

## Chapter-II

### Taxes/VAT on Sales, Trade etc.

#### 2.1 Tax Administration

Sales Tax/Value Added Tax (VAT) laws and rules framed thereunder are administered at the Government level by the Additional Chief Secretary, Finance Department. The Commissioner of Commercial Taxes (CCT) is the head of the Commercial Taxes Department (CTD) who is assisted by 14 Additional Commissioners. There are 13 Divisional VAT Offices (DVO), 13 Appeal offices, 13 Enforcement/Vigilance offices and one Minor Acts Division in the State managed by 40 Joint Commissioners (JCCTs). There are 123 Deputy Commissioners (DCCT), 317 Assistant Commissioners (ACCT) and 522 Commercial Tax Officers (CTO) in the State. At the field level, VAT is being administered through 118 Local VAT Offices (LVOs) and VAT Sub Offices (VSOs) headed by ACCTs and CTOs respectively. The DCCTs, ACCTs and CTOs head 266 Audit Offices where assessments/re-assessments are finalised by the Department.

#### 2.2 Internal Audit

The Department has an Internal Audit Cell under the charge of the JCCT (Internal Audit & Inspection). This cell was to conduct test check of cases of assessment as per the approved action plan and in accordance with the criteria decided by the Steering Committee so as to ensure adherence to the provisions of the Act and Rules as well as Departmental instructions issued from time to time.

As per the information furnished by the Department, the Internal Audit wing is functioning from the year 2011-12. During the year 2013-14, internal audit of only two offices were conducted as against 30 offices covered during the previous year. 83 objections involving ` 9.87 crore were raised during 2013-14. As at the end of 31 March 2014 there were 1,107 objections involving ` 166.13 crore pending.

#### 2.3 Results of audit

In 2013-14, test check of the records of 181 offices of the CTD relating to VAT, Sales Tax, Entry Tax, Profession Tax and Entertainment Tax showed underassessment of tax and other irregularities involving ` 134.83 crore in 847 paragraphs, which fall under the following categories as given in **Table - 2.1**.

Table 2.1

( ` in crore)			
Sl. No.	Category	No. of cases	Amount
1.	Performance Audit on "Assessment, levy and collection of VAT and entry tax on works contract"	1	47.90
	<b>Value Added Tax</b>		
2.	Non/short Payment of Tax	182	26.19
3.	Unacknowledged returns	21	13.88
4.	Incorrect/Excess carry forward of credit/refund	113	6.29
5.	Incorrect allowance of TDS	14	4.65

(₹ in crore)

Sl. No.	Category	No. of cases	Amount
6.	Non/short levy of penalty	170	4.37
7.	Non/short levy of output tax	66	4.14
8.	Non/short levy of interest	114	3.39
9.	Incorrect/excess allowance of input tax credit	42	0.98
10.	Other irregularities	48	14.83
	<b>Total</b>	<b>770</b>	<b>78.72</b>
	<b>Sales Tax</b>		
11.	Incorrect exemption of road cess	10	5.09
12.	Short levy of purchase tax	2	0.21
	<b>Total</b>	<b>12</b>	<b>5.30</b>
	<b>Entry Tax</b>		
13.	Non/short levy of tax under KTEG	13	1.36
14.	Other irregularities	33	0.45
	<b>Total</b>	<b>46</b>	<b>1.81</b>
	<b>Professions Tax</b>		
15.	Non/short levy of interest	3	0.07
16.	Other irregularities	6	0.06
	<b>Total</b>	<b>9</b>	<b>0.13</b>
	<b>Entertainments Tax</b>		
17.	Non/short levy of interest	3	0.02
18.	Other irregularities	5	0.59
	<b>Total</b>	<b>8</b>	<b>0.61</b>
	<b>Expenditure Audit of CCT office</b>		
19.	Avoidable expenditure of ₹ 36.27 lakh towards payment of Service Tax on procurement of IT software licenses	1	0.36
	<b>Grand Total</b>	<b>847</b>	<b>134.83</b>

During the course of the year, the Department accepted the underassessment and other deficiencies of ₹ 13.12 crore in 81 cases which were pointed out in audit during the earlier years. An amount of ₹ 5.93 crore was realised in 324 cases pointed out during earlier years. A few illustrative cases involving ₹ 56.82 crore are discussed in the following paragraphs.

## 2.4 Assessment, levy and collection of VAT and entry tax on works contract receipts

### Highlights

Five Developers in four LVOs did not declare the turnover of ₹ 300.47 crore relating to the land owner's share of the building. This resulted in short levy of tax of ₹ 19.49 crore including interest and penalty.

(Paragraph 2.4.2.2)

Absence of controls in the e-Filing System (EFS) to validate deductions claimed by contractors in their returns as payments made to 'Sub-contractor' resulted in short levy of tax of ₹ 15.56 crore including interest and penalty.

(Paragraph 2.4.2.7)

TDS claimed in returns filed by the works contractors exceeded the revenue realised through remittance of TDS by the concerned authorities by ` 941.14 crore.

**(Paragraph 2.4.2.9)**

Incorrect computation of taxable turnover in the re-assessment order resulted in loss of revenue of ` 3.78 crore.

**(Paragraph 2.4.3.1)**

## **2.4.1 Introduction**

Under the Karnataka Value Added Tax Act (KVAT Act), 2003, tax shall be levied on every sale of goods in the State by a registered dealer or a dealer liable to be registered, in accordance with the provisions of the Act. 'Sale' as defined under the Act includes "a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract". The term 'works contract' is also defined under the KVAT Act, to include "any agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property". The manner of assessment, levy and collection of tax on consideration received by a dealer for execution of works contract shall be as provided under the Karnataka Value Added Tax Rules (KVAT Rules) 2005.

The KVAT Act provides that a dealer who executes works contract may elect to pay in lieu of the net amount of tax payable, by way of composition, an amount at such rate not exceeding five<sup>1</sup> *per cent* on the total consideration for the works contract executed. This provision is called Composition of Tax (COT) under the KVAT Act. Under KVAT Act, every dealer shall be deemed to have been assessed to tax based on the returns filed by him. The LVO/VSO monitors the payments of taxes due based on the returns (deemed assessments) filed. Re-assessment of selected returns under Section 39 of the KVAT Act can be entrusted by the CCT to any Audit Office. Under the Karnataka Tax on Entry of Goods Act (KTEG Act), 1979, tax shall be levied and collected on entry of any goods specified in the First Schedule to KTEG Act into a local area for consumption, use or sale therein, at such rates not exceeding five *per cent* of the value of the goods as may be specified by the State Government by Notification. In respect of their liability to pay entry tax, dealers are required to file their 'Monthly Statement of Tax' in Form 3 as prescribed under Karnataka Tax on Entry of Goods Rules (KTEG Rules) with the jurisdictional LVOs.

### **2.4.1.1 Organisational Set up**

Levy and collection of VAT is administered by the CTD, which is headed by the CCT and is under the administrative control of the Finance Department. In the State, there are 13 DVOs, each headed by a JCCT. At the field level, the dealers are under the jurisdiction of a specified LVO/VSO.

<sup>1</sup> In respect of dealers opting for payment of tax under Composition of tax scheme u/s 15 of the KVAT Act, the rate of tax shall be at the rate of four *per cent* on the total consideration for the works contracts executed.

