maintained for monitoring the details of audit in each office.

We noticed that the watch registers and the details were not maintained in any of the test checked DC/CTO offices, without which the information on the status of audits authorised and completed could not be verified. Further, there is also a risk of duplicate or erroneous allocation of audits.

2.7.6.3 Non-production of files in the jumbling audit system

As per VAT Act and VAT Audit Manual, 2005 and the authorisation order in Form ADM 1B issued, after completion of audit, the Audit Officer shall transfer the files, along with the enclosures as prescribed in the manual, to the jurisdictional CTO for further action.

We noticed (September 2011 to March 2012) during audit that in five circles[8], the CTOs did not produce 970 audit files that were requisitioned by us. When reasons for non production were called for, it was replied that the files were not received from the respective Audit Officers.

A test check of the figures relating to completion of audits as given by the DC, Abids with the details furnished by the nine CTOs under his jurisdiction revealed that out of the 992 audits completed during 2010-11, these CTOs had received only 515 audit files; the balance 477 files though authorised for audit and shown as completed, were not received back by the respective jurisdictional CTOs. We are unable to derive an assurance regarding the completion of the audits. Further, even in respect of the files transferred, there was a delay in transmission of the files ranging from three months to three years.

2.7.6.4 Poor utilisation of the audit module in VATIS package

The VATIS software package has an audit module which provides for the departmental users for online processing of the various stages of audit such as (a) quarterly audit proposals by jurisdictional CTO through form ADM 1A, (b) the selection and authorisation by the DC in form ADM 1B, (c) audit notice in form VAT 304, (d) the basic information of the dealer by audit officer in form VAT 303, (e) the notice for assessment in form VAT 305A and (f) the assessment order in form VAT 305. The audit officers are required to submit the above at each stage of audit.

[8] Hyderabad (Hydernagar, Jubilee Hills, Malkajgiri and Srinagar colony) and Tirupati-II.

We noticed (between September 2011 and March 2012) in the test checked offices that the audit module was not being used by the Departmental officers at any stage of the VAT audit process. On enquiry, the Commissioner of Commercial Taxes stated (October 2012) that the Audit module of the VATIS package was not being used by all the departmental officials, but a few officers were using the module in a limited manner to the extent of generating form ADM 1B.

2.7.6.5 Non-adherence to the procedure for selection of dealers for VAT Audits

The Commissioner issued instructions[9] for the period from 2006-07 to 2007-08 that top 50/100 dealers were to be audited once in a year/two years. According to the instructions[10] issued for the years 2008-09 to 2009-10 first priority was to be given to the audits of dealers which were not taken up even once since 1 April 2005. As per instructions[11] issued for the year 2010-11, all the top 25 dealers were to be audited once in a year. Further, paras 4.4 and 4.5 of VAT Audit Manual envisage a risk related system, including parameters such as throughput, high availment of ITC, non-filing of returns, sensitive commodities etc.

We noticed (between September 2011 and March 2012) from the test checked cases that there was no evidence of the CTO/DC selecting them based on the risk related selection system, nor were based on the proposals from jurisdictional CTO in form ADM 1A.

(a) Top dealers in the circle not selected for Audit

We noticed (between September 2011 and March 2012) in the test check of the records relating to selection of dealers in 11 circles[12] out of 13 test checked circles that 629 top dealers with high turnover (ranging between ₹ 0.29 crore to ₹ 679.46 crore) were not selected for audit by the DCs concerned so far since the inception of the APVAT Act, 2005. An illustrative list of the top 10 dealers who were not selected for audit so far is indicated below:

(₹ in crore)

Name of the dealer	Name of the circle	Turnover in 2010-11
Regen Powertech Private Ltd	Jubilee Hills	679.46
Sneha Farms Private Ltd	Jubilee Hills	379.98
American Solutions P.Ltd	Jubilee Hills	352.01
Spectrum Power Generation Ltd	Jubilee Hills	346.25
Quality Steel Shoppe	Dwarakanagar	251.28
Harsha Automotives P ltd	Jubilee Hills	246.01
Ratna Infrastructure Projects pvt Ltd	Srinagar Colony	161.11
Aamoda Publications	Jubilee Hills	132.01
Donear Trading P Ltd	Malkajgiri	123.46
Srinivasa Hatcheries	Benz Circle	105.69

[9] CCT Ref No. BII(2)/122/2006 dated 19 June 2006.

[10] CCT Ref No. BV(3)/120/2008 dated 16 April 2008 and CCT Ref No. BV(3)/60/2009 dated 11 May 2009.

[11] CCT Ref No. BV(3)/37/2010 dated 29 March 2010.

[12] Anantapur-II, Bhimavaram, Eluru, Hyderabad (Jubilee Hills, Malkajgiri and Srinagar colony), Nandyala-II, Siddipeta, Tirupati-II Vijayawada (Benz circle) and Visakhapatnam (Dabagardens)

(b) Authorisation of audit of the same dealer to two/multiple AOs

We noticed that authorisation for audits in some cases was being issued to multiple AOs for the same dealers and for the same or converging audit periods. We noticed (October 2011) from the list of audits authorised by the DCs of three Divisions[13] that audit of 52 dealers for converging periods was authorised to two or three different audit officers. As a result, the AOs issued form ADM 1C for non completion, stating that the audit was taken up by another AO.

(c) Parts of financial year authorised for audit

Para 5.11.4 and Appendix VIII on "Examination of annual accounts" of the VAT Audit Manual, 2005 prescribed verification of the annual accounts of the dealers so as to review disparities between the details furnished in the VAT returns and annual accounts for the relevant period.

We noticed in three circles[14] from the VAT audit files of 168 dealers that the audit was authorised for fractions of financial year, which prevented the AOs from complying with the manual provisions noted above. As a result, AOs were not in a position to compare the turnovers declared by the dealers in their VAT returns vis-à-vis the turnover declared in their Annual Accounts. Consequently, we were also not able to verify the turnovers declared by the dealers in their returns.

(d) Fictitious invoices identified–but no special audit authorised

According to para 4.7 of the VAT Audit Manual, 2005, the selection of cases for special audit visits would result from other audits where AOs had identified evidence of serious fraud, cases where fraudulent intent could be proved.

We noticed (November 2011) in NS Road circle, that in respect of a dealer, a criminal case was registered as the dealer furnished fake invoices for ₹ 20 lakh. However, no special audit was authorised by the DC for conducting an in depth investigation into the matter and for further outcome of the issue.

2.7.6.6 Absence of coordination between offices resulting in faulty selection/non selection of dealers

We noticed that there was no co-ordination between the Divisional officer, who authorised the audit and the jurisdictional CTO, who was responsible for cancellation of registration of dealers. As a result, the DCs were not aware of the status of registration of the dealers. On one hand, authorisations were issued for conduct of audits in respect of dealers whose registrations were already cancelled; on the other hand, the cancelled dealers were not selected

[13] Hyderabad (Saroornagar and Secunderabad) and Visakhapatnam.
[14] Nandyala-II, Tirupati-II and Visakhapatnam (Dabagardens).

for audit before cancellation of their registration, as is described in the following paras.

2.7.6.7 Selection of dealers whose registrations are already cancelled for audit

We noticed (between November 2011 and March 2012) that three DCs[15] issued authorisations for audit of 27 dealers, whose registrations were already cancelled, by their respective jurisdictional CTOs. The AOs issued ADM 1C for non completion of audit, stating that the registrations of the selected dealers were already cancelled. Thus, poor coordination between the divisional and circle officers resulted in wastage of scarce human resources, which could have been deployed on other audits.

2.7.6.8 Non-selection for audit of dealers before cancellation of their registration

As per Section 19 (1) read with Rule 14(4), every dealer, whose registration is cancelled, shall pay back ITC availed in respect of all taxable goods on hand on the date of cancellation. If the dealer applies for cancellation, an audit should be conducted to ascertain the ITC availed by the dealer and only after completion of audit, the cancellation was to be allotted.

We noticed (between September 2011 and March 2012) during the test check of the records relating to eight circles[16] that 942 cancelled dealers were not selected for audit before cancelling their registration. This could result in probable loss of revenue to Government as their input tax claims and output tax liability went unverified and their assessments would become time barred due to lapse of time.

2.7.6.9 Authorisation of audit of same dealers consecutively by the same AOs

The Commissioner of Commercial Taxes issued clear instructions[17] that the DCs should ensure that the same dealer is not inspected by the same officer within a period of three years.

We noticed (October 2011) in Benz circle that the DC (CT), Vijayawada-II division authorised audit of three dealers to the same audit officers before completion of the period of three years from the date of completion of audit, clearly violating the Commissioner's instructions.

Sl. No.	Name of dealer	Audit officer/No. of times authorised for audit	Periods authorised for audit
1.	Sri Sai Constructions	CTO, Krishnalanka/ Two	2009-10 &2010-11
2.	Agrigold Constructions	CTO, Krishnalanka/ Two	2009-10 & 2010-11
3.	D.Jayaprakash Rao	DCTO I, Benz Circle/ Three	2006-07,2008-09& 2010-11

[15] Anantapur, Kurnool and Secunderabad Divisions.
[16] Bhimavaram, Eluru, Hyderabad (Malkajgiri and Srinagar colony), Nandyala-II, Siddipeta, Tirupati-II and Visakhapatnam (Dabagardens).
[17] CCT's Letter no.BII (2)/122/2006-1 dated 4 October 2006.

Thus, the requirement of maintaining objectivity and a neutral attitude towards the audit was defeated.

2.7.6.10 Authorisation of audit without verification of the dealer status

We noticed (November 2011) in two Divisions[18] that the DCs had issued authorisations to audit officers for audit of 112 dealers. However, the AOs, in these cases did not complete the audits, and issued ADM 1C for non-completion, stating that the dealers were not available at the stated addresses. This was unwarranted and could have been avoided had the selection been done as per the prescribed procedure.

2.7.7 Execution of VAT Audits

2.7.7.1 Non-observance of checks prescribed in Audit Manual

As per section 5.11 of the VAT Audit Manual, 2005, every Audit officer shall exercise the basic checks prescribed such as verification of the purchase particulars, comparison with the Annual Accounts, verification of payment of Output tax etc., and enclose these particulars along with the audit files.

We noticed (between September 2011 and March 2012) in six circles[19] that there were several omissions in the audit files, as a result of which we do not have assurance that the audit officers had followed the prescribed checks.

Sl. No.	Type of omission	No. of cases (percentage of the 1,777 test checked cases)
1.	Audit officers did not enclose the checklist	225 cases (13 *per cent*)
2.	P&L account was not enclosed	305 cases (17 *per cent*)
3.	Purchase particulars were not enclosed	286 cases (16 *per cent*)
4.	Audit period was not mentioned in the files	139 cases (8 *per cent*)
5.	Returns were not available	163 cases (9 *per cent*)
6.	Details of Closing stock were not available	307 cases (17 *per cent*)

As a result of the above omissions and absence of any documentary evidence, the assessment orders for levy of tax, penalty/the orders for completion with no variation were not susceptible for verification by higher authorities as well as audit at a later date.

[18] Anantapur and Secunderabad Divisions.

[19] Bhimavaram, Eluru, Nandyala-II, Siddipeta Tirupati-II and Visakhapatnam (Dabagardens).

2.7.7.2 Seizure not followed by auction

According to section 43(1) of the APVAT Act 2005, for the purpose of enforcing compliance of the provisions of the Act, any officer not below the rank of Deputy Commercial Tax Officer shall have the power of entry, inspection, search and seizure and confiscation. Further as per Rule 53(8) the APVAT Rules, the officer shall effect auction of the material so confiscated.

We noticed (November 2011) in Anantapur-II circle from the VAT audit file of one dealer that the AO issued a notification of seizure of goods as the dealer did not produce records for audit, and seized goods worth ₹ 1.01 crore. However, the AO directly proceeded to issue the assessment order, without issuing notice for assessment or auctioning the confiscated goods, in violation of the Rules. The AO without discussing the facts of the case, only stated that the dealer had affected unaccounted sale of rice valued at ₹ 1.10 lakh which was taxable at four *per cent*. Thus, the AO levied tax of a paltry amount of ₹ 8,800 including penalty, although goods worth over ₹ one crore were seized. The failure of the audit officer to follow the procedure of auction of seized material provided undue benefit to the dealer.

2.7.7.3 Short levy of penalty due to failure to adhere to the provisions of APVAT Act

As per section 53(1) of APVAT Act, 2005, where any dealer has under declared tax, and where it has not been established that fraud or willful neglect has been committed and where under declared tax is:-

i) less than ten *per cent* of the tax, a penalty shall be imposed at ten *per cent* of such under-declared tax.

ii) more than ten *per cent* of the tax due; a penalty shall be imposed at twenty five *per cent* of such under-declared tax.

For any audit finding of under declared tax, penalty of at least 10 *per cent* of the under declared output tax or excess claim of input tax raised should be levied by the audit officer.

From the analysis of information received (October 2011) from the CCT, we noticed that the penalty of 10 *per cent* as stipulated in the provisions was not levied. Consequently, there was short levy of penalty at least by ₹ 133.16 crore as summarised in the following table:

Table 2.7 - Short levy of Penalty

(₹ in crore)

Year	Under declaration of tax[20]	Minimum Penalty to be levied @10%	Penalty levied	Short levy of penalty
2006-07	418.39	41.84	30.21	11.63
2007-08	1083.51	108.35	40.12	68.23
2008-09	932.29	93.23	61.24	31.99
2009-10	669.47	66.95	45.64	21.31
Total	**3103.66**	**310.37**	**177.21**	**133.16**

Compliance Issues: VAT Audited cases

2.7.8 Failure to detect excess claims/incorrect allowance of ITC

2.7.8.1 Incorrect allowance of claim of ITC on manipulated invoices

According to Section 13(1) of the APVAT Act, 2005, ITC shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods made by that dealer during the tax period, if such goods were for use in the business of the VAT dealer. ITC can be claimed under the sub-sections 3(a) (1) ibid, on the date the goods were received by him, provided he was in possession of a tax invoice.

We noticed (March 2012) during the course of audit of Nandyala-II Circle from the special audit file of a dealer that the assessing authority disallowed the claim of ITC of the dealer. However, when the matter was remanded by the Appellate DC on the ground that the dealer was not given reasonable time, the AA allowed the input tax claim of ₹ 76 lakh though the jurisdictional CTO of the selling dealers concerned confirmed that in respect of some invoices, the selling dealers issued invoices before their VAT registration. The dealer in respect of some invoices had manipulated the dates and TIN numbers so as to fit into the ITC claims, as the purchases were made well before their VAT registration.

Thus, incorrect allowance of ITC, though the dealer willfully manipulated the invoices, resulted in loss of revenue of ₹ 76 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

[20] The amount of additional demand raised has been taken as the under-declaration of tax.

2.7.8.2 Short levy of tax due to excess claim of ITC on exempt sales

According to Section 13 (5) (d) read with Rule 20(7), where a VAT dealer is making taxable sales and sale of exempt goods (Schedule I) for the tax period and inputs are common for both, the amount which can be claimed as ITC for the purchases of goods at each rate shall be calculated by the formula A*B/C (A: the input tax credit claimed by the dealer B: Taxable turnover C: total Turnover).

As per Section 13 (4) read with Rule 20(2) (o), no input tax is allowed on any goods purchased and used as inputs in job work.

Under Entry 59 of Schedule I to APVAT Act, sales of goods to any unit located in SEZ are exempted vide G.O.Ms.No.716, dt.4.6.2008 w.e.f. 1.6.2008.

Under entry 41, 14, 3 and 16 of Schedule I to APVAT Act, 'husk of pulses', 'firewood', 'poultry feed' and 'milk' are exempt from tax.

We noticed (between December 2010 and March 2012), during the test check of VAT audit files in 10 circles[21], 13 dealers effected job works, sales to SEZs and sale of commodities which were exempted from tax, along with taxable sales but the ITC was not restricted by applying A*B/C formula. However the audit officers failed to restrict the same during the VAT audit of the accounts of these dealers. This resulted in short levy of tax of ₹ 72 lakh.

After we pointed out the cases, the Department replied (November 2012) that in four cases action had been initiated for revision. Replies in respect of remaining nine cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

[21] Hyderabad (Hydernagar, Mahankali Street, Malkajgiri, Tarnaka and Vengalraonagar), Nandyala-II, Tirupati-II, Vijayawada (Governorpet) and Visakhapatnam (Dabagardens and Suryabagh).

2.7.8.3 Short levy of tax due to incorrect allowance of ITC on sales returns

According to Section 13(1) of the APVAT Act, 2005, ITC shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods, made by that dealer during the tax period, if such goods were for use in the business of the VAT dealer.

According to Rule 23(6) of AP VAT Rules, if any VAT dealer having furnished a return on Form VAT 200, finds any omission or incorrect information therein, other than as a result of an inspection or receipt of any other information or evidence by the authority prescribed, he shall submit an application in Form VAT 213 within a period of six months from the end of the relevant tax period.

We noticed (February 2012) in Malkajgiri circle during the test check of VAT audit file of a dealer that the AO, while conducting the audit of tax returns of the period from 2005-06 to 2009-10, allowed ITC to the dealer in September 2010 for the purchases made by him in the month of December 2009, although the dealer had neither claimed the same nor had submitted the Form 213 correcting the details furnished by him in his VAT returns. Thus, the incorrect allowance of ITC by the AO resulted in short levy of tax of ₹ 32 lakh.

