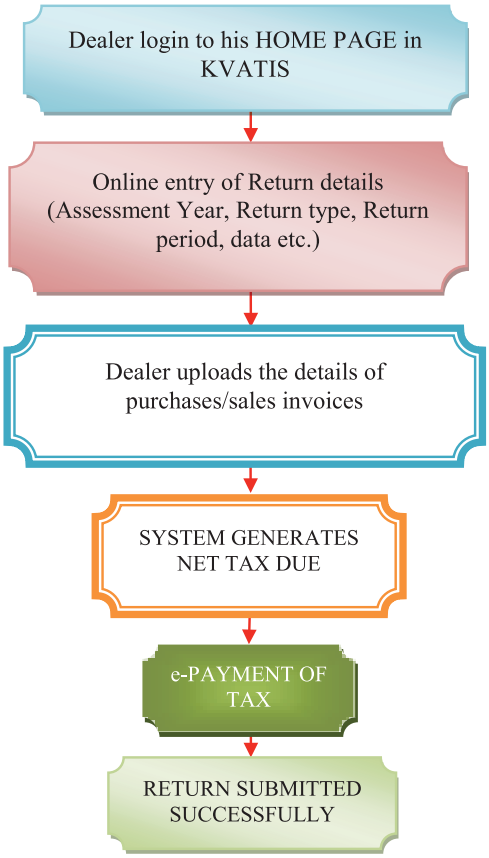
CHAPTER-IV : RETURN PROCESSING SYSTEM

4.1 Introduction

VAT is a self-assessment system, which contemplates that the tax liability is calculated and paid by the dealers through periodical returns. Hence, Return Processing System should ensure that, all the dealers carrying out business have filed periodical returns regularly; the returns filed are in complete shape and with all enclosures required; and dealers have shown their tax liability correctly and paid them to Government.

4.2 Process Automation

Government incorporated a new provision (2A) to Section 20 of KVAT Act to facilitate electronic filing of returns, mandatory for all dealers from 1 April 2009. In order to facilitate better and simplified services to dealers, the various returns to be filed under KVAT Act, CST Act, and KGST Act were integrated into a single return and 8,230 commodities were grouped into 361 commodity groups. Rule 22(1) and (2) of KVAT Rule, 2005 (Rule) stipulates that every dealer should file periodical[1] and annual return showing the details of transactions effected during the return period. A flow chart of the e-filing process of periodical return is shown below:



[1] Returns filed monthly and quarterly

Periodical Return is the return uploaded by the dealer in each month (in some cases quarterly) reporting all the transactions effected by him during the previous month along with the details of his purchases and sales invoices and the e-payment of tax. Annual Return is the consolidated figure of all periodical returns generated by the system on the command of the dealer.

In the e-filing system, the dealer can file returns electronically from any place at any time through the Internet. Once the returns are submitted by the dealers, the assessing authority has to accept the return. The dealer can revise the return within two months. The KVATIS provides the platform for the detailed effective scrutiny of returns through verification of invoices, checkpost declarations, crime files etc.

The Department introduced e-payment of net tax payable in September 2009. The system generates an e-challan for the payment of net tax payable, which is automatically calculated. The payment is effected through the bank account of the dealer, connected with the KVATIS.

KVATIS also provides the facility for downloading the statutory forms (prescribed under CST Act, for the claim of concessional rate or exemption) needed for the interstate transactions and upload the details of closing stock and audited statements in Form 13/13A.

4.3 Filing of Returns

4.3.1 Default in filing of periodical and annual returns

As per Section 20 of the Act every registered dealer shall submit to the assessing authority such return or returns on or before the date prescribed. Further, under Section 22(3) of the Act, if a dealer failed to submit any return as provided, the assessing authority shall estimate the turnover of the return period and complete the assessment to the best of judgment and a penalty under Section 67(1)(c) not exceeding Rupees ten thousand may be imposed on him.

The system should have an inbuilt input control mechanism to give alert to the assessing authority on the non-filing of returns, so that the assessing officer could complete the best judgment assessment effectively.

Audit extracted the number of dealers who have not submitted the periodical returns and annual return during the period 2009-10 to 2011-12 and found that 75,758 dealers failed to submit returns. Non-mapping of the business rule and absence of a system to generate a demand notice for penalty for non-filing of returns restricted the system in imposing penalty.