### **2.4.1.2 Audit Objectives**

The audit objectives were to assess whether

- (i) the system is adequate to ensure that all the dealers executing works contract in the State are registered with the CTD and are filing returns periodically;
- (ii) the correctness of declared turnover, input tax credits availed and Tax Deducted at Source (TDS) claimed by the works contractors are ensured; and
- (iii) the systems and procedure in place for processing of refunds and VAT re-assessment are adequate.

### **2.4.1.3 Audit Criteria**

The audit criteria for the Performance Audit were derived from the provisions of various Acts/rules as mentioned in the following:

- i) The KVAT Act, 2003
- ii) The KVAT Rules, 2005
- iii) The Central Sales Tax Act, 1956
- iv) The KTEG Act, 1979
- v) The KTEG Rules, 1979
- vi) Notifications issued under the KVAT Act, 2003
- vii) Circulars issued by the CCT from time to time

### **2.4.1.4 Scope and Methodology of Audit**

The performance audit covering a period from 2008-09 to 2012-13 was conducted from November 2013 to September 2014. The data available in the e-filing system (EFS) of the CTD with respect to registered works contractors and the re-assessment orders passed by Audit Offices of the CTD in respect of works contractors were scrutinised. With a view to ensure that the dealers executing works contract in the State are registered under the KVAT Act, data from external sources like Service Tax Department, Income-Tax Department, Department of Stamps and Registration (for Developers under the Joint Development Agreements registered), Chief Electrical Inspectorate (for licensed electrical works contractors) were obtained and cross verified with the registration database of the CTD.

In addition to the above, details<sup>2</sup> from 743<sup>3</sup> works contractors (292 VAT works contractors, 362 COT works contractors and 89 sub-contractors<sup>4</sup>) were

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<sup>2</sup> Soft copy of detailed sales list/works contract receipt list, purchase list and stock account in excel format for the years 2008-09 to 2012-13.

<sup>3</sup> Selected based on Monetary Unit Sampling technique using Interactive Data Extraction and Analysis (IDEA) software.

<sup>4</sup> Works contractors registered under either VAT or COT scheme but termed as sub-contractors in relation to works contractors who have sub-contracted their work to such contractors and had claimed this turnover under deduction.

called for by Audit under section 52(1-A)<sup>5</sup> of KVAT Act. Out of this, only 250 works contractors (117 VAT works contractors, 111 COT works contractors and 22 sub-contractors) furnished the details. We also scrutinized the returns filed, taxes paid and re-assessment orders passed by the CTD in respect of all the selected 743 works contractors.

An entry conference was held with the Principal Secretary, Finance Department and CCT in April 2014, in which the objectives, scope and methodology were discussed in detail. The draft PA Report was forwarded to the Government in August 2014 and was discussed in the Exit Conference held with the Principal Secretary, Finance Department and CCT in September 2014.

#### **2.4.1.5 Acknowledgement**

We acknowledge the co-operation of the Finance Department, Government of Karnataka and CTD in providing the necessary information and records for audit. We also acknowledge the co-operation extended by the Service Tax Department, Income Tax Department, Stamps and Registration Department and Chief Electrical Inspectorate for providing the necessary information.

#### **Audit findings**

##### **2.4.2.1 Registration of works contractors**

Section 22 (9-A) of the KVAT Act, 2003 stipulates that “every dealer engaged in the execution of works contract shall be liable to register and shall report such liability after the end of the month in which execution of any works contract is undertaken”.

We gathered information relating to dealers executing works contract in the State as per the records maintained in the Service Tax Department, Income Tax Department, Sub-Registrar Offices and Office of the Chief Electrical Inspectorate. Cross verification of the information so obtained with the details of registered works contractors available in the EFS of the CTD revealed that 407<sup>6</sup> works contractors who were executing works contract in the State were not registered with the CTD.

A ‘White paper on VAT’ brought out by the Government in January 2005 provided for “a cross-checking computerized system to be worked out on the basis of co-ordination between the tax authorities of the State Governments and the authorities of Central Excise and Income Tax to compare constantly the tax returns and set-off documents of VAT system of the State and those of Central Excise and Income Tax”.

This mechanism could have helped the CTD to detect and register the unregistered dealers who are liable to get themselves registered under the KVAT Act. The CCT while accepting the audit view point, stated in the exit

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<sup>5</sup> Section 52(1-A) of KVAT Act – “The audit party authorised by the Comptroller and Auditor General of India shall have powers to direct any registered dealer to produce at such time and such place as it may specify , accounts, registers, electronic tax register and documents relating to his business activity for examination”.

<sup>6</sup> 165 registered with Service Tax Department, 196 registered with Income Tax Department and 46 registered with Chief Electrical Inspectorate.

conference that the issue was taken up by the Department in the Regional Economic Intelligence Council<sup>7</sup> (REIC) but the Income Tax and Service Tax Departments were yet to (September 2014) provide the information.

### 2.4.2.2 Non-disclosure of taxable turnover by the Developers

As per the CCT Circular No.12/2009-10 dated 7.12.2009, in case of Joint Development Agreements, the consideration or total turnover in respect of land owners share of the building should be taken as part of the turnover relating to the works contract executed by the developer and assessed to tax after adding it to the total turnover declared by the developer if it is not already included.

We noticed that five Developers in four LVOs did not include the turnover relating to the land owner's share of the building in the turnover<sup>8</sup> declared by them. Of these, M/s Siri Homes was the one found to have executed projects prior to the date of registration with CTD. The total non-payment of tax including penalty under Section 72(2) and interest under Section 36 of the KVAT Act works out to ` 19.49 crore as detailed in **Table 2.2** below:

**Table 2.2 Details of non-payment of tax and penalty due to exclusion of land owners' share from the total turnover of the developer**

(₹ in crore)

Sl. No.	Tax Payer's Identification Number(TIN)/ LVO	Tax period	Taxable turnover of owner's share not included in the total turnover	Non-payment of tax including penalty u/s 72(2) and interest <sup>9</sup> u/s 36
1.	29020738850 (LVO-130)	2009-13	105.99	7.45
2.	29380586556 (LVO-35A)	2008-13	47.12	2.64
3.	29081144180 (LVO-60)	2008-13	21.80	1.42
4.	29660470099 (LVO-35A)	2008-13	122.26	7.74
5.	29310490419 (LVO-45A)	2008-13	3.30	0.24
	<b>Total</b>		<b>300.47</b>	<b>19.49</b>

During the exit conference the CCT stated that the matter would be examined.

### 2.4.2.3 Filing of returns by works contractors

As per the statement of objects and reasons for introduction of VAT system, "it promotes voluntary compliance by providing for acceptance of returns filed by dealers on self-assessment basis and for scrutiny of books of account only in selected cases".

Section 35 of the KVAT Act, 2003 stipulates that every registered dealer shall furnish a return in such form and manner including electronic methods, and shall pay the tax due on such return within twenty days (for VAT works

<sup>7</sup> REIC is the apex forum consisting of the members from the Central and State Departments, which oversees Government agencies responsible for economic intelligence and combating economic offenses in the respective states of India.

<sup>8</sup> Turnover calculated based on the guidance value as per the rate prevailing on the date of first registration of the flat relating to the project. In the absence of the same, the rate prevailing on the date of sharing agreement between the developer and land owner was adopted.