After we pointed out the case, the assessing authority replied that the matter would be examined and detailed reply would be submitted.

We referred the matter to the Department (between May and June 2012) and to the Government (August 2012); their reply has not been received (January 2013).

2.7.8.4 Short levy of tax due to excess claim of ITC on exempt transactions

According to Section 13 (5) (e) read with Rule 20(8), where transactions of a VAT dealer involve sale of taxable goods and exempt transaction* of taxable sales, the claim for eligible ITC should be restricted as prescribed in respect of purchases of goods taxable at 1 *per cent*, 4 *per cent* and for the 4 *per cent* tax portion in respect of goods taxable at 12.5 *per cent*, the VAT dealer shall apply formula i.e., A*B/C where A is input tax for common inputs for each tax rate, B is the taxable turnover and C is the total turnover.

** Exempt transactions involve inter-state branch transfer, sale on consignment basis where no tax is payable under the APVAT Act*

We noticed (between February 2011 and March 2012) during the test check of VAT audit files in two Divisions[22] and seven circles[23] of 10 dealers that though their transactions involved both taxable sales and exempt transaction, the audit officers allowed the ITC on the exempt transactions. This resulted in short levy of tax due to excess allowance of ITC of ₹ 32 lakh.

After we pointed out the cases, the Department replied (November 2012) that in one case action had been initiated for revision. Replies in respect of remaining nine cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

2.7.8.5 Short levy of tax due to incorrect allowance of input tax on the purchase of goods in the negative list

As per Section 13(4), no ITC is allowable in respect of the purchases of those taxable goods listed in Rule 20(2) of the APVAT Rules 2005, and also on purchase of goods listed in Schedule VI to the Act.

We noticed (between November 2010 and January 2012) during the test check of records of five circles[24] that the audit officers failed to disallow the claims of ITC by five dealers on their purchase of goods, such as proclains, furnace oil, cement, coal etc., listed in Rule 20(2). Thus, incorrect allowance of ITC resulted in short levy of tax of ₹ 23 lakh.

After we pointed out the cases, the Department replied (November 2012) that the audit observation was accepted in one case, and action had been initiated for revision in another case. Replies in respect of the remaining three cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

[22] Hyderabad (Begumpet) and Nizamabad Divisions.

[23] Eluru, Hyderabad (Hydernagar, Jeedimetla, Malkajgiri and Vengalraonagar), Nalgonda and Visakhapatnam (Suryabagh).

[24] Anantapur-II, Hyderabad (Mahanakali Street, Srinagar Colony and Vengalraonagar) and Kurnool-II.

2.7.8.6 Short levy of tax due to excess claim of ITC on exempt transactions and exempt sales

According to Section 13(5) of APVAT Act 2005, where transactions involve sale of taxable goods, exempt sales as well as exempt transaction of taxable sales, the claim for eligible ITC should be restricted by calculating the eligible ITC separately for different kinds of sales/ transactions as per the formula prescribed i.e., A*B/C where A is input tax for common inputs for each tax rate, B is the taxable turnover and C is the total turnover.

We noticed (between November 2011 and March 2012) in four circles[25] from the VAT Audit files of four dealers that they effected exempt sales, taxable sales and exempt transactions of taxable sales, but did not restrict the ITC. The AOs, while verifying their accounts during VAT Audits, also failed to restrict the ITC of the dealers and this resulted in short levy of tax of ₹ 24 lakh.

After we pointed out the cases, the Department replied (November 2012) that in two cases action had been initiated for revision. Replies in respect of remaining two cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

2.7.8.7 Short levy of tax due to excess claim of ITC

According to Section 13(1) of APVAT Act, 2005, ITC shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods made by that dealer during the tax period, if such goods are for use in the business of the VAT dealer, provided that dealer is in possession of original tax invoices.

We noticed (between July 2011 and March 2012) during the test check of VAT audit files in four circles that the audit officers incorrectly allowed input tax of ₹ 8.42 lakh as shown below:

(₹ in lakh)

Sl. No.	Name of the Division/Circle	Excess claim of ITC	Audit observation
1	DC(CT), Adilabad	1.73	The dealer claimed incorrect ITC of the year 2006-07 in 2010-11. The audit officer did not restrict the ITC by disallowing the time-barred claim in the assessment.

[25] Bhimavaram, Hyderabad (Ashoknagar and Srinagar colony) and Nandyal-II

(₹ in lakh)

Sl. No.	Name of the Division/Circle	Excess claim of ITC	Audit observation
2	IDA Gandhinagar (Hyderabad)	3.22	The dealer, a works contractor, claimed 100 *per cent* ITC on the material used in the work under non-composition. As per section 4(7) (a) of the Act, the works contractor under non-composition shall claim only 90 *per cent* of input tax. The audit officer failed to restrict the ITC to 90 *per cent*. This resulted in short levy of tax due to excess ITC.
3	Narayanaguda (Hyderabad)	1.83	The dealer claimed higher rate of input tax than eligible under the Schedules. The audit officer failed to restrict the ITC which was claimed by the dealer at the rate of 12.5 *per cent* on Zinc Metal, Soda salt, Dimethyl Amine, Sodium Bromide, Pyridine etc., which were enlisted in Schedule IV (4 *per cent*) to the Act.
4	Tirupati-II	1.64	The dealer incorrectly claimed ITC on purchases from unregistered dealer. The audit officer failed to cross verify the invalid purchases on which ITC was claimed as the selling VAT dealer in this case was not registered on the date of issue of the sale invoice. This resulted in short levy of tax.
Total		**8.42**	

After we pointed out the cases, the Department accepted (November 2012) the audit observation in one case. Replies in respect of the remaining three cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

2.7.9 Failure to detect omissions in respect of Works Contracts

2.7.9.1 Short levy of tax due to incorrect determination of taxable turnover under non-composition where books of accounts were not available

According to Section 4(7)(a) of the APVAT Act, every dealer executing works contract shall pay tax on the value of goods at the time of incorporation of such goods in the works executed at the rates applicable to the goods under the Act. To determine the taxable turnover on works contract, the dealer should keep the records as prescribed under Rule 31 of the APVAT Rules.

Where no such accounts were maintained to determine the correct value of the goods at the time of incorporation, tax at the rate of 12.5 *per cent* was applicable on the total consideration received subject to the deductions specified under Rule 17(1) (g) of the APVAT rules. Further, the dealer is also not eligible to claim ITC.

We noticed (between June 2011 and March 2012) from test check of records of 14 circles[26] from the VAT audit files of 30 dealers that the assessing authorities determined taxable turnover after allowing deductions such as labour charges, hire charges etc under Rule 17(1)(e), though the dealers did not maintain or furnish books of accounts to arrive at correct value of goods incorporated in the works. In such cases, the tax should be calculated at the rate of 12.5 *per cent* on the gross receipts after standard deduction as the case may be, under Rule 17(1)(g). The audit officers failed to ensure adherence to the appropriate provisions under the Rules, resulting in under declaration of tax of ₹ 5.14 crore.

After we pointed out the cases, the Department accepted (November 2012) the audit observations in one case and in four cases the department contended that the assessing authority was satisfied with the findings of the audit officer. The reply is not acceptable as Section 4(7)(a) read with Rule 17(1)(g) is a separate charging section, applicable in cases where detailed accounts were not available. Replies in respect of the remaining 25 cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

[26] Anantapur-II, Aryapuram, Bhimavaram, Hyderabad (Malkajgiri, Rajendranagar, SD Road and Vanasthalipuram) Mandapeta, Nandyal-II, Tirupati-II, Vijayawada (Benz Circle and Seetharampuram) and Visakhapatnam (Dabagardens and Dwarakanagar)

2.7.9.2 Short levy of tax due to incorrect determination of taxable turnover under non-composition where books of accounts were available

When the dealers maintain books of accounts, the taxable turnover is to be determined under Rule 17(1) (e). The Rule prescribes the method to arrive at the value of goods at the time of incorporation after allowable deductions on pro rata basis at different rates.

We noticed during the course of audit of 10 circles[27] (between June 2011 and March 2012) from the VAT Audit files of 26 works contractors that the audit officers in their audits, determined the tax payable by the contractors by allowing inadmissible deductions from the taxable turnover in contravention of the above provisions. This resulted in under declaration of tax of ₹ 2.30 crore.

After we pointed out the cases, the Department accepted (November 2012) the audit observation in two cases and in 12 cases action had been initiated for revision. Replies in respect of the remaining 12 cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

2.7.9.3 Short levy of tax due to incorrect allowance of exemptions under composition

According to Section 4 (7) (b) or (c) of the APVAT Act, 2005, any dealer executing any works contracts for the Government, local authority or others may opt to pay tax by way of composition at the rate of 4 per cent on the total value of the contract or the total consideration received or receivable for any specific contract subject to such conditions as may be prescribed.

We noticed (between October 2011 and January 2012) during the test check of VAT audit files of four works contractors in four Circles[28] that the audit officers, in two cases, allowed exemption of turnover relating to earth work and royalty received by the dealers and in one case, the audit officer allowed exemption of excise duty etc. In the fourth case, the development charges were shown exempt from tax. In all these cases it was incorrect, as the tax at the rate of four *per cent* shall be levied on the gross receipt without allowing any exemptions. This resulted in short levy of tax of ₹ 1.02 crore.

[27] Bhimavaram, Hyderabad (Hydernagar, IDA Gandhinagar, Jubilee Hills and Rajendranagar), Vijayawada (Benz Circle) and Visakhapatnam (Dabagardens, Dwarakanagar, Gajuwaka and Steel Plant).

[28] Hyderabad (Jubilee Hills and Malakpet) and Vijayawada (Autonagar and Benz circle).

After we pointed out the cases, the Department replied (November 2012) that in one case action has been initiated for revision. Replies in respect of remaining three cases have not been received (January 2013).

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

2.7.9.4 Short levy of tax due to misclassification of works contract

Under section 4(7) (b) of the APVAT Act, 2005, any dealer executing any works contracts for the Government or local authority may opt to pay tax by way of composition at the rate of 4 *per cent* on the total value of the contract executed for the Government or local authority.

As per section 4(7) (c), any dealer executing works contracts other than for Government and local authority may opt to pay tax by way of composition at the rate of 4 *per cent* of the total consideration received or receivable for any specific contract subject to such conditions as may be prescribed.

As per section 4(7) (d), any dealer engaged in construction and selling of residential apartments, houses, buildings or commercial complexes may opt to pay tax by way of composition at the rate of 4 *per cent* of twenty five *per cent* of the consideration received or receivable or the market value fixed for the purpose of stamp duty, whichever is higher, subject to such conditions as may be prescribed.

Under Section 13(5)(a) of the Act, no input tax shall be claimed in case of the works contracts where the VAT dealer pays tax under the provisions of clauses (b),(c) and (d) of sub-section (7) of Section 4.

We noticed (between July 2011 and March 2012) in five circles from the VAT Audit files of five dealers that the audit officers misclassified the works contracts under inappropriate sections of the Act as shown below, resulting in short levy of tax of ₹ 64.10 lakh.

(₹ in lakh)

Sl. No.	Name of the circle	Nature of work and correct section to be applied	Section applied by the audit officer	Tax to be levied	Tax levied	Short levy	Observation
1	Ashok Nagar (Hyderabad)	Construction of flats 4(7)(c)	4(7) (d)	46.79	11.70	35.09	The builder entered into separate agreement for construction with the prospective buyer. The audit officer included the amount of construction agreement as part of sale of flat.

(₹ in lakh)

Sl. No.	Name of the circle	Nature of work and correct section to be applied	Section applied by the audit officer	Tax to be levied	Tax levied	Short levy	Observation
2	Jubilee hills (Hyderabad)	Construction of college building 4(7) (c)	4(7) (d)	14.54	3.93	10.61	The contract was only for construction of college building but the audit officer levied tax as applicable to construction and sale.
3	Somajiguda (Hyderabad)	Construction of flats 4(7)(c)	4(7) (d)	1.80	0.45	1.35	The builder collected development charges after sale of residential unit and the audit officer levied tax treating it as part of sale of flat.
4	Benz circle (Vijayawada)	Construction of commercial complex and swimming pool 4(7) (c)	4(7) (d)	14.61	5.86	8.81	The work of construction of commercial complex and swimming pool does not include the sale of the same. But the audit officer levied tax as applicable to construction and sale.
5	Dabagardens (Visakha-patnam)	Construction of Building for APSPHC Limited, Visakhaptnam 4(7)(b)	4(7) (a)	19.55	11.31	8.24	The contract was only for construction of residential building but the audit officer levied tax as applicable to works contract under non-composition scheme.
		Total		**97.29**	**33.19**	**64.10**	

After we pointed out the cases, the Department accepted (November 2012) the audit observations in two cases and in one case stated that action had been initiated for revision. Replies in respect of the remaining two cases have not been received (January 2013).

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

2.7.9.5 Incorrect determination of taxable turnover in case of builder of apartments

Under Section 4(7)(d) of the Act, any dealer engaged in construction and selling of residential apartments, houses, buildings or commercial complexes may opt to pay tax by way of composition at the rate of four *per cent* of 25 *per cent* of the consideration received or receivable or the market value fixed for the purpose of stamp duty whichever is higher subject to such conditions as may be prescribed.

Under Section 4(7)(e) of the Act, any dealer having opted for composition under clauses (b) or (c) or (d), purchases or receives any goods from outside the State or India or from any dealer other than a Value Added Tax dealer in the State and uses such goods in the execution of the works contracts, such dealer shall pay tax on such goods at the rates applicable to them under the Act and the value of such goods shall be excluded (from the total turnover) for the purpose of computation of turnover on which tax by way of composition at the rate of four *per cent* was payable.

We noticed in Khairatabad circle that the audit officer in one case deducted the turnover of purchases made out of state from the 25 *per cent* of the taxable turnover and levied tax on the balance of turnover. However, tax on the turnover of purchases made from out of state should be turnover levied according to the rates of tax applicable and such was to be deducted from the total turnover and then tax was to be calculated at the rate of four per cent on the 25 *per cent* of the turnover. This resulted in short levy of tax of ₹ 4 lakh.

After we pointed out the case, the Department replied (November 2012) that action had been initiated for revision.

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

2.7.9.6 Short levy of tax due to incorrect exemption

As per Section 4(7)(e) of the Act, any dealer having opted for composition under clauses (b), (c) or (d), purchases or receives any goods from outside the State or India or from any dealer other than a Value Added Tax dealer in the State and uses such goods in the execution of the works contracts, such dealer shall pay tax on such goods at the rates applicable to them under the Act and the value of such goods shall be excluded (from the total turnover) for the purpose of computation of turnover on which tax by way of composition at the rate of four percent is payable. The commodity 'Siporex Slabs and blocks' fall under Schedule V to the APVAT Act and were liable to tax at the rate of 12.5 *per cent* upto 14 January 2010 and at the rate of 14.5 *per cent* with effect from 15 January 2010.

We noticed (June 2011) during the test check of SD Road circle from VAT returns for the year 2010-11 and assessment file of one dealer that the turnover of ₹ 2.64 crore towards imported siporex slabs and blocks was exempted based on Commissioner's circular[29] dated 23 January 2006. This was not correct, as neither was such exemption envisaged in the Act nor was the Commissioner empowered by the Act to allow such exemptions. This resulted in short levy of tax of ₹ 36 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

[29] Circular No.A1(3)/911/2005-1 dt.23 January 2006.

2.7.9.7 Short levy of tax due to incorrect claim of ITC under non-composition under Rule 17(1) (g)

As per section 4(7) (b) (c) or (d) the works contractor shall opt for composition in form VAT 250 to pay tax under composition i.e., at the rate of four *per cent*.

If not opting for composition, as per Rule 17 (1) (e) of the APVAT Rules, 2005, amounts like labour charges; charges for planning, designing etc.; cost of consumables like water, electricity, fuel etc.; hiring charges for machinery and tools etc.; profit earned by the contractor etc. used for execution of works contract were allowed as deductions from the total consideration to determine the correct value of the goods at the time of incorporation. In such cases the VAT dealer shall be eligible to claim under Rule 17 (1) (b) 90 *per cent* of the tax paid on the goods purchased.

Similarly, as per Rule 17(1) (g), where the VAT dealer has not maintained the accounts, he shall pay tax at the rate of twelve and a half *per cent* on the total consideration received or receivable subject to the standard deductions specified in the Rules. In such cases, the contractor VAT dealer shall not be eligible to claim ITC and shall not be eligible to issue tax invoices.

We noticed in Benz circle (in October 2011) from the VAT Audit file for the year 2010-11 of one dealer dealing in electrical works contracts who had not opted to pay tax under composition that the audit officer allowed deductions of labour charges only but did not make other deductions as per Rule 17(1)(e) and allowed ITC amounting to ₹ 11 lakh. It was observed that the details of other goods incorporated in the execution of works contract were not available in the file. In the absence of detailed accounts, the tax should have been levied under Rule 17(1)(g) at the rate of 12.5 per cent on the gross receipts after allowing standard deduction (25 *per cent* in the case of electrical works) and no ITC was to be allowable. Hence, the ITC of ₹ 11 lakh allowed by the AO was incorrect.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.10 Short levy of tax due to non comparison of turnover declared in VAT returns with that of Profit and Loss Accounts

As per para 5.11.4 of the VAT Audit Manual, 2005, the audit officer is required to verify whether there exists wide disparity between the details given by the dealer on the VAT returns and the annual accounts for that period.