On this being pointed out, Government stated (April 2014) that in the e-filing scenario, no separate annual return is to be filed by the dealers. Moreover, it was stated that, they had verified the cases and the number of defaulters comes to 13,677 only as against 75,758 pointed out by audit as there were many dealers who may have commenced business in the middle of the year. The Department stated that remedial action will be taken by the assessing authorities.

The reply of the Department that no separate annual return need to be filed by the dealer is incorrect as the same is mandatory under Rule 22(2) of KVAT

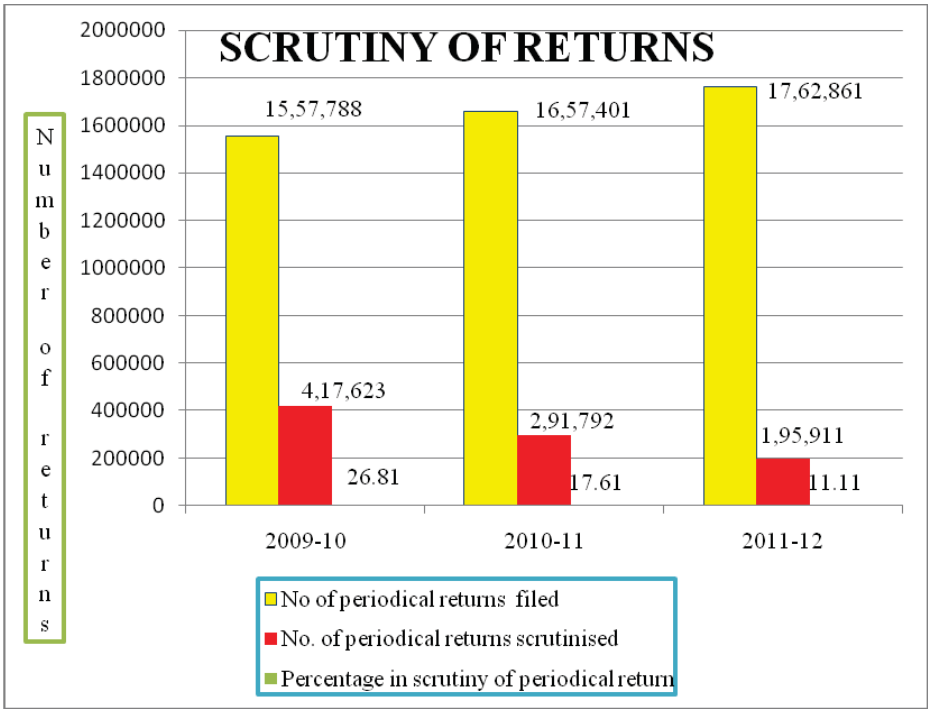
Rules. Further, non-levy of penalty on return defaulters as verified by the Government, works out to ₹ 13.68 crore[2].

During the Exit conference (April 2014), the Secretary, Taxes Department assured that, necessary steps would be taken to ensure that the business rules are properly mapped in the system to prevent such deficiencies.

4.4 Scrutiny of Returns

It is the primary duty of the assessing officers to scrutinise the returns filed by the dealers and to ensure that the receipt due to Government are correctly and properly assessed, realised and credited to government account. Under Section 22 of the KVAT Act, assessing authority has to issue notices in cases of non-filing/defective filing of self assessment returns and complete the assessments in deserving cases.

Return scrutiny is an important function in the administration of VAT and a provision was incorporated in the KVATIS for the detailed scrutiny of returns filed. Audit extracted and analysed the details of online scrutiny of periodical/ annual returns by assessing officers and the percentage of scrutiny done are shown in the chart given below:



On this being pointed out, Government stated (April 2014) that, even though the scrutiny status is provisioned in KVATIS, the officers were not mandated to record the scrutiny status due to slow performance of the system. Further, it was stated that, the actual *per cent* of scrutiny can be known from monthly diary of Assessing Officers and that steps are being undertaken to upload the diaries of assessing authorities so that the Department can review the assessments made by them through KVATIS.

[2] 13,677 cases @ ₹ 10,000

The reply depicts constraints in incorporating controls due to insufficient server capacity. Further, there exist no inbuilt controls in the system to assist the assessing officers to identify high risk transactions for assessment.