<sup>9</sup> Interest calculated upto the date of audit i.e, 20 June 2014.

contractors) or fifteen days (for COT works contractors) after the end of preceding month or any other tax period as may be prescribed. Failure to furnish returns for any tax period also attracts penalty under section 72(1) of the KVAT Act.

We noticed from the EFS that 2,894 works contractors across 108 LVOs had stopped filing the returns for periods ranging from 2 to 35 months and continued to be non-filers as of March 2013. After the matter was pointed out by Audit, only three<sup>10</sup> LVOs reported issue of notices to the concerned works contractors.

During the Exit Conference, CCT has confirmed that an automated system of sending message regarding non filing of returns has already been taken up based on the observation in the previous report on “Online Systems in Commercial Taxes Department” with effect from October 2013. However, action taken in respect of the cases pointed out in audit was not furnished to audit (October 2014).

#### 2.4.2.4 Delayed submission of returns and payment of tax

Under Section 72(1) of the KVAT Act, “A dealer who fails to furnish a return or who fails to pay the tax due on any return furnished as required under the Act shall be liable to pay penalty at the stipulated rate along with the tax or interest due”.

We noticed that three works contractors under LVOs 45A, 240 and 260 had filed and paid taxes amounting to ` 83.10 lakh due on 7 monthly returns belatedly. The LVOs concerned did not levy penalty of ` 5.82 lakh under section 72(1) of the KVAT Act which needs to be recovered.

#### 2.4.2.5 Filing of audited statement of accounts

Section 31(4) of the KVAT Act stipulates that every dealer whose total turnover in a year exceeds one hundred lakh rupees shall have his accounts audited by a Chartered Accountant or a Cost Accountant or a Tax Practitioner and shall submit to the prescribed authority, a copy of the Audited Statement of Accounts along with the certificate in Form VAT 240.

Scrutiny of EFS database revealed that 24.11 *per cent* to 28.07 *per cent* of the works contractors did not comply with the provision of Section 31(4) of the KVAT Act during the years 2010-11 to 2012-13. Details are given in **Table 2.3**.

**Table 2.3 Year-wise details of works contractors who defaulted in submitting Audited Statement of Accounts**

Year	No. of works contractors who had to file VAT 240	No. of works contractors who had not filed VAT 240	Percentage of defaulters
2010-11	3,689	921	24.96
2011-12	4,392	1,059	24.11
2012-13	5,079	1,426	28.07
<b>Total</b>	<b>13,160</b>	<b>3,406</b>	<b>25.88</b>

<sup>10</sup> LVOs 120, 290, 330.

The above table reveals that the filing of VAT 240 was not being monitored adequately by the CTD to ensure that the accounts of the works contractors having turnover of more than hundred lakh rupees are audited and correct amount of tax is paid by such works contractors.

#### **2.4.2.6 Delayed submission of Audited Statement of Accounts**

Under Section 74(4) of the KVAT Act, “any dealer who fails to submit within the time prescribed a copy of the audited statement of accounts, shall be liable to pay a penalty of five thousand rupees and, a further penalty of fifty rupees per day for so long as the failure to submit a copy of the audited statement of accounts continues, after being given an opportunity of showing cause in writing against such imposition of penalty by the prescribed authority”.

Of the 250 sampled dealers who furnished details to us under Section 52(1-A) of KVAT Act, we noticed that 25 works contractors in 19 LVOs<sup>11</sup> had not filed the Audited Statements of Accounts for the years 2010-11 to 2012-13. However, penalty of ` 14.64 lakh leviable (upto the date of Audit) under section 74(4) of the KVAT Act was not levied.

After we reported these cases to CTD, recovery of ` 0.67 lakh was effected by the CTD in only four out of 25 cases.

#### **2.4.2.7 Deduction of payments made to sub-contractor from turnover**

As per Rule 3(2) of KVAT Rules, the taxable turnover shall be determined by allowing the deductions from the total turnover as prescribed in sub-clauses (a) to (m) of Rule 3(2). Rule 3(2)(i-1) of the KVAT Rules provides for deduction of all amounts paid or payable to sub-contractors as the consideration for execution of works contract whether wholly or partly. It is provided that no such deduction shall be allowed unless the dealer claiming deduction produces document to prove that the sub-contractor is a registered dealer liable to pay tax under the Act and that the turnover of such amounts is included in the return filed by such sub-contractor.

It was observed that neither the CTD has specified the document to be produced as proof to substantiate the claim for such deductions, nor the prescribed form VAT 100<sup>12</sup> filed by works contractors under VAT scheme requires the works contractors to provide the details of the sub-contractors. This leads to non-availability of information in the EFS for further scrutiny by CTD and carries an inherent risk of incorrect deductions or non-realisation of the tax from the sub-contractors.

Though form VAT 120<sup>13</sup> prescribed for COT dealers provides for submission of information to capture the details of sub-contractors and their turnover in respect of whom deductions are claimed, the EFS does not have any control mechanism to verify if the said sub-contractors are still registered and had filed returns for the relevant tax period declaring turnover which is equal to or

<sup>11</sup> LVOs, 25, 35,35A, 45, 45A, 50A, 65A, 70A, 130, 150, 150A, 153, 155, 175, 200, 240,390, 480, 500

<sup>12</sup> Form VAT 100 is the monthly return filed by works contractors under regular scheme(VAT).

<sup>13</sup> Form VAT 120 is the monthly returns filed by the works contractors under COT.



more than the amount of sub-contractor turnover for which deduction was claimed by the principal contractor. This was also pointed out in the Report No.1 of the year 2014, Report of the Comptroller and Auditor General of India on Revenue Sector for the year ended 31 March 2013 tabled in 2014. However, the irregularities still persist.

Our analysis of EFS data relating to claim of 'sub-contractor turnover' deductions by principal contractors under COT scheme compared with turnover declared by the sub-contractors concerned for the period 2010-11 to 2012-13 revealed the following:

(i) 351 sub-contractors (COT-252 and VAT-99), had declared turnover of ` 323.90 crore as against ` 619.95 crore claimed as deduction towards works entrusted to them by their principal works contractors. The differential turnover amounting to ` 296.05 crore had escaped assessment on which tax at four *per cent* amounting to ` 11.84 crore was due. Interest leviable (upto August 2014) under section 36 of the KVAT Act amounted to ` 3.44 crore.

(ii) 18 principal works contractors under 13 LVOs<sup>14</sup> had claimed 'sub-contractor deduction' of ` 6.58 crore in respect of 22 sub-contractors, who were already de-registered and had not filed the return/paid tax for the tax periods in which the main contractors had claimed these deductions. However, the loss of revenue due to the deduction claimed by the main contractor towards 'sub-contractor payment' was not detected and disallowed by the CTD. The non levy of tax amounted to ` 26.31 lakh<sup>15</sup>. Besides, interest of ` 8.85 lakh<sup>16</sup> under section 36 and penalty amounting to ` 2.32 lakh under Section 72(2) of the KVAT Act were also leviable.

#### 2.4.2.8 Excess refund of tax

As per circular instructions issued (June 2011) the CCT had directed that while processing refunds, details of input tax credit (ITC) claim, sub-contractor payments and TDS certificates should be verified from the EFS before issue of refund payment orders.