A mention had been made at para no. 2.7.7.1 of this report, wherein the non-availability of P&L Accounts in 17 per cent (305 cases) of the test checked cases was pointed out. Even where it was enclosed, we noticed that the audit officers did not conduct the necessary checks.

We noticed (between June 2011 to March 2012) in 24 circles[30] from the VAT Audit files of 74 dealers that the audit officers failed to determine the correct turnover as they did not compare the turnovers declared in VAT returns with those declared in the Profit and Loss Accounts of the dealers for the same period. Consequently, the audit officers failed to observe under declaration of output tax as the dealers reported lesser sales in the VAT returns, while claiming excess input tax as they declared more purchases in their returns. This failure resulted in short levy of tax of ₹ 7.03 crore.

After we pointed out the cases, the Department communicated (November 2012) acceptance of the audit observations in two cases and stated that in three cases, action had been initiated for revision. In eight cases, the Department contended (November 2011) that the variation between annual accounts and returns are exempted turnovers. The reply of the Department is not acceptable since the dealers had not reported any exempted turnovers in monthly returns. In one case, the Department replied (November 2011) that the data operator incorrectly entered sale turnover as ₹ 1.61 lakh instead of ₹ 61.52 lakh for the month of June 2008. The reply of the Department is not acceptable as the turnover reported for the month of June 2008 was ₹ 26.26 lakh. In one case, it was stated (November 2011) that matter would be examined. Replies in respect of the remaining 59 cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

[30] Anantapur-II, Hyderabad (Fatehnagar, General Bazar, Hydernagar, Jeedimetla, Jubilee Hills, Madhapur, Malkajgiri, Musheerabad and Vengalraonagar), Kakinada, Mandapeta, Miryalaguda, Nandyala-I, Nandyala-II, Rajahmundry, Ramachandrapuram, Siddipeta, Tirupati-II, Vijayawada (Benz Circle and Seetharampuram) and Visakhapatnam (Dabagardens and Dwarakanagar).

2.7.11 Non-levy of tax on unregistered purchases

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

We noticed (between May 2011 and March 2012) during the test check of VAT audit files of six dealers in four circles[31] that the audit officers failed to levy tax on purchases made by the dealers from persons not registered under the Act -which were used as input for exempt goods or disposed of otherwise than by way of sale like branch transfer or consignment sale. This resulted in non levy of tax of ₹ 12 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.12 Short levy of tax due to incorrect availing of deferment

According to Section 69 of the APVAT Act, 2005, any industrial unit availing a tax holiday or tax exemption on the date of commencement of the Act shall be treated as a unit availing tax deferment. The period of eligibility, the method of debiting eligibility amount, repayment and any other benefits for all units availing tax deferment shall be in the manner prescribed. According to Rule 67 of the APVAT Rules, 2005, where any unit is availing a tax holiday on the date of commencement of the Act, it shall be treated as converted to the unit availing tax deferment. The balance period available as on 31 March 2005 to such units shall be doubled. The Government amended the illustration given under the above rule in GO.Ms.No.503, Rev (CT-II) Dept. Dt. 8.5.2009 to the effect that the repayment of the first year shall start immediately after the expiry of the availment period.

Para 5.11.6(b) of the VAT Audit Manual, 2005 clearly prescribes the procedure for audit of units availing tax deferment such as verification of the eligibility stipulated in the Final Eligibility Certificate (FEC), and other conditions such as the product for which the deferment was sanctioned, the base turnover in case of expansion units etc.

[31] Medak, Nandyala-II, Siddipet and Tirupati-II.

We noticed (between September 2011 and March 2012) during the test check of the VAT audit files in one Division[32] and three circles[33] and that in case of four industrial units, the audit officers failed to verify the availing of the deferment of tax and repayment of the same by the dealers. In one case, the availing of the deferment of ₹ 9 lakh was allowed even though the base turnover prescribed in the FEC was not attained by the Company. In another case, the dealer availed deferment of tax and subsequently got cancelled his VAT registration. The AO found no variation, though he was to point out and recover the deferred tax of ₹ 2 lakh. In the third case, the FEC stipulated that the product and the location of the unit availing of deferment should not be changed but the audit officer did not comment on the fact that the dealer stopped production and changed the location, which would have been resulted in recovery of the deferred tax of ₹ 57 lakh. Further, in the remaining case, the deferment period was completed and the audit officer did not point out repayment of tax payable of ₹ 33 lakh.

Failure of the audit officers to point out the incorrect availing of deferment resulted in short levy of tax due of ₹ 1.02 crore.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.13 Short levy of tax due to non-conversion of Turnover Tax (TOT)[34] dealers as VAT dealers

Under Section 17(3) of the APVAT Act, every dealer whose taxable turnover in the preceding three months exceeds ₹ 10 lakh or in the preceding 12 months exceeds ₹ 40 lakh up to 30 April 2009 shall be liable to be registered as VAT dealer. Any dealer who fails to apply for registration shall be liable to pay penalty of 25 *per cent* of the amount of tax due prior to the date of registration. Further, there shall be no eligibility for ITC for sales made prior to the date from which the VAT registration is effective.

We noticed (between January 2012 and March 2012) during the test check of VAT audit files in three circles[35] that though the turnover of three TOT dealers exceeded ₹ 10 lakh in the preceding three month period, the audit officers did not convert these dealers into VAT dealers. Failure of the audit officers to insist upon the conversion of these dealers resulted in non-levy of tax of ₹ 13 lakh.

Thus, there was a failure in the monitoring mechanism in the Department, even during audit of the dealers, to watch the registration of the TOT dealers who may have crossed the threshold limit for registration as dealers under the

[32] Nizamabad.
[33] Hyderabad (Hydernagar and Malkajgiri) and Nandyala-II.
[34] Dealer, whose annual turnover is between ₹ 5 lakh and ₹ 40 lakh. The tax payable by a TOT dealer is one per cent of the total turnover and he is not eligible for ITC.
[35] Bhimavaram, Hyderabad (Begum Bazaar) and Nandyala-II.

APVAT Act, as a result of which the dealers continued business without being registered as VAT dealers with the Department.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.14 Non levy of tax on hire charges

Under Section 4(8) of the APVAT Act, every VAT dealer who transfers the right to use goods taxable under the Act for any purpose whatsoever, whether or not for a specified period, to any lessee or licensee for cash, deferred payment or other valuable consideration, in the course of his business shall, on the total amount realised or realisable by him by way of payment in cash or otherwise on such transfer of right to use such goods from the lessee or licensee pay a tax for such goods at the rates specified in the Schedules.

We noticed (between February 2011 and March 2012) in two circles[36] from VAT audit files that two dealers during 2007-08 received hire charges on equipment and generators but did not pay tax on the same. The audit officers, while conducting audit, failed to point out the tax liability on hire charge receipts though shown in the P&L Accounts of the assessees. This resulted in non-levy of tax of ₹ 15 lakh on turnover of ₹ 1.24 crore.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.15 Short levy of tax on sale of Bus Body Building Units

The Supreme Court of India held in the case of M/s. Mckenzies Ltd Vs State of Maharashtra (16 STC 518) and various other cases that construction of bus body building on the chassis supplied is a contract of sale.

The Commissioner of Commercial Taxes in his circular (circular no. Ref. no. LV(1)/892/2008 dt.30.12.2008) clarified that the transaction of fabrication of bus bodies on the chassis supplied by the APSRTC and others should be treated as 'sale' of bus bodies and not a transaction of works contracts and therefore liable to tax at the rate of 12.5 *per cent*.

We noticed (between November 2011 and February 2012) in two circles[37] in the test check of VAT audit files of two dealers that despite the ruling of the Supreme Court, the turnover relating to bus body building was treated as works contract and tax was declared accordingly. The AOs also failed to levy tax on the

[36] Guntur (Brodipet) and Hyderabad (Vanasthalipuram).
[37] Hyderabad (Malkajgiri) and Vijayawada (Autonagar).

turnover of receipts towards bus-body building as sale. This failure of the audit officers resulted in short levy of tax of ₹ 49 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.16 Non-Forfeiture of excess tax collected resulting in loss of revenue to Government

Under Section 57(2) (4) of the APVAT Act, no dealer shall collect any amount by way of tax at the rates exceeding the rates at which he is liable to pay tax under the provisions of the Act, and if any person collects tax in contravention of the provisions of this section, any sum so collected shall be forfeited to the Government. Further, under Section 57(5) of the Act, no order for forfeiture under this section shall be made after the expiry of three years from the date of collection of the amount.

We noticed (between July 2011 and November 2011) during the test check of VAT audit files of one dealer audited in 2009-10 in Hydernagar circle that the audit officer noticed tax collection from customers in excess of his liability by ₹ 11 lakh in the years 2007-08 and 2008-09. However, the audit officer did not order for forfeiture of the tax to the Government, as required under the provisions. In this case, the Department had lost the opportunity to forfeit the amount since there was a lapse of three years from the date of collection. Thus non forfeiture of ₹ 11 lakh towards excess tax collected resulted in loss of revenue to the Government.

We referred the matter to the Department (between May and June 2012) and to the Government (August 2012); their reply has not been received (January 2013).

2.7.17 Short levy of tax due to application of incorrect rate

Under section 4(1) of the APVAT Act, tax at the rates specified in the Schedules I, II, III, IV & VI of APVAT Act is leviable on the commodities included in these schedules. The commodities "storage tanks", "Xerox machines", "mosquito repellants, rat killers-chalks and sprays for domestic use" and "PSCC poles" were not specified in any of the schedules to the Act and hence fall under Schedule V and are liable to be taxed at the rate of 12.5 *per cent* from 1 April 2005.

We noticed (between August 2011 and March 2012) during the test check of VAT audit files in three circles and one division[38] that during the period from March 2006 to March 2011, four dealers declared tax on the turnovers relating to storage tanks, Xerox machines, 'mosquito repellants, rat killer-chalks and sprays for

[38] Anantapur-II, Hyderabad (Vidyanagar) and Peddapalli and DC(CT) Secunderabad.

domestic use' and PSCC poles at the rate of four *per cent*. The failure of the audit officers to comment on the same during audit and levy tax at the correct rates resulted in short levy of tax of ₹ 27 lakh.

After we pointed out the cases, the Department replied (November 2012) that in one case, action had been initiated for revision. Replies in respect of the remaining three cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

2.7.18 Short levy of tax due to incorrect application of rate of tax under section 4(9)(d) instead of under section 4(9)(c)

As per Section 4(9)(c) of the Act, every dealer, other than those not attached to hotels and whose annual total turnover is ₹ 1.5 Crore and above shall pay tax at the rate of 12.5 *per cent* of the taxable turnover of the sale or supply of goods, being food or any other article for human consumption or drink, served in restaurants, sweet-stalls, clubs, any other eating houses or anywhere whether indoor or outdoor or by caterers.

As per section 4(9)(d), if the annual turnover is less than ₹ 1.5 crore, he shall pay tax at the rate of four per cent.

We noticed (March 2012) during the test check of VAT audit files of Tirupati II Circle that a dealer paid tax at the rate of four *per cent* on the total turnover under Section 4(9)(d) of the Act, even though his total turnover exceeded ₹ 1.50 crore. The AO failed to levy tax under section 4(9)(c) of the Act. This resulted in short levy of tax of ₹ 14 lakh.

We referred the matter to the Department (between May and June 2012) and to the Government (August 2012); their reply has not been received (January 2013).

2.7.19 Short-levy of tax due to escapement of turnover

The commodity "Skimmed Milk Powder" exigible to tax at the rate of four *per cent* vide entry 58 of Schedule IV to the APVAT Act.

We noticed (February 2012) in Begum bazar circle from the VAT Audit file of a dealer that the AO had noticed in 2010-11 from the CST assessment relating to skimmed milk powder that the AA had treated it as transit sale during the year 2007-08 and allowed exemption accordingly. The AO after verification of records concluded that the transaction was not a transit sale and was not qualified for exemption under CST Act as it was first sale effected in the State and was liable to be taxed at the rate of four *per cent* under the APVAT Act. However, verification of VAT audit records for the year 2007-08 revealed that while the turnover of ₹ 6.67 crore was taxable, a turnover of ₹ 3.00 crore only was taxed and balance turnover of ₹ 3.67 crore had escaped assessment. This failure of the AO resulted in short levy of tax of ₹ 15 lakh.

We referred the matter to the Department (between May and June 2012) and to the Government (August 2012); their reply has not been received (January 2013).

2.7.20 Non/short payment of tax due

According to Section 4(1) of the APVAT Act 2005, every dealer registered or liable to be registered as a VAT dealer shall be liable to pay tax on every sale of goods in the State at the rates specified in the Schedules.

As per Rule 24 of APVAT Rules, in the case of a VAT dealer, the tax declared as due on Form VAT- 200, shall be paid not later than fifteen days after the end of the tax period if the payment is by way of cheque and not later than twenty days after the end of the tax period if the payment is by way of demand draft or bankers cheque or by way of remittance into the Treasury or by electronic funds transfer (EFT).

We noticed (between February 2012 and March 2012) in two circles[39] from the VAT audit files of three dealers that the audit officers failed to point out the fact that the dealers had either not paid or had short paid the tax along with the VAT returns. This resulted in short payment of tax of ₹ 15 lakh.

After we pointed out the cases, the Department contended (November 2012) in one case that the payment particulars were produced. The reply is not acceptable since on cross verification of the challan, particulars were not tallied with the VATIS report. Replies in respect of the remaining two cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

[39] Nandyala-II and Visakhapatnam (Dabagardens).

2.7.21 Short levy of tax due incorrect determination of taxable turnover

As per para 5.11.4 of the VAT Audit Manual, 2005, the audit officer is required to verify whether there exists wide disparity between the details given by the dealer in the VAT returns and the annual accounts for that period.

As per Section 2(39) of the APVAT Act, 2005, sale price means the total amount set out in the tax invoice or bill of sale or the total amount of consideration for the sale or purchase of goods as may be determined by the assessing authority, and shall include any other sum charged by the dealer for anything done in respect of goods sold at the time of, or before, the delivery of the goods.

Under Section 2(38), taxable turnover means the aggregate of sale prices of all taxable goods.

Under section 13(5)(a), no ITC shall be allowed on the purchases made in respect of works contracts where the VAT dealer pays tax under the provisions of clauses (b),(c) and (d) of sub-section (7) of Section 4.

We noticed (between August 2011 and March 2012) in six circles and two division offices from the VAT Audit files of eight dealers that the audit officers incorrectly determined the taxable turnover, which resulted in short levy of tax of ₹ 39 lakh.

(₹ in lakh)

Sl. No.	Name of the Division/Circle	Tax effect	Audit observation
1	Abids (Hyderabad) Division	6.46	The turnover of works contract receipts was correctly added in the notice for assessment but the audit officer failed to include the turnover in the final assessment order.
2	Hydernagar (Hyderabad)	6.77	In this case, the amount of labour charged to the sale of air conditioners was to be treated as incidental to sale. The audit officer misclassified the sale as works contract and allowed exemption of turnover relating to labour. This resulted in short levy of tax. In a similar case of elevators, the Honourable Supreme Court of India held in the case of assessee Vs state of AP (2005) 140 STC 22 that supply and installation of lifts is "sale" and not "works contract". It was held that the major component into the end product was the material consumed on producing the lift to be delivered and the skill and labour to be employed for converting the main component into the end product was only incidentally used and delivery of the end product to the customers constituted a sale and not works contract.
3	Nacharam (Hyderabad)	4.68	The dealer sold machinery to export oriented units and claimed exemption of tax. The AO allowed the exemption treating the same as sales to SEZ, which was not correct. This resulted in non levy of tax.

(₹ in lakh)

Sl. No.	Name of the Division/Circle	Tax effect	Audit observation
4	Vanasthalipuram (Hyderabad)	11.52	The audit officer incorrectly adopted the turnover of ₹ 15.49 crore of 12.5 *per cent* rated goods instead of actual taxable turnover of ₹ 16.74 crore. This resulted in short levy of tax**.**
5	Mandapeta	6.48	The dealer purchased gunnies from out of state and within the state and failed to report the same in the VAT returns. The AO failed to comment upon the same as he did not cross verify the returns data with the data at the check post in this regard, resulting in short levy of tax.
6	Nandyala-II	0.56	The dealer purchased tractors from out of state and failed to report the same in the VAT returns. The AO failed to comment on the same as he did not consider the data at the check post in this regard. Instead the audit officer issued VAT 312 for no variation. This resulted in short levy of tax.
7	Nizamabad Division	0.62	The AO, while issuing notice, proposed tax at the rate of 12.5 *per cent* on ₹ 15.38 lakh towards waste maize and paddy husk and dropped the objection basing on the dealer's plea that they are exempt commodities. However, while allowing the exemption, the AO deducted the turnover twice from the taxable turnover, resulting in short levy of tax.
8	Dabagardens (Visakhapatnam)	2.28	The AO incorrectly adopted the turnover to be taxable at the rate of two *per cent,* instead of the applicable four *per cent*, which resulted in short levy of tax.
	TOTAL	**39.37**	

After we pointed out the cases, the Department replied (November 2012) that in two cases, action had been initiated for revision. In respect of one case the Department contended that the dealer reported out of state purchases in his annual accounts. The reply is not acceptable as the dealer reported the same turnover as local purchases and claimed ITC. Replies in respect of the remaining five cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

2.7.22 Non /Short levy of Interest

According to Section 22(2) of the APVAT Act, if any dealer fails to pay the tax due on the basis of return submitted by him or fails to pay any tax assessed or penalty levied or any other amount due under the Act, within the time prescribed or specified there for, he shall pay, in addition to the amount of such tax or penalty or any other amount, interest calculated at the rate of one *per cent* per month for the period of delay from such prescribed or specified date for its payment. The interest in respect of part of a month shall be computed proportionately and for this purpose, a month shall mean a period of 30 days.