4.5 Short fixation of compounded tax for Gold dealers

Section 8(f)(v) of the Act provides that where a dealer in Gold had paid compounded tax[3] for the previous year, the compounded tax payable for the year 2011-12 shall be at the rate mentioned in item (i) below[4] the said clause or at the rate of 1.25 *per cent* of the turnover of the sales of the goods covered under the said clause for the previous year, whichever is higher.

Non-mapping of business rules and lack of process control in the system to automatically calculate the compounded tax of a dealer based on his previous years return had resulted in remittance of compounded tax less than due.

Analysis of the electronic data revealed that due to the above, compounded tax amounting to ₹ 5.08 crore was short collected in 10 assessment files and that self assessments were not reopened in any of the cases. Illustrative cases noticed are given below:

TIN	Year	1.25 *per cent* of previous year's turnover (₹)	Compounded tax fixed (₹)	Compounded tax short fixed (₹)
32010177712	2011-12	1,93,74,053	1,52,10,336	41,63,717
32150890664	2011-12	23,38,725	10,45,125	12,93,600

Penalty under Section 67 should also have been imposed. Maximum penalty leviable would work out to ₹ 8.61 crore.

On this being pointed out, Government stated (April 2014) that the dealers can file compounding option online and the assessing authority can upload the orders issued in KVATIS. The dealer can file 10D return entering the tax due and at the end of the financial year if more tax is to be paid on the turnover, he can make manual payment on the order of the assessing authority. The short levy arrived at by audit without physical verification of assessment records is not correct and sustainable.

The reply is not correct. As per Departmental instruction physical payment is not allowed from 2011-12. Payment could be made only electronically. Further, on verification (May 2014) of the returns filed, Audit found that no additional payment of tax have been made in any of the above cases.

Government assured that, necessary steps would be taken to ensure that the business rules are properly mapped into the system to prevent such deficiencies.

---

[3] To attract more dealers dealing with Gold, Works Contractor etc into the tax net, they are permitted to pay tax at a specified rate instead of paying tax under Schedule rate.

[4] Turnover for the previous year (a) below ₹10 lakh – same as tax paid in previous year,
(b) ₹ 10 lakh to ₹ 40 lakh – 105 *per cent* of tax paid in the previous year,
(c) above ₹ 40 lakh to ₹ one crore – 115 *per cent*,
(d) above ₹ one crore – 125 *per cent*

4.6 Accounting of Purchases

VAT is charged on the value addition on the purchase of a dealer. Accounting of purchases, so as to avail Input Tax Credit (ITC), is one of the important information to be included in the returns filed.

As per Section 24(1)(a) of the Act, if it is found during the scrutiny of books of accounts that the dealer had submitted incorrect return, his return shall be rejected and the assessment to be completed on "best of judgment". Audit observed that while reporting the local purchases, certain dealers claimed ineligible ITC and thereby reduced their tax liability. Instances noticed are discussed below:

4.6.1 Discrepancies in reporting of purchases

Audit observed that out of the 40,981, 40,006 and 39,573 dealers who filed audit certificate along with their annual return, in 7,293, 7,425 and 7,271 cases, purchase disclosed in the Statement of Particulars (Form 13 A) was less than that declared in the annual return during the year 2009-10, 2010-11 and 2011-12 respectively. The system had no input validation to match the purchase data declared through return and through Form 13A. This had the risk of dealers boosting their purchase in the return to avail excess ITC on local purchase or to issue C/F Form on non-existent interstate purchase/ stock transfer or for reporting a lower purchase in the accounts to suppress sales. Lack of control in the system to integrate the data in the return filed with that of the figures uploaded in Form 13A could result in short payment of tax.

Audit compared the details of assessments completed and found that the self assessments were not reopened in 1,902 assessments in respect of 1,283 dealers whose purchase figures did not match. Short-remittance of tax on this account could not be ascertained in audit as the details of opening stock, closing stock, purchases and sales available in the system were not integrated.

On this being pointed out, Government stated (April 2014) that cross verification of the value by the system is very difficult in the present situation due to slow performance of the system and that the tax impact can be arrived at only after verifying the opening stock, purchases and closing stock manually by the assessing officers while completing assessments.