In case of one works contractor (TIN 29290276254), ` 2.07 crore was allowed as sub-contractor's turnover for the year 2009-10 without disclosure of any details of the sub-contractors by the works contractor. Further, during 2010-11, ` 3.41 crore was allowed as sub-contractor's turnover against the actual turnover of ` 3.13 crore declared by sub-contractors.

In these cases, refunds of ` 13.71 lakh and ` 15.12 lakh was allowed without ensuring the accuracy of the claims regarding sub-contractor's turnover. This resulted in excess refund of ` 9.40<sup>17</sup> lakh.

#### 2.4.2.9 Tax Deduction credits

Rule 44(2)(a) of the KVAT Act Rules stipulates that every authority deducting tax under Section 9-A shall submit a monthly statement in Form VAT 125 to

<sup>14</sup> LVOs 15, 20, 35, 40, 50, 55, 65A, 70A, 100, 130, 150, 150A, 320

<sup>15</sup> Calculated at the composition rate of four *per cent*.

<sup>16</sup> Calculated upto the date of issue of Audit Enquiry.

<sup>17</sup> Calculated at four *per cent* of ₹ 2.35 crore i.e. ( 2.07 crore + ₹ 3.41 crore less ₹ 3.13 crore)

the jurisdictional Local VAT Officer together with proof of full payment of tax deducted, within 20 days after the end of the relevant month.

We observed that the Form VAT 125 does not contain the details of dealers in respect of whom the tax deduction is made and the tax deducted certificates. Hence, on production of tax deducted certificate, the CTD cannot ensure the actual remittance of such tax deducted. The amount of tax deducted and remitted by the deducting authorities during 2011-13 vis à-vis tax deducted credits claimed in the returns by the works contractors is given in **Table 2.4** below:

**Table 2.4 Details of revenue realized from remittance of tax deductions and tax deduction credits claimed**

(` in crore)

Tax period	Revenue realized from remittance of tax deducted by deduction authorities <sup>18</sup>	Total amount of tax deduction claimed		Difference between tax deduction remittances and tax deduction adjustments claims
		No. of dealers	Amount	
2011-12	119.21	11,049	576.63	457.42
2012-13	219.93	11,339	703.65	483.72
Total	339.14	22,388	1,280.28	941.14

It may be seen from the above that the claims of TDS credits in returns exceeded the revenue realised in the form of remittance of TDS by ` 941.14 crore. The details of e-payment remittances and book adjustments if any, made by the tax deducting authorities could not be ascertained as the information were not available in the EFS.

We checked the filing of tax deduction certificates in support of tax deduction claims of ` 77.57 crore by 32 sampled works contractors under the jurisdiction of 8 LVOs<sup>19</sup>. We noticed that 19 works contractors under the jurisdiction of 4 LVOs<sup>20</sup> had claimed deduction of tax amounting to ` 32.02 crore in 237 returns for which TDS Certificates were not available on record.

In absence of a mechanism for cross-verification of TDS claims and its actual remittances, there is a risk of non-remittance/incorrect claims which would result in loss of revenue to Government.

CCT while accepting the recommendation stated in the exit conference that CTD will undertake the development of such a system.

#### **2.4.2.10 Assessments of Tyre retreaders**

Works contract receipts from 'Tyre retreading' were taxed at 4, 5 and 5.5 *per cent* at different intervals during 2008-09 to 2012-13 under Entry 21 of the Sixth Schedule to the KVAT Act, 2003. It was noticed that the tyre retreaders had purchased input locally and claimed input tax at standard rate of tax ranging between 12.5 to 14.5 *per cent* during the tax periods 2008-09 to 2012-13. Thus, the rates of tax on inputs are higher than the output tax leading to refunds to the dealers. We noticed that though value addition was involved in

<sup>18</sup> Revenue figures generated from EFS

<sup>19</sup> LVOs 45, 45A, 175, 285, 380, 440, 450, 465

<sup>20</sup> LVOs 45, 45A, 175, 380

the process of 'tyre retreading', there was no realization of additional revenue to the Government.

In a similar circumstance, where 'cement', which is taxed at higher rate, was used as input in the business relating to cement pipes and fittings which are taxed at lower rate under Third Schedule to KVAT Act, input tax deduction was disallowed as per Notification No.FD 116 CSL 2006(10), Bangalore dated 31.3.2006.

Test check of records revealed that, four tyre retreading works contractors in their returns for the years 2008-09 to 2012-13 had declared output tax of ` 83.59 lakh and claimed input tax deduction of ` 1.27 crore with a net refund of ` 43.08 lakh. Analysis of the claims for input tax credit revealed that ` 70.75 lakh out of ` 1.27 crore was due to inputs being taxed at higher rate of tax than the output tax rate.

### **2.4.3 Re-assessments concluded by CTD**

Section 39 of the KVAT Act stipulates that where the prescribed authority has grounds to believe that any return furnished which is deemed as assessed or any assessment issued under Section 38 understates the correct tax liability of the dealer, the authority based on any information available can re-assess the case determining the additional tax payable along with penalty u/s 72(2) and interest u/s 36 of the KVAT Act. The prescribed authority shall issue a notice of re-assessment to the dealer demanding payment of tax within ten day of the date of service of notice after giving the dealer the opportunity of showing cause against such re-assessment in writing.

Test check of re-assessments concluded in respect of works contractor revealed the following deficiencies.

#### **2.4.3.1 Short levy of tax due to incorrect computation of taxable turnover**

Clause (h) of Rule 3(2) of KVAT Rules provides that the taxable turnover shall be determined after allowing for deduction of all amounts collected by way of tax under the KVAT Act. Clause (m) of Rule 3(2) prescribes deduction towards labour and like charges 'as a percentage of the value of the contract' in the execution of a works contract when such charges are not ascertainable from the books of accounts maintained by a dealer. This deduction towards labour and like charges was to be allowed on the turnover after deducting the VAT collected.

Test check of records revealed that in three cases of reassessment for the tax periods from 2008-09 to 2012-13, the assesses were allowed 30 *per cent* of the total turnover which includes the taxes collected, as deduction towards labour and like charges. This resulted in short levy of tax<sup>21</sup> including penalty u/s

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<sup>21</sup> Calculated at the applicable rate of 12.5 *per cent* for 2008-09 and 2009-10, 13.5 *per cent* for 2010-11, 14 *per cent* for 2011-12 and 2012-13 (upto 31.7. 2012) and 14.5 *per cent* from 1.8. 2012.

72(2) and interest u/s 36<sup>22</sup> of the KVAT Act amounting to ` 3.78 crore as detailed in **Annexure 1**.

CCT stated in the exit conference that the cases will be examined and appropriate action will be taken.

#### **2.4.3.2 Excess tax collected not forfeited**

Section 47 of the KVAT Act states that where any amount is collected by way of tax from any person by any dealer, whether knowingly or not, such dealer shall pay the entire amount so collected, to the prescribed authority within twenty days after the close of the month in which such amount is collected, notwithstanding that the dealer is not liable to pay such amount as tax or that only a part of it is due from him as tax under this Act. Any amount paid or payable by any dealer as above shall, to the extent it is not due as tax, be forfeited to the Government and be recovered from him.