We noticed (between June 2011 and January 2012) during the course of audit of six circles[40] and two division offices[41], from the VAT audit files of eight assessees that the audit officers had conducted audits and issued assessment orders in Form VAT 305 in these cases. The audit officers in four cases did not issue interest order amounting to ₹ 7.53 lakh. In the other four cases, the AOs did not calculate interest leviable amounting to ₹ 11.55 lakh as per the provisions of the Act. This resulted in non/short levy of tax of ₹ 19.08 lakh.

After we pointed out the cases, the Department accepted (November 2012) the audit observation in one case and in another case stated that action had been initiated for revision. Replies in respect of the remaining six cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

2.7.23 Non/Short levy of penalty

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

2.7.23.1 We noticed (between October 2010 and March 2012) in 15 circles[42] from the VAT Audit files of 19 dealers that the audit officers failed to levy penalty equal to tax although they had, in the course of their audit, concluded that the dealers had willfully suppressed their tax liabilities. This resulted in short levy of penalty of ₹ 1.26 crore.

[40] Hyderabad (Jubilee Hills, Market Street and Narayanaguda), Kadapa, Karimnagar and Siddipeta

[41] Abids and Secunderabad.

[42] Hyderabad (Begumbazar, Charminar, IDA Gandhinagar, Jubilee Hills, Lord Bazar , MJ Market, Malkajgiri, Nacharam, Tarnaka and Vidyanagar), Kavali, Kurnool-II, Nandyala-II, Tirupati-II and Visakhapatnam (Gajuwaka).

After we pointed out the cases, the Department replied (November 2012) that in two cases, action had been initiated for revision. Replies in respect of the remaining 17 cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

According to Section 53(1) of the APVAT Act, where any dealer has under declared tax, and where it has not been established that fraud or willful neglect has been committed and where under declared tax is (i) less than ten *per cent* of the tax, a penalty shall be imposed at ten *per cent* of such under-declared tax (ii) more than ten *per cent* of the tax due; a penalty shall be imposed at twenty five *per cent* of such under-declared tax.

2.7.23.2 We noticed (between April 2011 and March 2012) in 19 circles[43] and two division offices[44] from VAT Audit files of 27 dealers that the audit officers failed to levy penalty at a correct rate appropriate to the percentage of under declaration. This resulted in short levy of penalty of ₹ 68 lakh.

After we pointed out the cases, the department accepted (November 2012) the audit observations in three cases and in four cases stated that action had been initiated for revision. In one case, it was stated that the matter would be examined. Replies in respect of the remaining 19 cases have not been received (January 2013).

We referred the matter to the Government (August 2012); their reply has not been received (January 2013).

According to Section 51(1) where a dealer who fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, he shall be liable to pay tax and a penalty of ten *per cent* of the amount of tax due.

2.7.23.3 We noticed (between October 2011 and March 2012) in four circles[45] from VAT Audit files of four dealers that the audit officers failed to levy penalty at the rate of 10 *per cent* though the dealers did not pay tax in time on the basis of the return submitted by them. This resulted in short levy of penalty of ₹ 25 lakh.

After we pointed out the cases, the Department contended (November 2012) in one case that the tax payments were made within the prescribed time. The reply is not acceptable as the dealer paid tax after due dates as per VATIS

[43] Akiveedu, Anantapur-II, Bhimavaram, Bhongir, Eluru, Hyderabad (Basheerbagh, Gowliguda, Jeedimetla, Jubilee Hills, Malakpet, Market street, Srinagar Colony, Vengalraonagar and Vidyanagar), Jagtyal, Kakinada, Karimnagar-I, Kurnool-I and Peddapalli.

[44] Abids and Nellore.

[45] Hyderabad (Malkajgiri), Siddipet, Vijayawada (Seetharampuram) and Visakhapatnam (Dabagardens)

information. Replies in respect of the remaining three cases have not been received (January 2013).

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

According to Section 55(2) of the Act, any VAT dealer, who issues a false tax invoice or receives and uses a tax invoice, knowing it to be false, shall be liable to pay a penalty of 200 *per cent* of tax shown on the false invoice.

2.7.23.4 We noticed (March 2012) in two circles[46] from the VAT Audit files of four dealers that the audit officers instead of levying penalty under Section 55(2) either did not levy or levied penalty under Section 53(3) though they proved that the dealers used false invoices to claim ITC. This resulted in non-levy of penalty of ₹ 7 lakh.

After we pointed out the cases, the Department replied (November 2012) that in one case the department contended that the dealer had produced proper tax invoices but not false invoices. The reply is not acceptable since the audit officer himself levied penalty at the rate of 25 *per cent* by stating that the tax invoices are not proper and attracts penalty under section 55(2). Replies in respect of the remaining three cases have not been received (January 2013).

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

Compliance issues: Refunds

2.7.24 Excess grant of refund due to incorrect determination of taxable turnover in respect of works contracts

Under Section 4(7) (a) of the APVAT Act, tax is payable on the value of goods at the time of incorporation of such goods in the works at the rates applicable to such goods. To determine such value of goods incorporated in the works contract, deductions as prescribed under Rule 17(1)(e) were allowed from the consideration received.

Further, in the absence of detailed accounts to determine the taxable turnover under rule 17(1) (g) of the Rules, tax at the rate of 12.5 *per cent* after allowing the standard deduction prescribed.

According to Rule 17(1) (d), the value of the goods used in execution of work in the contract, declared by the contractor shall not be less than the purchase value and shall include seigniorage charges, blasting and breaking charges, crusher charges, loading, transport and unloading charges, stacking and distribution charges, expenditure incurred in relation to hot mix plant and transport of hot mix to the site and distribution charges.

[46] Nandyala-II and Visakhapatnam (Dabagardens).

2.7.24.1 We noticed (between December 2011 and March 2012) in two circles[47] that the assessing authorities granted refund to two works contractors, paying tax under non-composition after calculating the taxable turnover. However, the calculation was made under Rule 17(1)(e) even in the absence of the detailed accounts to arrive at the correct value of goods incorporated in the work. However, their tax was to be calculated under rule 17(1)(g) of the APVAT Rules i.e., at the rate of 12.5 *per cent* on the total consideration after allowing standard deduction of 30 *per cent* without input tax credit. The failure of the audit officers to follow Rule 17(1) (g) in the absence of the books of accounts resulted in excess grant of refund of ₹ 9.36 crore.

After we pointed out the cases, the Department replied (November 2012) that in one case, action has been initiated for revision. Reply in the remaining case has not been received (January 2013).

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

2.7.24.2 We noticed in four circles[48] (between September 2011 and March 2012) that the assessing authorities calculated the taxable turnover against the provisions of the Act and the Rules and granted refund to four works contractors. This incorrect determination of taxable turnover of the works contractors resulted in excess grant of refund of ₹ 2.46 crore.

After we pointed out the cases, the Department replied (November 2012) that in two cases action has been initiated for revision. Replies in respect of the remaining two cases have not been received (January 2013).

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

2.7.24.3 We noticed (between November 2011 and February 2012) in two circles[49] that the assessing authorities granted refund to two works contractors. Here the value of the material incorporated was lesser than the value of the material purchased and the other charges like seigniorage, blasting, crushing loading and unloading, stacking and distribution charges etc. However, the AO arrived at the taxable turnover as per Rule 17(1)(e) without observing Rule 17(1)(d). This resulted in excess grant of refund of ₹ 20 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

[47] Hyderabad (Basheerbagh) and Visakhapatnam (Suryabagh).
[48] Hyderabad (Basheerbagh, Khairatabad and Punjagutta) and Nellore.
[49] Hyderabad (Keesara) and Ongole-II.

2.7.25 Excess refund due to incorrect availing of deferment, non-levy of penalty and excess payment of interest

According to Section 38 of APVAT Act, 2005, every VAT dealer shall be eligible for refund of tax, if the ITC exceeds the amount of tax payable, subject to the conditions as prescribed. Further as per Rule 35(3) & (4) of APVAT Act, the assessing authority shall have power to adjust any amounts due to be refunded against taxes, penalty and interest outstanding under the Act.

We noticed (February 2012) in Nalgonda Division from refund audit file of one dealer engaged in manufacturing and sale of cement, that the company had two units, A (Cement Division) and B (Slag Division). Unit B showed procurement of the raw material i.e., clinker from Unit-A as inter-division-transfer. The AC (CT) LTU, Nalgonda Division completed the assessments of Unit-A for the years 2002-03 to 2004-05 under APGST Act and for 2005-06 under APVAT Act 2005 and raised a demand of ₹ 11.41 crore treating transfer of clinker from unit-A to unit-B as sale.

Aggrieved by the orders, the dealer filed an appeal before appellate authorities and the same was dismissed. Further, the dealer filed a second appeal before the Hon'ble STAT, Hyderabad. The STAT held that the material transferred from Unit-A to Unit-B is only an internal transfer, but not a sale of clinker. In the meantime, the dealer filed a writ petition in the Hon'ble High Court of AP for stay of collection of the above demand of ₹ 11.41 crore. The said court granted 50 *per cent* stay and accordingly, the dealer (Unit-A) paid ₹ 6.23 crore on 12/2005 for the years 2002-03 to 2004-05 and ₹ 1.18 crore for the year 2005-06. The Hon'ble High Court of AP allowed the dealer's appeal in its common order dated 31 July 2009 and directed the assessing authorities "to determine the amount payable to the petitioner within two weeks from the date of order and pay the amount so determined along with interest therein within four weeks thereafter". The Department received the order on 31 August 2009.

According to the directions of the Hon'ble High Court of AP, the AC (CT) Nalgonda Division issued a refund of ₹ 7.41 crore (` 6.23 crore for the years 2002-03 to 2004-05 and ₹ 1.18 crore for the year 2005-06) in September 2009 and paid interest of ₹ 2.47 crore (₹ 2.20 crore and ₹ 0.27 crore) in March 2011.

On scrutiny of the assessment file, we noticed the following:

(a) The Commissioner of Industries in its Proceedings[50] originally sanctioned Unit-B sales tax exemption for an amount of ₹ 36.35 crore to be availed during the period of 7 years from 11-03-2002 to 10-03-2009. The total tax exemption and deferment availed by the unit was ₹ 41.97 crore. Thus,

[50] 1. Proceeding no. 10/3/2000/0866/ID dated 6.6.2000.
2. Proceeding No. 30/2/2002/0788/0788/FD Dated 23-10-2002.

there was excess availing of ₹ 5.62 crore during the year 2006-07. After the AA issued notice for repayment, the dealer paid an amount of ₹ 2.65 crore from June 2008 to March 2009 on various dates. The remaining balance of ₹ 2.97 crore was not paid till the date of audit. Further, the AA issued an interest notice of ₹ 0.79 crore (i.e., interest levied on payment of ₹ 2.65 crore) and penalty notice of ₹ 1.41 crore for delay in payment of tax for the year 2006-07, which were also not paid by the dealer till date of audit.

(b) It is seen from the Vigilance & Enforcement report dated 20 July 2009 that the dealer had availed excess ITC of ₹ 0.80 crore and ₹ 0.38 crore on ineligible items for the years 2005-06 to 2008-09 and the same was communicated to AC (CT), LTU, Nalgonda.

However, while processing the refund amount due to the dealer, the AA did not take into account these amounts due to the Department.

(c) Interest of ₹ 2.20 crore was paid to dealer at the rate of 18 *per cent* on the amount refunded of ₹ 6.23 crore instead of at 12 *per cent* as prescribed under Section 33-E of APGST Act.

The above resulted in excess grant of refund of ₹ 8.58 crore.

After we pointed out the case, the Department replied (October 2012) during the Exit Conference that the records would be called for and reply would be submitted after examining the case.

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

2.7.26 Refund granted without completing CST assessment

According to Section 38 (1) read with Rule 35(4), the authority prescribed shall not refund any VAT where tax, penalty, interest or any other amount was outstanding against such VAT dealer under the Andhra Pradesh General Sales Tax Act, 1957 and/or under the Central Sales Tax Act, 1956.

We noticed (January 2012) in CTO, Jubilee Hills circle from the refund file that the assessing authority issued ₹ 1.77 crore in two cases (₹ 0.86 crore and ₹ 0.91 crore) without finalising the CST assessments for the years 2008-09 and 2009-10. This resulted in incorrect grant of refund of ₹ 1.77 crore.

2.7.27 Excess grant of refund due to incorrect exemptions for exports under CST Act

According to Section 38 of APVAT Act, 2005, a VAT dealer effecting sales falling under sub-section (1) or (3) of Section 5 (and sub-section (6) of Section 8) of the Central Sales Tax Act, 1956 in any tax period shall be eligible for refund of tax, if the ITC exceeds the amount of tax payable subject to the condition that the exports have been made outside the territory of India.

As per Rule 35(6) of the APVAT Rules, in the case of sales falling within the scope of sub section (1) of Section 5 of Central Sales Tax Act, 1956, the VAT dealer shall be in possession of the documents such as copy of contract or order from a foreign buyer, copy of the invoice issued to the foreign purchaser, transport documentation i.e. Bill of Lading, Airway Bill, or a like document, evidence of payment or evidence of letter of credit from the foreign purchaser or copy of the document in proof of export duly certified by Customs Department.

In the case of sales falling within the scope of sub-section (3) of Section 5 of Central Sales Tax Act, 1956, the VAT dealer shall be in possession of the documents viz., Declaration in Form 'H', purchase order from exporter, evidence of export in the form of transport documentation i.e., bill of lading, air way bill or a like document.

We noticed (between November 2011 and March 2012) in three circles[51] that the assessing authorities granted refunds to three dealers engaged in exports without the complete documentary evidence (such as the purchase order from the foreign buyer and the bill of lading and shipping bill in respect of exports; purchase agreement after the actual dispatch of goods bound to India and the bill of entry evidencing that the goods are delivered to third party in respect of high-sea sales) to prove that the goods they claimed as exported/imported actually crossed the customs barrier of India. In the absence of such evidence, the ITC claimed on purchase of such goods and the exemption of such sale turnover was incorrect. This resulted in excess refund of ₹ 1.10 crore.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

[51] Anantapur-II and Hyderabad (Basheerbagh and Jubilee Hills).

2.7.28 Excess grant of refund under Government notification

According to Section 15 of the APVAT Act, 2005, the Government may, subject to such conditions as it may impose, by a notification, provide for grant of refund of tax paid to any person, on the purchases effected by him and specified in the said notification. An application for refunds shall be made in duplicate to the Commissioner within a period of six months from the date of purchase or as the Government may prescribe in the notification and it shall be accompanied by the purchase invoice in original.

According to Section 51(1) of the Act, where a dealer who fails to pay the tax due to on the basis of the return submitted by him by the last day of the month in which it is due, shall be liable to pay tax and a penalty of ten *per cent* of the amount due.

We noticed (between September 2011 and March 2012) in two Divisions[52] from two refund files that the authorities allowed refund without conducting the prescribed checks and the conditions laid out in the respective notifications before granting refund of tax. The AO, in the case of M/s Larsen and Toubro Limited who claimed refund of ITC on purchases from M/s GMR International Airport Limited, basing on the Government notification[53] granted refund. The selling company did not report the sale, but the AO failed to verify and restrict the refund. In the second case, M/s Navayuga Engineering Company, being contractor to M/s Krishnapatnam Port Company Limited, claimed refund of tax paid based on the Government notification[54]. The AO failed to levy penalty on the belated payments before granting refund. This resulted in excess refund of ₹ 1.02 crore.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

[52] Hyderabad (Abids) and Visakhapatnam.
[53] GO.Ms.No.1254, Revenue (CTII) Department, dt.24-6-2005.
[54] GO.Ms.No.609 Rev(CT-II) Dt.29-5-2006.

2.7.29 Excess grant of refund due to non-levy of penalty and interest on belated payments

As per section 51(1) of the APVAT Act, where a dealer who fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, shall be liable to pay tax and a penalty of ten *per cent* of the amount of tax due.

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

We noticed (November 2011) from the refund file of one dealer in Division office, Anantapur that the assessing authority while granting refund to the dealer did not point out the fact that the dealer had not paid tax on the due dates and did not levy penalty and interest on such belated payments as prescribed in the above provisions. This resulted in excess grant of refund of ₹ 87 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.30 Excess grant of refund due to short levy of interest

According to Section 38 of APVAT Act, 2005, every VAT dealer shall be eligible for refund of tax, if the ITC exceeds the amount of tax payable, subject to the conditions as prescribed.