The reply is not acceptable as the details of opening stock, closing stock, purchases, sales etc are available in the system. The requirement is only to integrate the data. This reiterates the need for the automated validation checks.

Government in the exit conference assured that, steps would be taken to incorporate necessary controls into the system to prevent such deficiencies.

4.6.2 Excess Input Tax Credit (ITC) availed

4.6.2.1 Availing of ITC by dealers for purchases from dealers who are not liable to pay tax under Section 6 of KVAT Act

As per Section 11(5) of KVAT Act, no ITC shall be allowed for the purchases effected from a registered dealer who is not liable to pay tax under Section 6 of KVAT Act.

Necessary validation and process control checks needs to be provided in the system to identify the status of the selling dealers from whom the taxable purchases were effected and reject the claim of ITC paid on purchases from dealers who are not liable to pay tax under the Act. Audit observed that due to lack of adequate controls, in 21 assessment files of 18 assessment circles, 19 dealers claimed ITC for the purchases effected from registered dealers who are not liable to pay tax under Section 6 of KVAT Act, and that their self assessments were not reopened. The short-levy of tax including interest worked out to ₹ 0.98 crore in the mentioned cases. The maximum penalty under Section 67 leviable on those cases would work out to ₹ 1.46 crore.

On this being pointed out, Government stated (April 2014) that during return scrutiny such irregularities would be verified by the assessing authorities and assessments completed by creating additional demand. It was also stated that it is impossible to cross check the TIN furnished using existing server capacity. Once the system is upgraded by replacing the server, linkage could be provided to cross check the TIN.

4.6.2.2 Availing of ITC by dealers for the purchases of goods not coming under the purview of Capital goods

As per Section 11(2) of the KVAT Act, ITC on capital goods shall be allowed to a registered dealer from the date from which the capital goods are put to use. Section 2(x) defines Capital Goods and SRO No.324/2005 excludes certain capital goods[5], from the purview of the definition.

Non mapping of the above business rules into the system resulted in dealers availing ITC for the purchases of goods not coming under the purview of capital goods such as, air conditioners, building materials etc.

Excess ITC claimed including interest by 31 dealers in 43 assessment files worked out to ₹ 1.64 crore. The maximum penalty under Section 67 leviable on them worked out to ₹ 2.45 crore. Two illustrative cases are given below:

(₹ in crore)

TIN	Goods description	Year	Purchase value	VAT paid
32151208509	Air Conditioners And Coolers	2010	0.27	0.03
32151044158	Cement / White Cement	2009	0.12	0.02

On this being pointed out, Government stated (April 2014) that while disposing the application in Form 25B the assessing authority would verify the eligibility of the claim and such verification is a manual process. Further, it was stated that as per notification, all kinds of Cranes, Earthmovers and similar machines used in connection with the supply of labour and services alone were coming under negative list.

The reply is not correct since the notification *inter alia* includes Air Conditioners, Building materials and Fixtures used in construction activities and the system allows to avail ITC on the purchases made for goods coming under the negative list.

[5] Air conditioners, civil structure, vehicles other than delivery vehicles, office furniture elevators, all kinds of cranes, earth movers, excavators, building materials etc.

Audit cross verified (May 2014) 10 cases out of the above 43 cases with respect to the details available in KVATIS and found that in all the cases the dealers effected purchases of capital goods falling under the negative list.

Government assured in the exit conference that the business rules would properly be mapped in the system enabling it to reject the claim of ITC on capital goods coming under the negative list.

4.6.2.3 Availing of more ITC by dealers than the tax actually paid/due on the purchases

ITC is available for any registered dealer for the tax paid on the purchases made by him and no ITC shall be available for any amount illegally collected by way of tax as specified in Section 30(3)(a) of the Act.

Lack of necessary validation and process control in the system, to calculate the actual ITC eligible on the purchase as per the invoices uploaded and to detect and block any excess claim of ITC had resulted in dealers availing excess ITC than eligible.

Audit observed that in respect of 485 assessments files of 404 dealers , tax and interest to the tune of ₹ 43.37 crore was short paid by availing ITC in excess than the tax actually due or paid by them. The maximum penalty under Section 67 to be imposed on these cases would work out to ₹ 66.03 crore.