We noticed from two re-assessment orders, concluded in February 2012 and June 2012 for the tax period April 2010 and 2008-09 respectively, that two works contractors had collected tax in excess of their liability by ` 32.52 lakh. However, the excess tax collected was not forfeited to Government in the re-assessment orders issued. Interest of ` 16.72 lakh under section 36 of the KVAT Act was also leviable.

#### **2.4.3.3 Excess carry forward of credit/refund**

In case of re-assessment order in respect of one works contractor (TIN: 29820868972) for 2011-12, additional demand of ` 474.04 lakh was raised by ACCT(Audit & Recovery)-5.10, Bangalore. We noticed that the assessee as per his return filed for March 2012 had carried forward the credit of ` 95.71 lakh which was adjusted against output tax for April 2012 onwards. However, this was not considered while concluding the re-assessment for the tax period 2011-12, which resulted in loss of revenue of ` 95.71 lakh.

#### **2.4.3.4 Non/short levy of penalty u/s 72(2) and interest u/s 36 of the KVAT Act**

We noticed that in the reassessment orders concluded in respect of eight works contractors under 8 LVOs<sup>23</sup>, penalty u/s 72(2) and interest u/s 36 for the tax periods ranging from 1 month to 41 months were not levied which amounted to ` 2.64 crore.

After we pointed out these cases, Department recovered an amount of ` 2.04 lakh in two cases.

#### **2.4.4 Discrepancies noticed based on the details furnished by dealers to Audit**

Examination of details furnished by 250 works contractors under section 52(1-A), revealed the following instances of loss of revenue.

<sup>22</sup> Calculated at the applicable rate of 1.25 *per cent* p.m upto 31.3.2011 and @ 1.5 *per cent* p.m from 1.4.2011 upto the date of re-assessment order.

<sup>23</sup> LVOs 20, 45, 45A, 70, 70A,130, 285, 540

#### 2.4.4.1 Non/short payment of Entry Tax and interest

Under the KTEG Act, on entry of specified goods into a local area, tax is leviable at the rates notified from time to time.

Scrutiny of the purchase statements furnished by the sampled works contractors revealed that four works contractors under four LVOs<sup>24</sup> had made purchases of commodities like bitumen, furnace oil etc., amounting to ` 12.44 crore which were liable for Entry Tax. It was however noticed that Entry Tax was not declared and paid by the contractors as per the provisions of the KTEG Act. Short levy of tax including interest worked out to ` 94.90 lakh (Tax ` 51.32 lakh and interest ` 43.58 lakh<sup>25</sup>).

#### 2.4.4.2 Discrepancies noticed in input tax claimed by works contractors

The local purchase statements submitted to us by the sampled works contractors were cross verified with the purchase invoice details of the selling dealers available with the returns filed through EFS. Instances of loss of revenue of ` 85.28 lakh (including penalty and interest of ` 21.03 lakh) on account of claims of ITC are given in **Table 2.5** below:

**Table 2.5 Details of excess claim of ITC**

(` in lakh)

Sl. No.	Number of Works Contractors/ LVOs	No. of selling dealers/LVOs	Ineligible amount of ITC claimed	Penalty and interest <sup>26</sup>	Observation in brief
1.	1/ LVO 45 Addl.	--	58.70	18.20	The works contractor claimed ITC of ` 373.80 lakh against the eligible amount of ` 315.10 lakh as per the purchase statement submitted.
2.	7/ LVO 320, 35A, 390, 130	8/ LVOs 340, 35A, 15, 100, 500, 310, 221, 65	2.58	1.44	Purchasing works contractor claimed ITC of ` 2.58 lakh whereas selling dealers declared Nil output tax. .
3.	1/ LVO 45A	3/ LVOs 15, 520	1.41	0.76	Purchasing works contractor claimed ITC of ` 1.41 lakh against de-registered selling dealers.
4.	2/ LVOs 15A, 390	2/ LVOs 210, 390	1.56	0.63	ITC was claimed incorrectly on purchases made from COT Dealers.
Total			64.25	21.03	

#### 2.4.4.3 Penalty leviable on under-statement of output tax or over-statement of input tax credit

Section 72(2) of the KVAT Act stipulates that any dealer who understates his liability to tax or overstates his entitlement to tax credit by more than five *per cent* of his actual liability to tax or his actual tax credit, shall be liable for a

<sup>24</sup> LVOs 15A, 240, 285,325

<sup>25</sup> Calculated upto the date of audit i.e, April 2014 or date of de-registration whichever is earlier.

<sup>26</sup> Interest calculated till the date of audit i.e, June 2014 or date of de-registration whichever is earlier.

penalty equal to ten *per cent* of the amount of such tax which was under or overstated.

We noticed that four works contractors under four LVOs<sup>27</sup> in their 10 returns filed for the tax periods between November 2010 and March 2012 reported net tax liability of ` 59.43 lakh. The net tax liability was subsequently revised by the dealers concerned to ` 1.47 crore. The short disclosure of net tax liability in the original return amounted to ` 87.49 lakh on which penalty under Section 72(2) of the KVAT Act amounting to ` 8.75 lakh was leviable.

#### **2.4.4.4 Tax on purchases from Un-registered dealers (URDs) in respect of works contractors opting for composition of tax**

Section 15(5)(e) of the KVAT Act stipulates that any dealer executing works contract and opting for composition of tax shall be liable to pay tax under Section 3(2) of KVAT Act in respect of purchases from URDs in addition to the tax by way of composition on the total consideration of the works contract executed.

We obtained the details of purchases from URDs in respect of sampled works contractors who were served with notice under Section 52(1-A) of the KVAT Act and who had opted for composition of tax. In respect of 16 works contractors under 15 LVOs<sup>28</sup>, it was noticed that, tax on URD purchases were not declared and paid. The loss of such tax amounted to ` 60.36 lakh<sup>29</sup>. Besides, penalty<sup>30</sup> leviable under Section 72(2) and interest<sup>31</sup> u/s 36 of the KVAT Act works out to ` 33.43 lakh.

After these cases were pointed out, Department recovered an amount of ` 10.92 lakh in three out of 16 cases.

#### **2.4.4.5 Non payment of tax, penalty and interest based on Form VAT 240**

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

Of the sampled dealers who furnished details to us, we noticed that 6 works contractors under 6 LVOs<sup>32</sup> were liable for payment of tax, penalty and interest as per the details furnished in Form VAT 240. However, these works contractors were not advised by the Auditors to pay the tax, penalty and interest amounting to ` 79.99 lakh and the same was also not paid. No action

<sup>27</sup> LVOs 15,45, 130, 240

<sup>28</sup> LVOs 25, 35A, 45A, 50A, 65A, 70A, 90, 120, 130, 175, 240, 350, 390, 520, 540

<sup>29</sup> Calculated at the composition rate of four *per cent*.

<sup>30</sup> Calculated at the rate of 10 *per cent*

<sup>31</sup> Calculated up to April 2014, at the rate of 1.25 *per cent* till 31.3.2011 and at the rate of 1.5 *per cent* from 1.4.2011 (calculated upto the date of audit i.e., April 2014).

<sup>32</sup> LVOs 45, 60, 120, 260, 330, 510

had been initiated by the LVOs concerned. After we pointed out these cases to CTD, recovery of ` 54,000 was effected in one case. Remaining amount was yet to be recovered.