According to section 16(3)(b) of APGST Act,1957, if the delay in payment exceeds one year, the assessee is liable to pay interest at the flat rate of 36 *per cent* of the tax per annum.

We noticed (March 2012) in Hyderguda circle from the refund audit file of one dealer that the AA granted refund as per G.O.Ms. No. 383, Revenue (CT.II), dated 2.3.2009. But, the AA incorrectly calculated and adjusted the interest payable for the delayed payments at the rate of 12 *per cent* instead of at the rate of 36 *per cent* per annum. The failure of the AA resulted in short levy of interest of ₹ 41 lakh and excess refund to the same extent.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.31 Excess grant of refund due to incorrect allowance of concessional rate of tax on invalid 'C' declarations

As per Section 8(4) of the CST Act 1956 read with proviso to Rule 12(1) of CST (R&T) Rules 1957, a single declaration may cover all transactions of sale which take place in one quarter of financial year between the same two dealers, are eligible to claim concessional rate of tax.

We noticed (November 2011) from the Refund file of one dealer in Division office, Anantapur that the AA, while granting refund did not verify the validity of the 'C' declarations submitted by the dealer which covered transactions of more than a quarter of the financial year for claiming the concessional rate of tax under CST Act. The failure of the AA to verify the validity of the declarations resulted in short levy of tax, which in turn, resulted in excess grant of refund of ₹ 29 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.32 Excess grant of refund due to non-forfeiture of excess tax deducted

As per Section 38 (1) read with Rule 35 (9), where any refund is due to a VAT dealer, the authority prescribed shall issue a notice in Form VAT 351, either adjusting such refund against any tax, interest, penalty and any amount due under the Act outstanding against such dealer or notifying the refund within fifteen days of date of receipt of the order.

As per Section 4 (7) read with Rule 18(3)(b), where tax, collected at source, is in excess of the liability of the contractor, who has not opted for payment of tax by way of composition, such amount of tax, collected in excess of the liability shall be deemed to have been payable by the contractor and shall be liable to be forfeited.

We noticed (October 2011) in Vijayawada (Benz circle), that the AA while granting the refund to the dealer calculated the tax payable under composition scheme, though the dealer submitted the option for composition after the commencement of the work. Hence the tax should have been calculated under non-composition under rule 17(1) (e) of the Act and the excess tax deducted at source was to be forfeited which was not done This resulted in short levy of tax, which, in turn, resulted in excess refund of ₹ 11 lakh.

We referred the matter to the Department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

2.7.33 Incorrect grant of refunds due to excess allowance of ITC on ineligible purchases

According to Section 13 read with Rule 20(2), input tax shall be claimed on the purchase of items used in the business of the VAT dealer and which are not in the negative list in the Rule.

We noticed in two circles[55] (between January and February 2012) that the audit officers in respect of two dealers (drugs manufacturers), while granting refund, allowed ITC on the purchases of construction material in one case and literature and vehicles in the second, which were ineligible for claiming ITC. This resulted in excess refund of ₹ 7 lakh.

After we pointed out the cases, the Department replied (November 2012) that in one case, action has been initiated for revision. Reply in respect of the remaining case has not been received (January 2013).

We referred the matter to the Government in August 2012; their reply has not been received (January 2013).

2.7.34 Excess grant of refund due to non-levy of purchase tax

Under Section 4(4) of AP VAT Act 2005, every VAT dealer, who purchases any taxable goods from a person or a dealer not registered as a VAT dealer or from a VAT dealer in whose case no tax is payable by the selling VAT dealers, if after such purchase, (a) the goods are used as input for goods exempt under the Act, (b) used as input for goods disposed not by way of sale in the state, dispatched not by sale (i.e., branch transfer or sale on consignment basis) or (c) directly disposed not by sale (i.e., branch transfer or sale on consignment basis) shall be liable to pay tax at the rate of four *per cent* on the value of purchase proportional to such use.

We noticed (February 2012) in Malkajgiri circle that the AA granted refund to a dealer without levying purchase tax although the dealer was purchasing chillis from farmers and effected branch transfer of the same, thus attracting the provisions of the Act. This resulted in excess grant of refund of ₹ 4 lakh.

We referred the matter to the department between May and June 2012 and to the Government in August 2012; their reply has not been received (January 2013).

[55] Hyderabad (Jubilee Hills and Malkajgiri).

2.7.35 Delays in grant of refund

According to Section 39 (1) read with Rule 35(9)(e), where the refund is not made within ninety days, the interest shall be payable at the rate of one *per cent* per month from the date after the expiry of the said ninety days till the date of actual refund.

We noticed (March 2012) in two circles[56] and Abids division that the assessing authorities in nine cases granted refund with a delay ranging from four days to 182 days beyond the prescribed 90 days. The Department, in such cases, shall be liable to pay interest to the dealers.

2.7.36 Refund granted beyond powers

According to Section 38 (1) read with Rule 35(6) (b) and para 6.4.1 of the VAT Audit Manual, 2005, the refunds related to export must contain the evidence of export in the form of copy of the customs clearance certificate, contract or purchase order from a foreign buyer, evidence of actual export in the form of transport documentation related directly to the goods like bill of lading, airway bill or a like document. Further, according to Section 13(1) of the APVAT Act, 2005, ITC shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods, made by that dealer during the tax period, if such goods are for use in the business of the VAT dealer. Under the sub-section 3(a) ibid, a VAT dealer is entitled to ITC, on the date the goods are received by him, provided he was in possession of a tax invoice. As per Rule 59(1) (6) of the APVAT Rules, the refund beyond ₹ 10 lakh and above shall be granted by Joint Commissioner or Additional Commissioner in the office of Commissioner of Commercial Taxes.

We noticed (November 2011) from the refund file of a dealer in Anantapur circle that the dealer had applied for refund of input tax on the purchase of goods used for export. On examining the case, the AA reported (October 2006) to the Divisional Officer that the dealer did not possess the tax invoice as prescribed under the provisions of AP VAT Act and the Rules made thereunder and issued notice to the dealer questioning the eligibility of the refund. The dealer approached the Sales Tax Administrative Tribunal (STAT) on the plea that the assessing authority did not have jurisdiction to issue notice. The STAT struck down (December 2007) the notice and ordered grant of refund. The file was later sent to the JC by the Divisional Officer and refund of ₹ 12 lakh was ordered and paid (August 2008) without the orders of the JC.

Thus, the DC (CT), Anantapur Division issued refund beyond jurisdiction.

[56] Hyderabad (Basheerbagh and Nampally).

2.7.37 Conclusion

There were substantial arrears in completion of the planned audits in all the years from 2006-07 to 2010-11 ranging from 13 to 51 *per cent*. Further, there is no system to monitor the planning and selection of audits. Consequently, the audits were selected in an arbitrary manner without any adherence to the risk parameters prescribed or without the proposals from the jurisdictional officers. The audit module in the VATIS software package, which would help in selecting, monitoring and appraisal of VAT Audits, was not being utilised properly. As a result, we found audits of the same dealers for same/ overlapping periods being authorised to different audit officers, top dealers not being selected for audit since inception of the APVAT Act, audits being authorised without verification of the dealer status etc. The non-adherence to procedures like verifying the purchase particulars, documentary evidence in case of exports etc., also led to excess grant of refunds. Though the departmental audit manual and the circulars issued periodically prescribe the basic checks to be conducted in VAT audits and refund audits, the audit officers failed to follow them. This led to undue benefit to the dealers and loss of revenue in the form of short levy of tax due to excess claims of ITC, under declaration of output tax, incorrect determination of taxable turnover in works contracts, incorrect exemptions and excess deferment and excess refunds, etc.

Excess refunds were granted due to incorrect determination of taxable turnovers, incorrect exemption, non levy of penalty/interest etc. Refunds were granted without finalising the tax liability and beyond the powers of the Assessing authority.

2.7.38 Recommendations

We recommend that

- The Department should focus on quality, rather than quantity of VAT audits, by adopting a risk-based approach which involves planning of fewer VAT audits but higher revenue collection (for which the auditing officers should be held accountable). They should also ensure a set of comprehensive and standardised guidelines for selection of dealers for VAT audits, so as to minimise discretionary and arbitrary selection; this must be invariably enforced in all jurisdictions. The audit module in VATIS should be designed and implemented to facilitate automatic selection, based on these guidelines. Implementation of such standardised guidelines should be monitored, and failure penalised. If necessary, a specified percentage of VAT audits (10 per cent or so) can be selected by the DC, using his judgment based on specified parameters.

  During the Exit Conference (October 2012), the CCT, while agreeing with the recommendation for quality rather than quantity audits, stated that they would be starting a system, where initially 50 *per cent* of the audits would be selected through the system and 50 *per cent* based on local intelligence etc. The results of this system would be monitored over a period of six months, after which this would be reviewed.

The CCT also stated that the new VATIS (including the audit module) was in operation from 1 September 2012. The new audit module was so designed that no audit would be selected without going through VATIS, and every audit authorisation had a computer-generated unique ID.

- The Department should ensure effective monitoring of completion of VAT audits by specifying timelines (say 1 or 2 months), after which the VAT audited files must be mandatorily transferred to the respective jurisdictional offices. If the Department believes that the assessing officers are under excessive time pressure to complete VAT audits in timely manner, they may consider setting up a dedicated VAT audit wing (as is being followed by Tamil Nadu for VAT and by AP itself for Registration and Stamps).

  During the Exit Conference (October 2012), CCT stated that in most of the cases, audits would be completed within one month, and that all inordinate delays were monitored at his level. Further, the Principal Secretary to the Revenue Department stated that if records were not produced within 15 days, then best judgement should be exercised by the Department and the audit finalised.

- VAT-audited cases should be subject to a random check (based on a statistical sample), and poor quality VAT audits should result in penal action. The Department may also consider interaction with the Vigilance & Enforcement Department to discuss systemic trends of tax evasion, so as to plug leakage of revenue and also enrich the approach to VAT audits.

  During the Exit Conference (October 2012), the CCT stated that as per the new VAT Audit Manual, the Department had prepared a checklist and a model assessment order.

  The implementation of the systemic changes/commitments indicated by the Department during the Exit Conference would be verified in future audits.

2.8 Other Audit Observations

During scrutiny of the records of the Offices of the Commercial Taxes Department relating to revenue received from VAT and CST, we observed several cases of non-observance of the provisions of the Act/Rules resulting in non/short levy of tax/penalty and other cases as mentioned in the succeeding paragraphs in this Chapter. These cases are illustrative and are based on a test check carried out by us. We point out such omissions in audit every year, but not only do the irregularities persist; these remain undetected till an audit is conducted. There is a need for improvement of internal controls so that such omissions can be avoided, detected and rectified.

2.9 Payment of VAT on works contract

2.9.1 Payment of VAT under non-composition

2.9.1.1 Under declaration of tax by works contractors who did not maintain detailed accounts

According to Section 4(7)(a) of the Act, read with rule 17(1)(g) of the APVAT Rules, every dealer executing works contracts shall pay tax on the value of goods at the time of incorporation of such goods in the works executed at the rates applicable to the goods under the Act, provided that where the VAT dealer has not maintained accounts to determine the correct value of the goods at the time of incorporation, he shall pay tax at the rate of 12.5 *per cent* up to 25 April 2010 and 14.5 *per cent* with effect from 26 April 2010 on the total consideration received or receivable, subject to the deductions specified under the rules. Further, the dealer shall not be eligible to claim input tax credit (ITC).

We noticed (July and December 2011) during the test check of the records of four circles[57] that for the period 2009-10 and 2010-11, four dealers had not maintained accounts to ascertain the correct value of goods at the time of incorporation of such goods in the works executed by them. However, one of the dealers declared tax at the lower rate of four *per cent*, though purchase of goods was also made at 12.5/14.5 *per cent*. In the second case, the dealer claimed exemption on labour charges at a fixed rate though not stipulated under the Act. In the third case relating to installation of 'induced draft cross flow type timber cooling towers', the dealer reported the entire turnover as labour charges and claimed exemption, though the agreement stipulated 92.6 *per cent* of the contract as material value. In the fourth case, despite payment of tax under Rule 17(1)(g), the dealer claimed ITC, which is not stipulated under the Rules. These resulted in under declaration of tax of ₹ 52.11 lakh.

[57] Hyderabad (Bowenpally, Madhapur, and Nampally) and Peddapuram.

After we pointed out the cases, the AAs/Department stated that

- in one case (November 2012), the JC(CT) (Enf) had authorised CTO-III of enforcement wing to conduct audit of records of the dealer;
- in one case (August 2011) the books of accounts would be verified and intimated; and
- in the remaining two cases (November and December 2011), the matter would be examined.

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

2.9.1.2 Under declaration of tax due to claim of inadmissible deductions

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

We noticed (between February and December 2011) during the test check of the VAT records of three circles[58] for the period April 2009 to March 2011 that in three cases, the dealers claimed deductions like erection charges, earth work etc., from the gross turnover, which were inadmissible under Rule 17(1)(e). This resulted in under declaration of tax of ₹ 34.64 lakh.

After we pointed out the cases, the AAs/Department stated that

- in one case (November 2012), assessment was revised and an amount of ₹ 2.32 lakh collected;
- in one case (November 2011), notice was issued to the dealer;
- in the remaining case (November 2011), the file was submitted to DC(CT) Secunderabad for necessary action.

We referred the matter to the Government in July 2012; their reply has not been received (January 2013).

[58] CTO-Hyderabad (Begumpet and Market Street) and Rajahmundry (Alcot Gardens) .

2.9.1.3 Declaration of VAT by works contractors at incorrect rates

According to Section 13(7) of the Act, the ITC (Input Tax Credit) allowable to dealers paying tax under Section 4(7)(a) of the Act on the value of goods incorporated in works is limited to 90 *per cent* of the related input tax. As per Section 4(7)(d) of the Act, the dealers who are engaged in construction and sale of residential apartments may opt to pay tax at the rate of four *per cent* on 25 *per cent* of the consideration received or receivable.

We noticed (between January 2011 and January 2012) during the test check of the records of six circles[59] for the period from 2009-10 to 2010-11 that in five cases, the dealers engaged in tyre retreading, electrical works, printing works had not opted to pay tax by way of composition, but paid tax at lesser rates though the purchase of goods used in works was at higher rates. One of these dealers claimed ITC in excess of the allowable 90 *per cent.* Further, one dealer engaged in construction and sale of apartments paid tax at the rate of four *per cent* on 25 *per cent* on the value of work covered under development agreement and not by way of sale. This resulted in under declaration of tax of ₹ 25.18 lakh.

After we pointed out the cases, the Assessing Authorities (AAs) stated that

- in one case (January 2011), notice would be issued to the dealer;
- in two cases (between September and October 2011), books of accounts of the dealers would be verified and tax levied if found liable;
- in one case (September 2011), the balance tax would be collected;
- in the remaining two cases (between February 2011 and January 2012), the matter would be examined.

We referred the matter to the Department between October 2011 and April 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.9.2 Payment of VAT under composition

2.9.2.1 Under declaration of tax due to incorrect claim of ITC

According to Section 4(7)(b),(c) read with Section 13(5)(a) of the Act, any dealer executing any works contract may opt to pay tax by way of composition at the rate of four *per cent* on the total value of the contract executed; such dealers are not entitled to claim any ITC on purchase of goods incorporated in the works.

We noticed (October 2011) during the test check of the VAT records of Tadepalligudem circle for the year 2010-11 that in one case, the assessee claimed ITC on purchases relating

[59] Hyderabad (Jubilee hills, Vanasthalipuram and Vidyanagar), Rajahmundry (Aryapuram), Vijayawada (Autonagar and Seetharamapuram).

to the period from November 2010 to January 2011, despite opting for composition. This resulted in under declaration of tax of ₹ 6.18 lakh.

After we pointed out the case, the AA stated (October 2011) that the accounts of the dealer would be audited with the authorisation of the DC (CT) Eluru.

We referred the matter to the Department in March 2012 and to the Government in June 2012; their reply has not been received (November 2012).

2.9.2.2 Under declaration of taxable turnover

Under Section 4(7)(b), (c) and (d) of the Act, payment of tax on works contract at a concessional rate under composition is allowable, provided the dealer opts so in the prescribed form before commencement of each work. No other deductions, except payments made to sub-contractors, are allowable to the dealers who opt for composition.

We noticed (between August 2010 and November 2011) during the test check of VAT records of the DC (CT) Secunderabad and 16 circles[60] for the period 2008-09 to 2010-11, that in 15 cases, the dealers had under declared tax either due to incorrect claim of exemption though they had opted for composition or due to non-reporting of correct turnover/tax in the monthly returns. In seven other cases, the dealers paid tax at the concessional rate of four *per cent,* though their option for payment of tax under composition was invalid due to filing of option after commencement of work. This resulted in under declaration of tax of ₹ 1.89 crore.

After we pointed out the cases, the AAs/Department stated that

- in two cases (November 2012), the assessments were revised and as a result an amount of ₹ 0.96 lakh was collected in one case;
- in two cases (May and July 2011), the dealer would file detailed statements at the time of finalisation of accounts in respect of each work;
- in one case (December 2011), collection particulars would be intimated;
- in five cases (February and November 2011), notices would be issued calling for records;
- in one case (July 2011), the amount received in Form 501A may not be for the same month and may relate to previous months. The reply is not acceptable, since tax deducted was not adjusted against the tax liability of previous months.
- in the remaining 11 cases (between November 2010 and November 2011), the matter would be examined.