#### **2.4.4.6 Tax on interstate purchases by COT works contractors**

As section 15(5)(a) of the KVAT Act, COT works contractors who obtain goods from outside the State or from outside the territory of India and if the property of such goods is transferred in any works contract executed, the works contractor shall be liable to pay tax on the value of such goods at the rate specified in Section 4 and such value shall be deducted from the total consideration of the works contracts executed.

Of the sampled dealers who furnished details to us, we noticed that 2 works contractors under the jurisdiction of two LVOs<sup>33</sup> had not declared the interstate purchases and paid tax due thereon. The tax not realised including penalty leviable under section 72(2) and interest leviable under section 36 of the KVAT Act worked out to ` 95.86 lakh as given **Table 2.6** below:

**Table 2.6 Tax on interstate purchases by COT works contractors**

( ` in lakh)					
Sl. No.	TIN/LVO	Tax Period	Amount of inter-State purchases effected	Tax payable on inter-State purchases	Penalty and interest
1	29470390906/ LVO-240	2010-11	464.66	44.14	27.19
		2011-12	76.83	7.68	3.95
		2012-13	89.29	9.14	3.62
2.	29100366811/ LVO 50 Addl.	2010-11	0.90	0.09	0.05
Total			631.68	61.05	34.81

#### **2.4.5 Conclusion**

The Performance Audit revealed that CTD needs to put in place necessary systems to detect unregistered works contractors who are liable for registration. System of tax deductions, remittance and claims to adjust tax deductions against tax payable is not equipped to ensure correct and timely realisation of revenue. The huge difference between revenue realised on account of TDS and TDS claims adjusted in the returns needs urgent investigation. The EFS does not validate sub-contractor's turnover deductions claimed in the returns and auto generate liability for payment of taxes on inter-State purchases in respect of COT works contractors. CTD has not put in place proper strategies for cross verification with other Departments to ensure correct reporting of tax liability under KVAT. We also noticed cases of suppression of turnover, incorrect/excess claim of deductions etc from the details furnished to us by the sampled works contractors.

<sup>33</sup> LVOs 50A, 240

## **2.4.6 Recommendations**

We recommend that:

**CTD should collect the details of works contractors registered with Service Tax and Income Tax Departments and cross check with the information available in EFS to ensure that all the works contractors liable for registration are registered with the CTD.**

**(Para No. 2.4.2.1)**

**CTD may integrate a mechanism within the tax return module of EFS to validate 'sub-contractor turnovers' to plug loss of revenue.**

**(Para No. 2.4.2.7)**

**The submission of the details of the dealers in respect of whom the tax deduction is made and the tax deducted certificates may be made mandatory in form VAT 125. Further, CTD may develop a system for verification of the claims for TDS credits by cross linking it to the information provided in form VAT 125 before allowing such credits.**

**(Para No. 2.4.2.9)**

**The input tax credits in respect of inputs taxed at higher rates being used in the business of tyre retreading may be disallowed/restricted to generate additional revenue to the Government as is being done in case of cement.**

**(Para No. 2.4.2.10)**

**CTD may issue clarification to all dealers/VAT authorities to ensure that the deduction towards labour charges is applied after deducting the taxes collected.**

**(Para No. 2.4.3.1)**

**The details of movement of specified goods attracting entry tax as available in e-Sugam<sup>34</sup> database should be cross linked with EFS database to ensure payment of entry tax by the dealers causing entry of such goods.**

**(Para No. 2.4.4.1)**

## **2.5 Non/short payment of additional tax declared in VAT 240**

As per Section 10(3) of the Karnataka Value Added Tax (KVAT) Act, 2003, the net tax payable by a dealer in respect of each tax period shall be the amount of tax payable by him on the sale of taxable goods (output tax) less the tax paid under this Act on purchase of goods by him for use in the course of his business (input tax).

Further, according to Section 31(4) of the KVAT Act 2003, every dealer whose total turnover in a year exceeds a prescribed amount<sup>35</sup>, shall have the accounts audited by a Chartered Accountant or a Cost Accountant or a Tax Practitioner (Auditor) and shall submit to the prescribed authority a copy of

<sup>34</sup> E Sugam: Online request and download of delivery notes for goods movement.

<sup>35</sup> ₹ 40 lakh till 31-03-2010, ₹ 60 lakh from 1-04-2010 to 31-03-2011 and ₹ 100 lakh thereafter



the audited statement of accounts in Form VAT-240 and prescribed documents in the prescribed manner.

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

During test check of records in 25 LVOs in eight<sup>36</sup> districts between April 2013 and March 2014, we noticed that 52 dealers in their audited accounts in Form VAT 240 had declared additional tax liability of ₹ 3.07 crore, compared to the tax liability declared in the monthly returns for the years 2011-12 and 2012-13. As per the Act, this additional liability declared was to be paid by the dealers along with penalty at 10 *per cent* and interest at 1.5 *per cent* per month. However, the dealers concerned neither paid the dues on their own on filing the audited accounts, nor were the dues demanded by the LVOs concerned. This resulted in non/short payment of tax of ₹ 3.42 crore including penalty of ₹ 34.93 lakh. Further, interest at 1.5 *per cent* per month was also realisable on the date of payment of tax due.

After these cases were brought to the notice of the Department between June 2013 and April 2014 and referred to Government in July 2014, ₹ 47.74 lakh was collected in 13 cases. Reply was awaited in the remaining cases (October 2014).

## **2.6 Excess adjustment of credit amount**

Under Section 10 of the KVAT Act, 2003, the tax payable by a dealer under the Act on sale is called 'Output tax' while the tax paid by the dealer on purchases is called 'Input tax'. The process of setting off input tax credit (ITC) from the output tax is called input rebating. A dealer is liable to pay the net tax<sup>37</sup> after such adjustment.

The said provision of the KVAT Act also stipulate that "where the input tax deductible by a dealer exceeds the output tax payable by him, the excess amount shall be adjusted or refunded together with interest, as may be prescribed". Rule 127 of the KVAT Rules, 2005 provides that the dealer may adjust the excess amount towards the tax payable by him for any other month or quarter.

The audited statement of accounts in Form VAT-240 filed under Section 31(4) of the KVAT Act enables dealers either to pay the tax paid short in the returns or to claim refund, as may be determined by the Auditor.

Under Section 38 of the KVAT Act, "every dealer shall be deemed to have been assessed to tax based on the return filed by him". Section 39 of the KVAT Act provides for re-assessment of tax by the prescribed authority.