[60] Hyderabad (Bowenpally, Charminar, Fatehnagar, Madhapur, Marredpally, Mehdipatnam, Narayanaguda, Somajiguda, Vanasthalipuram), Jangaon, Kamareddy, Medak, Nellore-II, Peddapally, Suryapet and Warangal (Ramannapet).

We referred the matter to the Government in July 2012; their reply has not been received (January 2013).

2.9.2.3 Under declaration of tax on non creditable purchases used in works contract

According to Section 4(7)(e)* of the APVAT Act (Act), 2005, every dealer, opting to pay tax under composition under clauses (b) or (c) or (d) of section 4(7) of the Act, who purchases or receives any goods from outside the State or India or from any dealer other than a VAT dealer in the State and uses such goods in the execution of the works contracts, shall pay tax on such goods at the rates applicable to them under the Act. The value of such goods shall be excluded from the total turnover for the purpose of computation of turnover on which tax by way of composition is payable. 'Diesel oil' falls under entry 5 of the Schedule VI to the Act, and tax is leviable at the rate of 22.25 *per cent.*

**The sub-section has been omitted with effect from 15 September 2011 and the case pointed out pertained to the period prior to the date.*

We noticed (July 2011), during the test check of the VAT records of Rajendranagar circle for the period April 2010 to March 2011 that in one case, the dealer was under composition and declared purchase of diesel oil and other goods from outside the State and used the same in the execution of works contract. However, the dealer had not paid tax on purchase of diesel oil at the rate of 22.25 *per cent* on the purchase turnover of ₹ 41.23 crore as per the provisions of Section 4(7) (e) of the Act. Instead, he declared tax at the rate of four *per cent* under composition on the total turnover received, without excluding the value of the non-creditable purchase of diesel purchased from outside the State. This resulted in under declaration of tax of ₹ 7.52 crore at a differential rate of 18.25 *per cent*.

After we pointed out the case, the AA stated (July 2011) that show cause notice was issued to the dealer.

We referred the matter to the Department in May 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.10 Inter-state sales

2.10.1 Non/short levy of tax on inter-state sales

According to Section 8(2) of the CST Act read with Rule 12 of the CST (R&T) Rules, every dealer, who in the course of inter-state trade or commerce sells goods to a registered dealer located in another State, shall be liable to pay tax under this Act at the rate of four *per cent* (three *per cent* with effect from 1 April 2007 and two *per cent* with effect from 1 June 2008), provided the sale is supported by a declaration in form 'C'. Otherwise, tax shall be calculated at double the rate in case of declared goods and at the rate of 10 *per cent* or at the rate applicable to sale of such goods within the State, whichever is higher, in case of other than declared goods. With effect from 1 April 2007, the respective State rate is applicable to all goods. Government by Act No. 16 of 2007, abolished the concessional rate of tax on sales to Government Departments on submission of 'D' forms with effect from 1 April 2007.

The commodity 'film processor' falls under entry 2 of Schedule VI to the APGST Act, 1957 and was liable to tax at the rate of eight *per cent;* the commodities 'bran oil', 'continuous cast (CC) copper rods', 'galvanised transmission parts', 'pulses' and 'software' fall under schedule IV to the Act and are taxable at the rate of four *per cent*; the commodities 'air conditioners', 'chimneys', 'confectionery', 'cranes', 'diesel generators', 'electrical and electronic goods', 'flushing cistern', 'foam sheets', 'granites', 'machinery', 'paints', 'protein powder' and 'weapon parts' fall under schedule V to the Act and are liable to tax at the rate of 12.5 *per cent;* and the commodity 'beer' falls under schedule VI to the Act and is liable to tax at the rate of 70 *per cent.*

We noticed (between September 2010 and February 2012) during test check of assessment files of four Divisions[61] and 20 circles[62] that the assessing authorities (AAs), while finalising the CST assessments in 27 cases between March 2009 and March 2011 for the years 2003-04 to 2009-10, levied tax at rates lesser than the applicable rates on inter-state sales of the goods mentioned above, not covered by proper declaration forms, while in three cases the AAs incorrectly allowed exemption on inter-state sales of 'rexine' and 'software'. This resulted in short levy of tax of ₹ 3.32 crore on a turnover of ₹ 74.67 crore.

[61] Abids, Saroornagar, Secunderabad and Warangal.

[62] Hyderabad (Basheerbagh, Barkatpura, Bowenpally, Ferozguda, Hyderguda, IDA Gandhinagar, Jeedimetla, Jubilee hills, MG Road, Madhapur, Malakpet, Marredpally, Saroornagar, Tarnaka and Vengalraonagar), Nellore (Markapur), Ramachandrapuram, Rajahmundry (Alcot Gardens), Suryapet and Vijayawada (Convent Street).

After we pointed out the cases, the AAs/Department stated that

- in two cases (November 2012), assessments were revised and an amount of ₹ 0.64 lakh was collected;
- in one case (December 2010), the differential tax would be collected;
- in four cases (between November 2011 and November 2012), assessment files were submitted to, the concerned DC(CT) for revision;
- in five cases (between January 2011 and November 2012), notices were issued/would be issued to the dealers;
- in one case November 2010), action would be taken to collect the tax;
- in one case (August 2011), error would be rectified and report submitted;
- in one case (September 2010), the commodity 'leather cloth' is exempt as per the Uttar Pradesh High Court judgement[63] and hence 'rexine' is also classifiable under entry 45 of Schedule 1 to the Act. The reply is not acceptable as the case law relates to the assessment year 1971-72 where the APGST Act was in force, which was repealed by the AP VAT Act with effect from 1 April 2005. Under this Act, a specific entry for 'rexine' exists and it was judicially held in the case[64] by the AP High Court that where there is a specific entry for an item under the Act, it would prevail over a general entry; and
- in the remaining 15 cases (between January 2011 and January 2012), the matter would be examined.

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

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

Under Section 6-A of the CST Act read with Rule 9 A(2) of the CST (AP) Rules, each declaration in form 'F' shall cover transactions effected during a period of one calendar month. Therefore, a single declaration issued to cover transfer of goods for more than one month is to be treated as invalid, and the turnover has to be brought to tax, treating it as inter-state sale not covered by proper declarations.

As per the Government memo[65], excess demand raised over and above three *per cent* was waived in case of inter-state sale of rice not covered by declarations for the period from 1 April 2007 to 31 May 2008.

[63] M/s Arora Material Store Vs Commissioner, Sales Tax (1982), 51 STC 0235.
[64] M/s Replica Agency Vs State of AP (2002) 124 STC 271 APHC.
[65] Memo No. 20354/CT-II(1)/2011-12 dated 8 June 2011.

We noticed (between November 2010 and February 2012) during the test check of the CST assessment files of the offices of two Divisions[66] and 13 circles[67] that in 17 cases, consignment sales/branch transfers of goods valued at ₹ 84.27 crore were either not supported by 'F' forms or supported by 'F' forms covering transactions of more than one calendar month/pertaining to irrelevant period/obtained from the local dealers and the same were liable to be treated as invalid. The AAs, while finalising the assessments between November 2009 and July 2011 for the years 2006-07 to 2009-10, incorrectly exempted the turnover from levy of tax. This resulted in non-levy of tax of ₹ 3.05 crore as detailed below:

(₹ in lakh)

Sl. No.	Name of the Circle/Year of assessment	No. of Forms	Nature of irregularity	Taxable TO	Non-levy of tax	Department's Remarks
1	DC, Chittoor 2007-08	1	The AAs while finalising the CST assessments incorrectly allowed exemption on branch /consignment transfers supported by 'F' forms covering transactions of more than one calendar month.	33.26	4.16	The AA stated (September 2011) that the matter would be examined.
		1		17.91	0.72	The AA stated (September 2011) that the matter would be examined.
2	DC, Saroornagar 2008-09	1		49.99	2.00	The AA stated (January 2012) that the matter would be examined and report submitted.
3	Adoni 2006-07	4		49.37	4.94	The AA stated (December 2010) that the dealer would be addressed to submit separate forms for each month.
4	Bhongir 2007-08	4		87.79	3.51	The Department stated (November 2012) that assessment was revised and an amount of ₹ 0.12 lakh was collected by way of adjustment. For the balance amount, demand notice had been issued to the dealer.

[66] Chittoor and Hyderabad (Saroornagar.)

[67] Adoni-I, Bhongir, Chittoor-II, Guntur (Main Bazaar), Hyderabad (Khairatabad, Malkajgiri, Mehdipatnam, Srinagar Colony, Tarnaka and Vengalraonagar), Special. Commodities Circle, and Vijayawada (Benz Circle and Suryaraopet).

(₹ in lakh)

Sl. No.	Name of the Circle/Year of assessment	No. of Forms	Nature of irregularity	Taxable TO	Non-levy of tax	Department's Remarks
5	Khairatabad (Hyderabad) (2007-08)	9	The AAs while finalising the CST assessments incorrectly allowed exemption on branch /consignment transfers supported by 'F' forms covering transactions of more than one calendar month.	5859.00	176.00	The Department stated (November 2012) that a pre-revision notice had been issued to the dealer.
6	Malkajgiri (Hyderabad) 2007-08	7		156.12	6.25	The AA stated (February 2012) that the matter would be examined.
7	Mehdipatnam (Hyderabad) 2007-08	3		41.58	5.20	The Department stated (November 2012) that assessment had been revised.
8	Srinagar Colony (Hyderabad) 2007-08	3		250.43	10.02	The AA stated (December 2011) that the matter would be examined.
	Srinagar Colony (Hyderabad) 2008-09	1		22.59	0.90	The Department stated (November 2012) that the assessment file was submitted to DC (CT) Punjagutta for taking up revision.
9	Vengalrao nagar (Hyderabad) 2007-08	1		12.99	0.52	The Department stated (November 2012) that revision show cause notice was issued to the dealer.
10	Benz Circle (Vijayawada) 2007-08	4		139.07	17.38	The AA stated (October 2011) that revision of the assessment would be taken up.
11	Suryaraopet (Vijayawada) 2007-08 to 2009-10	55		532.00	21.28	The AA stated (June 2011) that the matter would be examined.
12	Chittoor-II 2007-08	3	The AA while finalising the CST assessments, incorrectly exempted the turnover covered by 'F' forms obtained from local dealers.	39.12	1.56	The AA stated (October 2011) that the matter would be examined.

(₹ in lakh)

Sl. No.	Name of the Circle/Year of assessment	No. of Forms	Nature of irregularity	Taxable TO	Non-levy of tax	Department's Remarks
13	Main Bazaar, Guntur 2009-10	2	The dealer filed 'F' forms pertaining to the year 2008-09 in support of consignment sales for the year 2009-10. Based on these 'F' Forms, the AA while finalising the CST assessment, incorrectly exempted the taxable turnover.	16.10	0.65	The AA stated (September 2011) that the matter would be examined.
14	Tarnaka (Hyderabad) 2006-07 & 2007-08	-	The AA, while finalising the assessments, incorrectly exempted the job work turnover, even though the transactions were not supported by 'F' forms.	170.00	11.92	The AA stated (July 2011) that the assessment file was submitted to DC (CT) Secunderabad for revision.
15	Special commodities circle 2007-08	-	The AA, while finalising the CST assessments, incorrectly allowed exemption on branch/consignment transfers not covered by 'F' forms	949.51	37.98	The AA stated (December 2011) that the matter would be examined.
			Total	**8,426.83**	**304.99**	

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

2.10.3 Short levy of tax and non-levy of penalty on false/fake declarations

According to Section 9(2)(A) of the CST Act read with Section 7(A)(2) of the APGST ACT, 1957, where a dealer produces false/fake declarations, and claim concessional rate of tax in support of these documents, he shall be liable for a penalty of three to five times the tax due for such transaction. Under Section 16 of the APVAT Act, read with Section 55(4)(b), penalty of 200 *per cent* of the tax due is leviable for such offence.

'Cotton' is one of the declared goods and classified under entry 8 of Schedule III to the APGST Act, 1957 and under entry 79 of Schedule IV to the APVAT Act and is assessable to tax at the rate of four *per cent*.

We noticed (between February 2009 and December 2011) during the test check of the CST assessments of Warangal circle for the period 1999-2000, 2006-07 and 2007-08, finalised between December 2007 and March 2011 that in the cases of three dealers, AAs had incorrectly levied concessional rate of tax on turnover relating to sale of cotton valuing ₹ 3.84 crore supported by 37 fictitious 'C' forms of Maharashtra State. This resulted in short levy of tax of ₹ 14.77 lakh and non-levy of penalty of ₹ 84.54 lakh.

After we pointed out the cases, the AAs/Department stated that

- in two cases (November 2012), pre-revision notices had been issued and served to the dealers;
- in one case (February 2009), the dealer had submitted fresh forms in lieu of the forms filed before, which were accepted by the AA without levy of any penalty and the proposed revision was withdrawn. The reply is not tenable as a scrutiny of the fresh C forms by audit revealed that they were also fake.

We referred the matter to the Government in July 2012; their reply has not been received (January 2013).

2.10.4 Non-levy of tax on export sales not covered by documentary evidence

Under Section 5(1) and 5(3) of the CST Act, 1956, export of goods and goods sold for export are not liable to tax. Further, under Section 5(4) of the Act read with rule 12(10) of the CST (Registration &Turnover) Rules, 1957 the dealer selling the goods shall furnish documentary evidence such as bill of lading, purchase order, certificate from the Software Technology Park of India (STPI), 'H' form duly filled and signed by the exporter in support of the transaction, failing which the transaction is required to be treated as inter-state sale not covered by 'C' form and tax levied under section 8(2) of the Act at the rates applicable to the sale or purchase of such goods inside the appropriate State.

We noticed (between June 2011 and February 2012) during the test check of the CST assessment files of seven circles[68] for the period 2007-08 and 2009-10, that out of seven cases where the assessments were completed between July 2010 and March 2011, in one case, the AA incorrectly allowed exemption on direct exports of hardware and software effected during 2007-08 on the basis of bills of lading relating to the year 2006-07. In two cases relating to dry chillies and rice, the bill of lading and shipping bill were prior to the date of invoices. In two cases, the export sales of unclassified machinery and fabrication items were not supported by documentary evidence. In the remaining two cases, certificates from the STPI were not furnished in support of the exports. The incorrect exemption of commodities worth ₹ 15.06 crore in these cases resulted in non-levy of tax of ₹ 69.86 lakh as detailed below:

[68] Guntur (Eluru Bazaar), Hyderabad (Balanagar, Begumpet, Keesara, Nacharam, and Vengalraonagar) and Palakol

(₹ in lakh)

Sl. No.	Name of the circle /year of audit	Commodity /Schedule/ Rate of tax	Taxable turnover	Short levy of tax	Audit observation and Remarks
1	Palakol 2007-08 July 2011	Rice -entry 85 of Schedule IV to APVAT Act, 2005 Four *per cent* -	14.08	0.56	It was observed that the date of bill of lading and shipping bill were prior to the date of invoice issued by the exporter. Hence, exemption cannot be allowed and taxed @ 4 per cent as it is not covered by proper declaration forms. The AA stated (October 2011) that the matter would be examined.
2	Eluru Bazaar (Guntur) 2007-2008	Dry Chillies – entry 59 of Schedule IV of APVAT Act, 2005 Four *per cent*	18.76	0.75	It was observed that the date of bill of lading and shipping bill were prior to the date of invoice issued by the exporter. Hence, exemption cannot be allowed and taxed at the rate of 4 *per cent* as it is not covered by proper declaration forms. The AA stated (January 2012) that the matter would be examined.
3	Balanagar (Hyderabad) 2007-08	Hardware and Software – Schedule IV of APVAT Act, 2005 Four *per cent*	637.50	25.50	The AA incorrectly allowed exemption on direct exports of Hardware and Software effected during 2007-08 on the basis of bills of lading relating to the year 2006-07. The AA stated (January 2012) that the matter would be examined.
4	Begumpet (Hyderabad) 2009-10	Software - entry 2 Schedule IV of APVAT Act, 2005 Four *per cent*	14.70	0.59	The AA incorrectly allowed exemption on export sale turnover of software without requisite certificate and documentary evidence from the competent authority of STPI. Hence, exemption cannot be allowed and taxed @ 4 per cent as it is treated as inter-state sales not covered by proper declaration forms. The AA stated (November 2011) that a show cause notice was issued to the dealer.
5	Keesara (Hyderabad) 2007-2008	Fabrication items - Schedule V of APVAT Act, 2005 12.5 *per cent*	12.86	1.61	The AA incorrectly exempted the export sales of unclassified 'fabrication items' although they were not supported by documentary evidence in proof of export. The AA stated (June 2011) that the assessment record would be submitted to the DC(CT) Saroornagar Division for necessary revision.

(₹ in lakh)

Sl. No.	Name of the circle /year of audit	Commodity /Schedule/ Rate of tax	Taxable turnover	Short levy of tax	Audit observation and Remarks
6	Nacharam (Hyderabad) 2007-08	Software – entry 2 of Schedule IV of APVAT Act, 2005 Four *per cent*	706.48	28.26	The AA incorrectly allowed exemption on export sale turnover of software without requisite certificate and documentary evidence from the competent authority of STPI. Hence, exemption cannot be allowed and taxed @ 4 per cent as it is treated as inter-state sales not covered by proper declaration forms. The AA stated (January 2012) that the matter would be examined.
7	Vengalrao nagar (Hyderabad) 2007-2008	Machinery items- Schedule V of APVAT Act, 2005 12.5 *per cent*	100.75	12.59	The AA incorrectly exempted the export sales of unclassified 'machinery' although they were not supported by documentary evidence in proof of export. The AA stated (June 2011) that the matter would be examined.
		Total	**1505.13**	**69.86**	

We referred the matter to the Department between February and May 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.10.5 Grant of incorrect concessional rate of tax due to acceptance of invalid 'C' forms

According to Section 8(4) of the CST Act, 1956 read with Rule 12(1) every dealer shall file a single declaration in form 'C' covering all transactions of sale, which take place in a quarter of a financial year between the same two dealers with effect from 1 October 2005.

We noticed (between October 2010 and November 2011) during the test check of the CST assessments of the DC (CT) Nellore and nine circles[69] that the AAs, while finalising the CST assessments in 11 cases between November 2009 and February 2011 for the years 2006-07 to 2008-09, incorrectly allowed concessional rate of tax on the turnovers of plywood, electric laminations, iron scrap, dry chillies etc., amounting to ₹ 4.03 crore supported by 'C' forms covering transactions of more than a quarter in a financial year. This resulted in short levy of tax of ₹ 23.54 lakh.

After we pointed out the cases, the AAs/Department stated that

- in one case (November 2012), assessment was revised and an amount of ₹ 0.33 lakh was collected;

[69] Guntur (Kothapeta and Main Bazaar), Hyderabad (Begumpet, Charminar, Sanathnagar and Vengalraonagar), Vijayawada (Convent Street and Nandigama) and Vizianagaram (Narasannapeta).

- in six cases (November 2011 and November 2012), show cause notices/ revised show cause notices were issued/would be issued to the dealers;
- in one case (March 2011), assessment files were submitted to concerned DC (CT) concerned for revision;
- in one case (December 2010), the books of accounts would be called for, for verification;
- in one case (November 2010), action would be taken to collect the tax ; and
- in the remaining case (November 2010), the matter would be examined.

We referred the matter to the Government in July 2012; their reply has not been received (January 2013).

2.10.6 Non-levy of tax due to incorrect exemption of transit sales

According to Section 6(2) of the Central Sales Tax (CST) Act 1956, where sale of any goods in the course of inter-state trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement to a registered dealer, shall be exempt from tax under this Act, provided such transit sales are supported by E1/E 2 and C Forms as prescribed.

According to Section 8(2) of the CST Act, the rates of tax on sales in the course of inter-state trade or commerce not covered by 'C' form shall be calculated at the rate applicable to the sale or purchase of such goods inside the appropriate State under the sales tax law of that State (from 2007-08 onwards). 'Air compressors, batteries, electrical goods, granites and switch gears' fall under Schedule V to the APVAT Act, 2005 and are liable to tax at the rate of 12.5 *per cent*. 'Software' falls under Schedule IV to the Act and is taxable at the rate of four *per cent.*

We noticed (between July and December 2011) during the test check of assessment files of five circles[70] that in five cases, the AAs while finalising the assessments relating to the years 2007-08 and 2008-09 between July 2010 and March 2011, incorrectly exempted the taxable turnover valued at ₹ 2.88 crore of transit sales not supported by proper declaration forms. This resulted in non-levy of tax of ₹ 32.06 lakh.

After we pointed out the cases, the AAs stated that

- in two cases (November 2011), notices would be issued;
- in one case (November 2011), books of accounts of the dealer would be called for and report submitted.

[70] Hyderabad (Begumpet, Madhapur, Mahankali street, Marredpally and Ramgopalpet)

- in the remaining two cases (between August and December 2011), the matter would be examined

We referred the matter to the Department between April and May 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.11 Misclassification of 'sales' as 'works contracts'

'Air Conditioners' and 'Lifts' fall under Schedule V to the APVAT Act and tax is payable at 12.5 *per cent* from 1 April 2005 and at the rate of 14.5 *per cent* with effect from 15 January 2010.

The Supreme Court of India had held that the contract for supply and installation of lifts and elevators constitute 'sale' but not 'works contract'. It was held that the major component into the end product was the material consumed on producing the lift to be delivered and the skill and labour to be employed for converting the main component into the end product was only incidentally used. Similarly, all other transactions of such type e.g. installation of air conditioners, where the major component was the material consumed in delivering the end product and labour was incidentally used, would also be classifiable as 'sale' and not 'works contract'.

2.11.1 We noticed (between July 2010 and February 2012) during the test check of the VAT records of the office of the DC (CT) Begumpet and two circles[71] for the years 2009-10 and 2010-11, that in six cases, the dealers misclassified the sales turnover of ₹ 35.36 crore pertaining to supply and installation of 'air conditioners and lifts' as 'works contract' and declared tax of ₹ 1.10 crore instead of ₹ 5.12 crore. This resulted in under declaration of tax of ₹ 4.02 crore.

After we pointed out the cases, the AAs stated that

- in one case, (January 2012), the authorisation for conducting VAT audit was issued and the same was pending for finalisation;
- in one case (June 2011), the dealer purchased air conditioners from another dealer and installed the same to the customers by carrying out necessary ducting works. The air conditioners portion was shown under 14.5 *per cent* sales and the installation portion under four *per cent*. The reply is not acceptable in view of the Supreme Court Judgement, and also keeping in view the lesser percentage of labour involved;
- in the remaining four cases, (between July 2010 and December 2011) the matter would be examined.

[71] Hyderabad (Aghapura and Musheerabad).

We referred the matter to the Department between July 2011and April 2012 and to the Government between June and July 2012; their reply has not been received (January 2013).

'Bus body building' is taxable at the rate of 12.5 *per cent* up to 14 January 2010 and 14.5 *per cent* with effect from 15 January 2010 under Schedule V of the APVAT Act, as the same is not classifiable under other Schedules of the Act.

The Supreme Court of India held that 'construction of bus body building' on the chassis of motor vehicles supplied is a contract of 'sale'. Further, the Commissioner of Commercial Taxes clarified that transaction of 'fabrication of bus bodies' on the chassis supplied by APSRTC and others should be treated as 'sale' of bus bodies and not a transaction of 'works contract'. Further, Government in their Memo dated 21 May 2010 clarified that the levy of tax at the higher rate of 12.5 *per cent* will be from 30 December 2008.

2.11.2 We noticed (between July 2010 and February 2011) during the test check of VAT records of AC (LTU) Anantapur and two circles[72] that during the period from 2009-10, in nine cases, dealers had incorrectly declared VAT of ₹ 29.47 lakh instead of ₹ 85.40 lakh by treating the sale contract relating to 'bus body building' as 'works contract'. This resulted in short payment of VAT of ₹ 46.72 lakh after allowing the ITC of ₹ 9.21 lakh eligible to a dealer. We noticed that the respective AAs did not raise the demands for the short paid tax.

After we pointed out the cases, the AAs stated that

- in one case (July 2010), the assessment would be completed by rectifying omissions and commissions, if any.
- in the remaining eight cases (between January and February 2011), the matter would be examined.

We referred the matter to the Department between July and September 2011 and to the Government in June 2012; their reply has not been received (January 2013).

[72] Hyderabad (IDA Gandhinagar and Jeedimetla).

2.12 Under declaration of VAT due to incorrect exemption

The commodities 'rexine', 'bacterial culture' and 'empty glass bottles' are taxable at four *per cent* under respective entries 86/88/90 of Schedule IV to the APVAT Act. The commodities 'automobile spare parts', 'bakery items' are not specified in Schedules I to IV and VI to the APVAT Act and hence these goods fall under Schedule V and are liable to VAT at the rate of 12.5 *per cent* with effect from 1 April 2005 and 14.5 *per cent* with effect from 15 January 2010.

We noticed (between June 2010 and January 2012) during the test check of VAT records in the office of the DC (CT) Punjagutta and four circles[73] for the period from April 2005 to March 2011 that five dealers had incorrectly declared the sales turnover of ₹ 53.44 crore relating to rexine, bacterial culture (drugs and medicines), empty glass bottles, automobile spares, bakery items etc., as exempted turnover. In one case, the commodity 'rexine' was claimed as exempted by classifying it as 'cotton coated fabric'. In the remaining cases, the reasons behind claiming exemption of the turnover were not forthcoming from the records made available to audit. The incorrect claim of exemption of taxable turnover resulted in under declaration of tax of ₹ 2.18 crore.

After we pointed out the cases, the AAs/Department stated that

- in one case (October 2011), the matter would be brought to the notice of the DC (CT)-II Vijayawada;
- in another case, the AA contended (September 2010) that as per Uttar Pradesh High Court judgment[74] the commodity 'leather cloth' was exempted as cotton coated fabric. Hence 'rexine' was also classifiable under entry 45 of Schedule I of the APVAT Act and exempted under the APGST Act as 'cotton coated fabric'. The reply is not acceptable as the case law quoted is not relevant to the APVAT Act, as a specific entry for 'rexine' exists in the Act and it was judicially held[75] by the AP High Court that where there is a specific entry for an item under the Act, it would prevail over a general entry.
- in two cases (between July 2010 and October 2011), the matter would be examined; and
- in the remaining case (November 2012), levy of tax would be considered while finalising the audit.

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

[73] Hyderabad (Hyderguda), Jagtial, Vijayawada (Benz Circle) and Visakhapatnam (Steel Plant).
[74] M/s Arora Material Store Vs Commissioner, Sales Tax (1982), 051 STC 0235.
[75] Replica Agency Vs State of AP(2002) 124STC 271 APHC.

2.13 Input tax credit

2.13.1 Excess claim of input tax credit

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

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

Entry 59 was inserted in Schedule I of the Act, with effect from 1 June 2008, by Act 28 of 2008, exempting the sale of goods to any unit located in Special Economic Zone (SEZ) from levy of VAT.

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

We noticed (between January 2010 and January 2012) during the test check of the VAT records of six DC (CTs)[76] and 17 circles[77] that for the period from April 2006 to March 2011, in 29 cases, the sale transactions of the dealers involved taxable sales, exempt sales and exempt transactions. These exempt sales and exempt transactions were on account of sale of exempted (Schedule-I) goods and consignment sales/branch transfers respectively. The dealers claimed ITC in excess of amount entitled for, without proper restriction. Further, the returns had not been scrutinised as mandated under the Act, as a result of which the input tax was not restricted as per the formula prescribed. This resulted in excess claim of ITC of ₹ 1.14 crore.

After we pointed out the cases, the AAs/Department stated that

- in two cases (June 2011 and November 2012), assessments were revised. Of these, in one case ₹ 1.29 lakh was collected;

[76] Anantapur, Hyderabad (Abids), Kakinada, Nalgonda, Nizamabad. and Vijayawada-I

[77] Chittoor-II, Hyderabad (Aghapura, Jeedimetla, M.G. Road Maharajgunj, Sanathnagar, Srinagar colony, Tarnaka, Vanasthalipuram and Vengalraonagar), Medak, Nalgonda, Nandigama, Parchur, Sangareddy and Special commodities circle.

- in one case (January 2010), the DC(CT) Saroornagar would be addressed to take up audit and to disallow the excess claim of ITC;
- in two cases (June and August 2011), action would be taken to collect the tax;
- in five cases (December 2010 and November 2012), show cause notices/notices would be issued/issued to the dealers;
- in three cases (December 2010 and August 2011), books of accounts of the dealers would be verified;
- in one case (June 2011), the zero-rated sales and taxable sales are clearly defined in sub-section 47 and 38 of Section 2 of the Act, as per which zero-rated sales also include SEZ sales. Hence, SEZ sales fall under taxable turnover as defined in sub-section 37 of Section 2 of the Act. Further, the sub-section 5 of Section 13 of the Act denies ITC on many transactions but do not include SEZ sales. The reply is not acceptable since the item "Sale of goods to any unit located in SEZ" was deleted from the ambit of 'zero-rated sales' with effect from 24 September 2008 by Act No. 28 of 2008 though the definition of zero-rated sales in sub-section 47 of Section 2 was not altered[78].
- in one case (August 2011), the dealer restricted ITC as per rule 20(9) of the AP VAT Act. The reply is not acceptable, as the restriction of ITC was not correctly worked out.
- in the remaining 14 cases (between November 2010 and January 2012), the matter would be examined.

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

2.13.2 Incorrect claim of ITC

According to Section 13 (1) of the AP VAT Act, 2005 (Act), subject to the conditions prescribed, ITC shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods made by that dealer during the tax period, if such goods are for use in the business of the VAT dealer. Section 5 of the Act inter-alia stipulates that the Act does not authorise the imposition of a tax on the sale or purchase of any goods outside the State.

As per Section 14 of the Act, a VAT dealer making a sale liable to tax to another VAT dealer shall issue at the time of sale, a tax invoice in such form as may be prescribed. Further, under Section 13(3), a VAT dealer shall be entitled to claim ITC, provided that he is in possession of a tax invoice. The ITC can be adjusted towards VAT or CST liability of the dealer.

[78] A separate letter has been written by us to the Commissioner of Commercial Taxes pointing out this incongruence and suggesting that the definition of zero rated sales in Section 2 also be altered in line with the deletion of sales to SEZ units from the ambit of zero rated sales in Section 13 of the Act.

We noticed (between November 2010 and February 2012) during the test check of the records of five circles[79] that in five cases for the years 2007-08, 2009-10 and 2010-11, the dealers claimed ITC on purchases reportedly made. However, on scrutiny of the VAT records of the selling dealers, it was observed that in two cases, the purchases were made from dealers whose registrations were cancelled. In one case, the sales turnover reported by the selling dealer was less than the purchase turnover reported. In one case, the AA, while finalising the CST assessment of the dealer for the year 2007-08 in March 2010, made an adjustment of ITC of ₹ 33.30 lakh in excess of the credit available under VAT against the CST liability of the dealer. In the remaining case, the dealer claimed ITC on the purchases made from out of the State. This resulted in incorrect/excess claim of ITC of ₹ 46.02 lakh.

(₹ in lakh)

Sl. No.	Name of the Circle/Year of assessment	Audit observation	Excess ITC claimed	Reply of the Assessing Authority/Department
1	Kothapet (Guntur) 2009-10	On scrutiny of the VAT ledger of the dealer from whom the purchases were reportedly made by the assessee, it was noticed that no sale turnover was reported in the corresponding month and also the dealership of the said dealer was already cancelled in the month of September 2008. Hence the claim of ITC by the assessee was not correct. This resulted in incorrect claim of ITC of ₹ 1.21 lakh.	1.21	The AA stated (March 2011) that action would be initiated by issuing VAT 305A to the dealer
2	Madhapur (Hyderabad) 2009-10	An assessee declared purchase turnover valued at ₹ 20.08 crore and claimed ITC for an amount of ₹ 80.31 lakh. However, on cross verification with the trading account, it was noticed that the actual purchases were valued at ₹ 18.62 crore inclusive of tax of ₹ 71.60 lakh. The dealer incorrectly claimed ITC of ₹ 80.31 lakh instead of ₹ 71.60 lakh. This resulted in excess claim of ITC of ₹8.71 lakh.	8.71	The AA stated (August 2011) that the matter would be examined.
3	Nacharam (Hyderabad) (2007-08)	An assessee had excess ITC of ₹ 1.15 crore as per VAT assessment order for the year 2007-08. The AA while finalising the CST assessment of the same dealer for the year 2007-08, adjusted an amount of ₹ 1.48 crore against the CST liability of the dealer. Thus, the excess adjustment of ITC resulted in short payment of tax of ₹ 33.30 lakh.	33.30	The AA stated (January 2011) that action would be taken to rectify the mistake.

[79] Guntur (Kothapet), Hyderabad (Madhapur and Nacharam), Nandigama and Nizamabad-III.

(₹ in lakh)

Sl. No.	Name of the Circle/Year of assessment	Audit observation	Excess ITC claimed	Reply of the Assessing Authority/Department
4	Nandigama (Vijayawada) 2009-10	On scrutiny of the VAT records of the selling dealers from whom the purchases were made by the assessee, it was observed that one dealer was not registered under the APVAT Act and the registration of the other dealer was cancelled in October 2008. Hence the claim of ITC by the assessee was not correct. This resulted in incorrect claim of ITC of ₹ 1.43 lakh.	1.43	The AA stated (December 2010) that the books of accounts of the dealer would be called for and after verification, a detailed reply would be sent to audit.
5	Nizamabad-III 2010-11	On scrutiny of VAT returns of the assessee it was observed that ITC was claimed on the purchases made out of the State (i.e., Maharashtra State) which is inadmissible. This resulted in incorrect claim of ITC of ₹ 1.37 lakh.	1.37	The AA stated (May 2011) that show cause notice would be issued and further action taken.
	Total		**46.02**	

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

2.13.3 Incorrect claim of input tax credit on ineligible items

According to Section 13(1) of the APVAT Act (Act), 2005, ITC shall be allowed to the VAT dealer for the tax charged in respect of all purchases of taxable goods made by that dealer during the tax period, if such goods are for use in the business of the VAT dealer. As per Section 13(4) of the APVAT Act, 2005 read with Rule 20(2)(q), with effect from 1 May 2009, an assessee is not entitled to claim ITC on 'furnace oil'. Further, as per Rule 20(2)(a),(i)(o) spare parts of automobiles including tyres and tubes, any input used in construction or maintenance of any buildings including factory or office buildings, unless the dealer is in the business of executing works contracts and has not opted for composition and any goods purchased and used as inputs in job work respectively, are not eligible for ITC. Under Rule 20(2)(d) of the APVAT Rules, 2005, ITC is not allowable for any goods purchased and used for personal consumption and as per Section 13(5)(d) of the Act, no ITC is allowable on exempt sales.