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<sup>36</sup> Bangalore, Belgaum, Bellary, Chikamagalur, Dharwad, Gulbarga, Kodagu and Mysore

<sup>37</sup> (Output tax – Input tax)

Test check of records in two<sup>38</sup> Audit Offices and 15<sup>39</sup> LVOs/ VSOs were conducted between March 2013 and January 2014. During audit, we cross verified the credit amounts brought forward and adjusted against the output tax liability by the dealers in their returns with respect to returns/revised returns filed by them for previous tax periods, advices given by auditors in Form VAT 240 and re-assessments concluded by the prescribed authorities. The cross verification showed that in the case of 34 returns relating to 31 dealers, against the admissible credit of ₹ 90.26 lakh from the earlier tax periods, credit of ₹ 2.83 crore had been adjusted by the dealers concerned. This had resulted in excess adjustment of credit amount of ₹ 1.93 crore. The details are given in **Table 2.7**:

**Table 2.7 Excess adjustment of credit amount**

(₹ in lakh)

Sl. No.	Description	No. of dealers	No. of returns	Credit amount adjusted	Admissible credit	Excess amount adjusted
1.	Amounts adjusted from previous returns in excess of the amounts shown as carried forward in the previous returns.	19	22	138.17	68.26	69.91
2.	The dealers adjusted credits in the returns as per the excess amounts available to them in their previous returns. Subsequently, the Auditors of the dealers reduced the excess amounts claimed in those previous returns. However, the dealers concerned did not revise the returns in which the excess amount was adjusted. No action was taken by the LVOs to reverse the credit adjustment made by the dealers or to demand and recover the same.	9	9	140.03	21.21	118.82
3.	The dealers adjusted credits in the returns as per the excess amounts available to them in their previous returns. Subsequently, the prescribed authorities of the Department, in the re-assessment orders, reduced the excess amounts carried forward by the dealers. However, no action was taken to reverse the adjustment already availed of by the dealers in their subsequent returns.	3	3	5.32	0.79	4.53
<b>Total</b>		<b>31</b>	<b>34</b>	<b>283.52</b>	<b>90.26</b>	<b>193.26</b>

After these cases were brought to the notice of the Department between March 2013 and January 2014 and referred to Government in July 2014, ₹ 4.84 lakh was collected in three cases. Reply was awaited in the remaining cases (October 2014).

<sup>38</sup> Bangalore: ACCT(Audit)5.1 and Bidar; ACCT(Audit & Recovery)-Bidar,

<sup>39</sup> LVO-25, 30, 45 Addl., 80, 100-Bangalore, LVO-495-Bellary, LVO-310-Dharwad, LVO-520 & 525-Gulbarga, LVO 320 & 330-Hubli, LVO-300-Madikeri, LVO-370-Srisi, VSO-241-Arasikere and VSO-222-Tarikere.

## 2.7 Non payment of tax liability declared in the returns

Under Section 35(1) of the KVAT Act, every registered dealer shall furnish a return in such form and manner and shall pay the tax due on such return within twenty days (or fifteen days<sup>40</sup>) after the end of the preceding month.

The CTD introduced (April 2010) online e-Filing System (EFS) for filing of returns, payment of taxes, issue of Forms and Transit Pass, etc.

Returns filed under EFS are assigned one of the following status given in **Table 2.8**.

**Table 2.8 – Status of Returns filed in EFS**

Sl. No.	Status	Meaning
1.	Deemed acknowledged	Dealer files his return after making e-payment of tax liability declared in the return or when the dealer has credit to be carried forward with no net tax liability for payment. This status is automatic.
2.	Acknowledged	Dealer files return online with details of cheque for payment of net tax liability. The return is acknowledged by the LVO on receipt of the cheque.
3.	Not acknowledged	Dealer files return online with details of cheque for payment of net tax liability. The status of the return is 'not acknowledged'. This means that payment was yet to be made or only partial payment was made

When the return is acknowledged by the LVO, the cheque is posted to the bank statement in EFS and then sent for realization. In cases of receipt of cheques in advance before return is filed, the LVO posts the cheque to bank statement in EFS in the 'manual receipt' module and sends the cheque for realization. Returns with 'Not acknowledged' status implies that the dealer has not handed over the cheque to the LVO or that there is an omission on the part of the LVO to post the acknowledgement in EFS even after receipt of the cheque. All payments of the dealer realised are reflected in the EFS against the TIN of the dealer.

During test check of VAT returns filed in seven LVOs in Bangalore district between September 2013 and February 2014, we noticed that 118 monthly VAT returns filed for the tax periods April 2011 to March 2013 by 58 assesseees were under 'not acknowledged' status in the EFS. Our scrutiny of the payment details of these assesseees in EFS also showed no realisation of the amounts due on these returns or only partial payments. Thus, either the dealers had not made the payments to the LVOs or the LVOs had omitted to acknowledge the returns and post the cheques for bank realization. The total tax amount payable by such dealers amounted to ` 1.25 crore. No action had been taken by the officers concerned to follow up these cases and ensure recovery. This resulted in non-demand of tax for ` 1.25 crore.

After these cases were brought to the notice of the Department between October 2013 and March 2014 and referred to Government in July 2014, an amount of ` 7.80 lakh had since been collected in six cases. Balance amount was yet to be recovered (October 2014).

<sup>40</sup> Twenty days for regular VAT dealers and fifteen days for composition dealers.

## 2.8 Non/short levy of interest

Under Section 36(2) the KVAT Act, every dealer is liable to pay simple interest at the rate of 1.25 *per cent* per month up to 31 March 2011 and 1.5 *per cent* per month with effect from 01 April 2011 on any amount of tax omitted to have been declared in a return and also for delay in payment of tax within the due date. Further, interest shall also be demanded on additional tax liability determined on re-assessment.

We conducted test check of the records in 24 offices (13 Audit Offices and 11 LVOs/VSOs) in eight<sup>41</sup> districts between April 2013 and January 2014. In respect of 29 dealers, we noticed that there was delay in payment of tax either against original returns or against additional amount of tax liabilities due to reassessments or revised returns. All such cases attracted interest under Section 36(2) of the KVAT Act. However, interest in these cases was either not levied or levied short. The total non/short levy of interest for the tax periods between April 2005 and March 2012 worked out to ` 1.13 crore.

After these cases were brought to the notice of the Department between March 2013 and April 2014 and referred to Government in July 2014, an amount of ₹ 27.68 lakh was collected in 11 cases. In three cases, notices were issued to the dealers concerned. Action taken in respect of the remaining cases was awaited (October 2014).

## 2.9 Non levy of penalty under Section 72(1) of the KVAT Act

According to section 35 (1) of the KVAT Act, every registered dealer shall furnish a return in such form and manner, including electronic methods, and shall pay tax due on such return within twenty days after the end of the preceding month or any other tax period as may be prescribed.

Further, as per section 72(1) of KVAT Act, a dealer who fails to furnish a return or who fails to pay the tax due on any return furnished as required under the Act shall be liable to pay together with any tax or interest due, a penalty equal to

- a) five *per cent* of the amount of tax due or fifty rupees whichever is higher, if the default is not for more than ten days, and
- b) ten *per cent* of the tax due, if the default is for more than ten days.

During test check of records of 13 Offices (12 LVOs and 1 Audit Office) in five<sup>42</sup> districts between May 2013 and March 2014, we noticed that 23 assesseees had filed returns and paid tax of ₹ 6.50 crore belatedly, i.e, beyond twenty days after the expiry of the applicable tax period. Though, all these cases attracted penalty u/s 72(1) of the Act, it was neither paid by the assesseees nor levied by the Officers concerned. This has resulted in non levy of penalty of ₹ 56.33 lakh.

<sup>41</sup> Bangalore, Bijapur, Belgaum , Bellary, Chickaballapur, Davangere, Dakshina Kannada, Mandya

<sup>42</sup> Bangalore, Belgaum, Bellary, Dharwad and Mysore

After these cases were brought to the notice of the Department between June 2013 and May 2014 and referred to Government in July 2014, an amount of ₹ 19.27 lakh was collected in seven cases. In four cases notice was issued to the dealers concerned. Reply in respect of the remaining cases was awaited (October 2014).