We noticed (between October 2010 and June 2011) during test check of VAT records of two DC (CTs)[80] and four circles[81] that during the period 2009-10 and 2010-11 in one case, the dealer claimed ITC of ₹ 4.81 lakh on the inputs

[80] Chittoor and Vijayawada-I.

[81] Hindupur, Hyderabad (Vanasthalipuram), Vijayawada (Nandigama) and Visakhapatnam (Steel Plant).

used by him in the execution of job works and also on exempt sales. In another case, a dealer manufacturer of cement incorrectly claimed ITC of ₹ 6.42 lakh on self-consumption of cement. In five other cases, the dealers claimed ITC of ₹ 15.25 lakh on purchase of 'furnace oil, tyres, tubes and spares of automobiles' and on items used in construction or maintenance of buildings not as a part of execution of works contract. This resulted in excess claim of ITC of ₹ 26.48 lakh.

After we pointed out the cases, the AAs stated that

- in two cases (December 2010), the books of accounts of the dealers would be called for, for verification;
- in one case (February 2011), notice would be issued to the dealer;
- in one case (October 2010), necessary action would be taken to conduct VAT audit of the dealer after verifying all the registers and records and a report would be submitted; and
- in the remaining three cases (between November 2010 and June 2011), the matter would be examined.

We referred the matter to the Department between June 2011 and January 2012; and to the Government between June and July 2012; their reply has not been received (January 2013).

2.14 Non-payment of purchase tax

Under Section 4(4) of the APVAT Act, 2005, every VAT dealer, who in the course of business, purchases any taxable goods from a person or a dealer not registered as a VAT dealer or from a VAT dealer in circumstances in which no tax is payable by the selling VAT dealer, shall be liable to pay tax at the rate of four *per cent* on the purchase price of such goods, if after such purchase, the goods are –

(i) used as inputs for goods which are exempt from tax under the Act; or

(ii) used as inputs for goods, which are disposed of otherwise than by way of sale in the State or dispatched outside the State otherwise than by way of sale in the course of inter-state trade and commerce or export out of the territory of India.

Provided that wherever a common input is used to produce goods, the turnover, taxable under this sub-section, shall be the value of the inputs, proportionate to the value of the goods, used or disposed of in the manner as prescribed under this section.

We noticed (May and December 2011) during the test check of the VAT records of the two DC (CTs)[82] for the year 2010-11 that in one case, the dealer purchased soya bean seeds from unregistered dealers within the State and

[82] Adilabad and Warangal.

effected taxable sales of soya bean oil and exempt sales of soya bean de-oiled cake; in the other case, the dealer purchased wood from unregistered dealers within the State and effected exempt sales, taxable sales and exempt transactions of paper and paper products. However, in the first case, the dealer did not pay purchase tax and in the second case, the dealer had not paid the purchase tax proportionately. This resulted in non/short payment of purchase tax of ₹ 77.41 lakh.

After we pointed out the cases, the AAs stated

- in the first case (December 2011), a notice had been issued to the dealer to produce the books of accounts and the correct liability of purchase tax would be arrived after verification of the books of accounts and
- in the second case (May 2011), the matter would be examined.

We referred the matter to the Department between July 2011 and April 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.15 Sales tax incentives for industrial units

With a view to encouraging the growth of industries in the State, the Industries Department has been notifying various incentive schemes from time to time providing sales tax incentives in the form of sales tax deferment and sales tax holiday (exemption) to industrial units. After introduction of the APVAT Act, with effect from 1 April 2005, Sales Tax Exemptions were converted into Sales Tax Deferment with the remaining period of availment being doubled without change in monetary value.

The Government constituted State Level Committee (SLC) and District Level Committees (DLC). On the basis of sanctions, the Commissioner of Industries issues final eligibility certificate indicating the extent and duration of incentives for implementation by the Commercial Taxes Department. Some of the discrepancies noticed by audit are presented in the following paras.

2.15.1 Incorrect availment of incentives under deferment

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

We noticed (August 2011) during the test check of Vidyanagar circle that in one case, the unit had stopped production in 2007-2008, i.e., before the stipulated period (February 2009). The unit had however, availed an incentive of ₹ 49.16 lakh up to 2007-08, which had not been demanded by the Department. This resulted in non-realisation of revenue of ₹49.16 lakh.

After we pointed out the case, the AA stated (August 2011) that the records would be verified and final report submitted.

We referred the matter to the Department in May 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.15.2 Non-levy of interest on belated payment of deferred sales tax

As per Government order (G.O.Ms.No.503 dated 8 May 2009), amendment to Rule 67 of the AP VAT Act, was made with effect from 1 May 2009 and the repayment of deferred Sales Tax shall be commenced after the completion of deferred sales tax period. In case of non-remittance of deferred tax on the due dates, interest at the rate of 21.5 *per cent* per annum (as mentioned in the Final Eligibility Certificate (FEC)) is liable to be paid.

We noticed (September 2011) during the test check of Nellore-I circle that in one case, the dealer who availed sales tax deferment had paid tax belatedly (delay ranging from 187 days to 691 days) for the period 2005-06 to 2006-07. However, interest was not levied. This resulted in non-levy of interest of ₹ 20.05 lakh.

After we pointed out the case, the Department stated (November 2012) that assessment was revised and an amount of ₹ 5.50 lakh was collected. A notice was issued (August 2012) to the dealer for collection of the balance amount.

We referred the matter to the Government in July 2012; their reply has not been received (January 2013).

2.15.3 Excess availment of tax towards deferment

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

We noticed (November 2011) during the test check of records of Hydernagar circle that in one case, a dealer was sanctioned 'sales tax deferment' for an amount of ₹ 94.03 lakh under Target 2000 scheme for the period from April 1999 to April 2013. Though the unit exhausted the amount sanctioned during the year 2006-07 itself, it had availed an amount of ₹ 100.35 lakh by the end of 2008-09. This resulted in excess availment of tax of ₹ 6.32 lakh towards deferment.

After we pointed out the case, the AA stated (November 2011) that the matter would be examined.

We referred the matter to the Department in April 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.16 Application of incorrect rate

Under Section 4(1) of the AP VAT Act, VAT is leviable at the rates prescribed in schedules I to IV & VI to the Act. Commodities not specified in any of the schedules fall under schedule V and are liable to VAT at 12.5 *per cent* from 1 April 2005 and at 14.5 *per cent* with effect from 15 January 2010.

We noticed (between November 2010 and December 2011) during the test check of the VAT records of 17 circles that during the period from April 2006 to March 2011, 20 dealers declared VAT of ₹ 135.24 lakh instead of ₹ 187.53 lakh on turnover relating to commodities falling under Schedule V to the Act such as air curtains, paraffin, hydrochloric acid, automobile body building, dyes and chemicals, mosquito repellents etc., due to application of incorrect rate and due to reporting of turnover taxable at 12.5 *per cent,* though the rate of tax was enhanced to 14.5 *per cent* with effect from 15 January 2010 (26 April 2010 in case of works contracts). This resulted in under declaration of VAT of ₹ 52.29 lakh as detailed below:

(₹ in lakh)

Sl. No	Name of the circle/year of assessment	Commodity/ item No./ Schedule to APVAT Act	Rate of applicable / applied (per cent)	Tax leviable/ tax levied	Short levy	Reply of the Assessing Authority
1	Ambajipeta 2010-11	Cement poles Schedule V w.e.f. 1-7-08	14.5/ 4	6.22/ 1.72	4.50	The Department stated (November 2012) that assessment was revised and an amount of ₹ 0.35 lakh was collected.
2	Adoni-I 2009-10	Dyes and chemicals Schedule V	12.5/ 4	2.12/ 0.66	1.46	The AA stated in December 2010 that a show cause notice would be issued.
3	Begumpet (Hyderabad) 2010-11	Chewing gum Schedule V	14.5/ 4	15.46/ 4.26	11.20	The AA stated in November 2011 that a show cause notice was issued.
4	Jeedimetla (Hyderabad) 2009-10	Air Curtains Schedule V	12.5/ 4	4.01/ 1.27	2.74	The AA stated in January 2012 that a show cause notice was issued to the dealer.
		Mosquito coils Schedule V	12.5/ 4	2.83/ 0.90	1.93	The AA stated in January 2012 that the assessment file was submitted to DC (CT) Hyderabad (Rural) for revision.
5	Khairatabad (Hyderabad) 2010-2011	Works contract	14.5/ 12.5	41.26/ 35.57	5.69	The AA replied in March 2012 that the DC (CT) Punjagutta Division had given authorisation to the Assistant Commissioner (CT) (LTU) Punjagutta to audit the books of accounts of the dealer and the extract of audit objection was submitted to him for further action.

(₹ in lakh)

Sl. No	Name of the circle/year of assessment	Commodity/ item No./ Schedule to APVAT Act	Rate of applicable / applied (per cent)	Tax leviable/ tax levied	Short levy	Reply of the Assessing Authority
6	Malakpet (Hyderabad) 2010-11	Furniture Schedule V	14.5/ 4	3.30/ 0.91	2.39	The Department stated (November 2012) that a show cause notice had been issued to the dealer.
7	Narayanguda (Hyderabad) 2010-11	Transformers Schedule V	14.5/ 12.5	6.34/ 5.47	0.87	The AA stated in June 2011 that the dealer's books would be verified and tax collected.
8	Somajiguda (Hyderabad) 2010-11	Snacks Schedule V	14.5/ 12.5	33.87/ 29.20	4.67	The Department stated (November 2012) that assessment was revised and an amount of ₹ 3.64 lakh was collected.
		Snacks Schedule V	14.5/ 12.5	7.97/ 6.87	1.10	The Department stated (November 2012) that matter was under verification.
		Bakery/ confectionery Schedule V	14.5/ 12.5	7.60/ 6.55	1.05	The Department stated (November 2012) that a show cause notice had been issued to the dealer.
9	Tarnaka (Hyderabad) 2009-2010	Others Schedule V	14.5/ 12.5	7.43/ 6.40	1.03	The Department stated (November 2012) that a show cause notice had been issued to the dealer.
10	Vidyanagar (Hyderabad) 2010-2011	Tyres- Schedule V	14.5/ 12.5	4.92/ 4.27	0.65	The AA stated in August 2011 that notice would be issued.
11	Jadcherla 2010-2011	Others - Schedule V	14.5	4.96/ 4.28	0.68	The AA replied in July 2011 that action would be taken to collect the amount.
12	Kurnool-II 2010-11	Paraffin, hydrochloric acid etc., Schedule V	14.5/ 12.5	27.01/ 23.28	3.73	The AA stated in January 2012 that proposals were submitted to the DC (CT), Kurnool for taking up revision.
12	Parchur 2009-10	Others - upto 14-1-10 and from 15-1-10 Schedule V	12.5/14.5 /4	2.58/ 0.76	1.82	The Department stated (November 2012) that assessment was revised and demand raised.
14	Tirupati-II 2009-2010	Manurope compressor, Aluminium water tanks, Drilling machine, motorcycle etc. Schedule V	12.5/ 4	1.56/ 0.50	1.06	The AA stated in March 2011 that the matter would be examined.
15	Autonagar (Vijayawada) 2009-10	Automobile body building Schedule V	14.5/ 4	1.39/ 0.52	0.87	The AA stated in February 2011 that the matter would be examined.

(₹ in lakh)

Sl. No	Name of the circle/year of assessment	Commodity/ item No./ Schedule to APVAT Act	Rate of applicable / applied (per cent)	Tax leviable/ tax levied	Short levy	Reply of the Assessing Authority
16	Samarangam Chowk (Vijayawada) 2010-11	Mosquito repellents Schedule V	14.5/ 4	3.41/ 0.94	2.47	The AA stated in September 2011 that the matter would be examined
17	Vizianagaram East 2010-11	Cement poles Schedule V	14.5/ 4	3.29/ 0.91	2.38	The AA stated in September 2011 that the details of accounts would be collected from the dealer and report submitted.
			Total	**187.53 135.24**	**52.29**	

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

2.17 Non/short levy of penalty on belated payment of tax

Under Section 51 of the Act, where a dealer who fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, he shall be liable to pay tax and a penalty of 10 *per cent* of the amount of tax due.

2.17.1 We noticed (between February 2010 and November 2011) during the test check of the records of four circles[83] for the period 2010-11, that in 10 cases, the dealers paid tax of ₹ 3.69 crore as declared in their monthly VAT returns with delays ranging from 20 days to 655 days from the scheduled dates. The AAs, however, did not levy penalty of 10 per *cent* of the amount of tax due on belated payments of tax. This resulted in non/short levy of penalty of ₹ 22.25 lakh in the above cases.

After we pointed out the cases, the AAs/Department stated that

- in three cases (November 2012), penalty orders were passed. Out of these, penalty of ₹ 1.10 lakh was collected in one case, demand was taken into Debt Management Unit (DMU) in one case and penalty orders were served to the dealer in other case; and
- in the remaining seven cases (between June and November 2011), the matter would be examined.

We referred the matter to the Government between June and July 2012; their reply has not been received (January 2013).

[83] Hyderabad (Sanathnagar and Vengalraonagar), Nalgonda and Special Commodities Circle.

Under Section 53(1) of the Act where any dealer has under declared tax, and where it has not been established that fraud or wilful neglect has been committed and where the under declared tax is (i) less than 10 *per cent* of the tax, a penalty shall be imposed at 10 *per cent* of such under declared tax (ii) more than 10 *per cent* of the tax, a penalty shall be imposed at 25 *per cent* of such under declared tax.

2.17.2 We noticed (February 2010) during the test check of the records of Proddatur-I circle for the period 2008-09, that in one case the AA did not levy penalty of 25 *per cent* on the under declared tax of ₹ 22.65 lakh noticed, although the under declared tax was more than 10 *per cent* of the tax due. This resulted in non-levy of penalty of ₹ 5.66 lakh.

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

We referred the matter to the Department in August 2011 and to the Government in July 2012; their reply has not been received (January 2013).

2.18 Non-paying back of ITC on cancellation of VAT Registration

According to Rule 14 (4) of APVAT Rules, 2005, every VAT dealer whose registration is cancelled under this rule shall pay back ITC availed in respect of all taxable goods on hand on the date of cancellation.

We noticed (February 2012) during the test check of the VAT records of Gowliguda circle that in one case, the assessee had not paid back the ITC on hand at the time of cancellation of his VAT registration. This resulted in non-payment of tax of ₹ 7.61 lakh.

After we pointed out the case, the AA stated (February 2012) that action would be taken if the refund is claimed. The reply is not acceptable, since as per rule, the dealer should pay the ITC back at the time of cancellation of VAT registration.

We referred the matter to the Department in May 2012 and to the Government in July 2012; their reply has not been received (January 2013).

2.19 Short payment of tax due to non-conversion of TOT dealer as VAT dealer

Under Section 17(7) of the Act, every dealer not registered or not liable for registration as VAT dealer and who sells any goods and has a taxable turnover exceeding ₹ five lakh in a period of twelve consecutive months, shall apply for registration as TOT dealer and as per Section 4(2), is liable to pay tax at the rate of one *per cent* of the turnover. Under Section 17(3) of the Act, every dealer whose taxable turnover in the preceding three months exceeds ₹ 10 lakh or in the preceding 12 months exceeds ₹ 40 lakh up to 30 April 2009 shall be liable to be registered as a VAT dealer. From 1 May 2009, every dealer whose taxable turnover in the 12 preceding months exceeds ₹ 40 lakh shall be registered as a VAT dealer. In terms of section 49(2) of the Act, any dealer who fails to apply for registration shall be liable to pay penalty of 25 *per cent* of the amount of tax due prior to the date of registration. Further, there shall be no eligibility for ITC for sales made prior to the date from which the VAT registration is effective.

We noticed (January 2011) during the test check of turnover tax (TOT) ledger of Mancherial circle that though the turnover of one TOT dealer exceeded ₹ 40 lakh in the preceding 12 months by April 2009, the AA did not convert the dealer into VAT dealer. The turnover that exceeded the threshold limits in this case worked out to ₹ 38.54 lakh, on which VAT was leviable by registering the dealer as VAT dealer. Thus the dealer was liable to pay VAT of ₹ 4.43 lakh on this turnover. The dealer had not applied for registration as VAT dealer nor was registered by the Assessing Authority. This resulted in short realisation of revenue of ₹4.43 lakh towards VAT. Besides, penalty of ₹ 1.11 lakh was also leviable.

After we pointed out the case, the AA stated (January 2011) that the matter would be examined.

We referred the matter to the Department in July 2011 and to the Government in June 2012; their reply has not been received (January 2013).