## 2.10 Short levy of purchase tax on sugarcane

According to section 25-B(1) of KST Act, a tax shall be levied and collected on the last purchase point of sugarcane in the State at the rate of –

- (i) rupees sixty five per tonne, when purchased by a manufacturer of sugar (including khandasari sugar) whose rate of recovery of sugar exceeds 10.5 percent;
- (ii) rupees fifty per tonne, when purchased by a manufacturer of sugar (including khandasari sugar) whose rate of recovery of sugar does not exceed 10.5 percent.

On a test check of records in respect of KST assessments concluded u/s 25-B of KST Act, we noticed that, in two cases, purchase tax on sugarcane was levied at the lower rate even though the rate of recovery of sugar was more than 10.5 per cent. The details are as given in **Table 2.9**.

**Table 2.9 Short levy of purchase tax on sugarcane**

Sl. No.	Name of the office	Year & Date of assessment	Quantity of purchase in MT	Rate of tax leviable per MT (₹)	Rate of tax levied per MT (₹)	Short levy of tax (₹)
1	DCCT(Audit)-1, Gulbarga	2010-11/ 22-7-2011	3,87,608.508	65/-	60/-	19,38,043
2	DCCT(Audit & Recovery), Bellary	2007-08/ 16-4-2009	14,992.184	65/-	50/-	2,24,883
<b>Grand Total</b>						<b>21,62,926</b>

We pointed out these cases in February 2014 and March 2014 and the Assessing Officers concerned agreed to examine and furnish compliance in due course.

This was also taken up with the CCT (June 2014) and was referred to Government in July 2014. Their reply was awaited (October 2014).

## 2.11 Non/short levy of tax in re-assessments concluded

Under Section 39(1) of the KVAT Act, “where the prescribed authority has grounds to believe that any return furnished which is deemed as assessed or any assessment issued under Section 38 understates the correct tax liability of the dealer, it may, based on any information available, re-assess, to the best of its judgement, the additional tax payable and also impose any penalty under

sub-section (2) or sub-section (5) of Section 72<sup>43</sup> and demand payment of any interest<sup>44</sup>”.

In the reassessment concluded by DCCT (Audit & Recovery), Udupi in respect of a dealer engaged in sales of printed packing materials, we noticed that sale of moulds of ` 53.82 lakh was not assessed to tax in the reassessment order. Resultant non levy of tax worked out to ` 6.73 lakh<sup>45</sup>. Penalty of ` 67,256 and interest of ` 2.02 lakh (at 1.25 *per cent* /month for 24 months from April 2009) were also leviable.

We brought this case to the notice of the Department and Government during June 2014. Their reply was awaited (October 2014).

## **2.12 Excess/incorrect allowance of input tax credit**

Under Section 10(3) of the KVAT Act, a dealer is liable to pay the net tax<sup>46</sup> after adjustment of input tax with the output tax. The Act stipulates that ITC can be claimed only on purchases made locally i.e. within the State and both the purchasing and the selling dealers should be registered under the KVAT Act.

Test check of records in three<sup>47</sup> Audit Offices and two<sup>48</sup> LVOs was conducted between March and December 2013. During audit, we cross verified the purchase lists filed by seven dealers with the returns filed by 10 dealers who were stated to have supplied goods to them. The cross verification showed that in respect of ITC claim of ` 18.06 lakh by the purchasing dealers, the corresponding revenue realised by Government was ` 32,800 only declared by two selling dealers. Audit noticed that out of the remaining selling dealers, four dealers were deregistered, one dealer had not filed returns for the corresponding months, two dealers had filed nil returns for the corresponding tax periods and one dealer was registered after the period of sale in which ITC was claimed. This resulted in excess/incorrect claim of ITC of ` 17.73 lakh.

These cases were brought to the notice of the Department between July and December 2013 and were referred to Government in July 2014. Their reply was awaited (October 2014).

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<sup>43</sup> Section 72(2) of KVAT Act – “ A dealer who for any prescribed tax period furnishes particulars for preparation of a return or furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five per cent of his actual liability to tax or his actual tax credit, as the case may be, shall after being given the opportunity of showing cause in writing against the imposition of a penalty, be liable to a penalty equal to ten percent of the amount of such tax over stated or under stated.

<sup>44</sup> Section 36 of KVAT Act – Interest at 1.25 per cent till 31 March 2011 and 1.5 *per cent* from 1 April 2011

<sup>45</sup> Calculated at the rate of 12.5 *per cent* on ₹ 53.82 lakh

<sup>46</sup> (Output tax –Input tax) – as explained in para 2.7 earlier

<sup>47</sup> Bangalore: ACCT(Audit) 5.8, DCCT (Audit&Recovery) 5.7, Bidar: ACCT (Audit & Recovery)

<sup>48</sup> ACCT(LVO-55) Additional, Bangalore and ACCT(LVO-330), Hubli

## 2.13 Non/short levy of penalty under Section 72(2) of the KVAT Act

Under Section 72(2) of the KVAT Act, a dealer who for any prescribed tax period, furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five *per cent* of his actual liability to tax or his actual tax credit, as the case maybe, shall after being given an opportunity of showing cause in writing against the imposition of a penalty, be liable to a penalty equal to 10 *per cent* (20 *per cent* up to 31 March 2006) of the amount of such tax under or overstated.

We conducted test check of records in 10 Offices (03 LVOs and 07 Audit Offices) in six<sup>49</sup> districts between March 2013 and February 2014, and noticed that in respect of 11 assesses, tax liability got revised upward when Audited Statement of Accounts in Form VAT 240 were filed or when re-assessment orders were passed by the Department. Though, in all these cases, additional tax liability was more than five *per cent* of the actual liability, penalty under Section 72(2) was either not levied or levied short. The details are given below:

### 2.13.1 Non levy of penalty in respect of re-assessments

In respect of six assesseees, additional tax liability of ` 57.26 lakh was determined by five<sup>50</sup> assessing authorities in nine re-assessments for the tax period from 2005-06 to 2010-11. It was, however, noticed that penalty under Section 72(2) was either not levied or levied short by the Assessing Authorities concerned. Non/short levy of penalty worked out to ` 5.73 lakh.

### 2.13.2 Non levy of penalty on revision of tax liability through VAT 240

On test check of the annual audited accounts filed in Form VAT 240, we noticed that in respect of three dealers under LVO 215, LVO 310 and LVO-440, tax liability got increased by ` 77.92 lakh compared to the tax liability declared in the monthly returns. Though penalty of ` 7.79 lakh was leviable under Section 72(2), the same was not levied by the Department.

After these cases were brought to the notice of the Department in June and July 2014 and referred to the Government in July 2014, an amount of ` 10.26 lakh was collected in four cases. Reply in respect of the remaining cases was awaited (October 2014).

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<sup>49</sup> Bangalore, Chickballapur, Bellary, Davangere, Mandya, Bijapur

<sup>50</sup> DCCT (Audit) 2.7, ACCT (Audit)5.4, ACCT (Audit) 5.1,-Bangalore, DCCT (Audit & Recovery) , Bellary and ACCT (Audit) 3, Davanagere