Two illustrative cases noticed are shown below:

(₹ in crore)

TIN	Year	Value of goods	Tax paid [6] on purchases	Tax due on purchase	ITC eligible	ITC claimed	Excess ITC claimed
32030583164	2010-11	14.40	1.79	1.67	1.67	1.79	0.12
32050817032	2011-12	51.27	2.06	2.05	2.05	2.06	0.02

On this being pointed out, Government stated (April 2014) that the automated control will adversely affect the system performance and hence the scrutiny is being done manually which is effective also. During scrutiny of returns the assessing authorities would find out such irregularities manually and complete the assessments. There is no loss of revenue as alleged by Audit.

The reply is not correct since the short levy pointed out in Audit resulted due to lack of process control in the system to calculate the actual ITC due. Audit verified (May 2014) 31 cases with respect to the details available in KVATIS and found that in all the cases the dealers availed ITC more than what was actually due to them. Short-remittance of tax on these cases comes to ₹ 3.36 crore**.** These cases do not figure in the list of cases for which additional demand is created. It is recommended that the system be upgraded to achieve effective automated control. Moreover, Government had assured in the exit conference that necessary changes would be incorporated once the system is upgraded, replacing the existing servers.

[6] Excess tax paid is the tax illegally collected by his seller than the actual tax due on that commodity.

4.6.2.4 Non reversal of ITC when the goods purchased are sent outside the State otherwise than by way of sale

Proviso third below Section 11(3) of the Act provides that where any goods purchased in the State are subsequently sent outside the State or used in the manufacture of goods and the same are sent outside the State otherwise than by way of sale in the course of interstate trade or export or where the sale in the course of interstate trade is exempted from tax, ITC under this Section shall be limited to the amount of input tax paid in excess of four *per cent* on the purchase turnover of such goods sent outside the State.

Non mapping of such business rules coupled with lack of necessary controls in the system to trace the interstate stock transfer of goods to which ITC was claimed and to reverse the ITC in the next return automatically resulted in non-reversal of ITC by dealers who sent goods to outside the state otherwise than by way of sale.

Audit noted that self assessments were not reopened in respect of 278 assessments files on which tax including interest of ₹ 30.21 crore was short paid due to non reversing of ITC claimed on goods sent outside the state other than by way of sale.

The maximum penalty under Section 67 to be imposed on 174 dealers in 278 files worked out to ₹ 46.83 crore. Two illustrative cases are shown below:

TIN	Year	Tax paid up to four *per cent*	*Percentage* of interstate stock transfer to total sale	ITC to be reversed	ITC reversed
				(₹ in crore)	
32080204326	2009-10	0.96	97	0.93	0
32070336232	2011-12	14.96	2	0.29	0.01

On this being pointed out, Government stated (April 2014) that the verification for disallowance of ITC on goods purchased locally and sent outside the state as stock transfer or used in the manufacture of goods coming under first schedule required application of human intelligence and verification of physical records.

The reply of the Government is not acceptable. Since all the data is available in the system, the system can do all the verification and calculations if proper control were built in it. Moreover, audit verified (May 2014) the 20 cases thrown up by the system for verification with physical records and found that short-reversal of ITC of ₹ 12.79 crore exist in all these cases.

Government assured that the observation would be taken care of once the system is upgraded, replacing the existing servers. Further report has not been received.

4.7 Accounting of Sales

4.7.1 Accounted sales escaped self assessment

Section 42 of the Act stipulates that every dealer whose total turnover in a year exceeds ₹ 40 lakh/₹ 60 lakh[7] shall get his accounts audited annually by a Chartered Accountant and shall submit copy of it in the manner prescribed. Further, Rule 22(1) and (2) stipulates that every dealer shall file periodical and annual return showing the details of transactions during the return period.

Section 24(1)(a) of the Act, stipulates rejection of the return, if there is discrepancy between the return filed and audited accounts and to complete the assessment to the "best of judgement". As per Section 42(2), the dealer is liable to pay any additional tax with reference to the audited figures.

Since audited statement is a key control instituted by the statute to ensure correctness of sales/purchase turnover declared by the dealers, the system should have necessary in-built controls to cross verify the annual return filed with the audited statement of accounts uploaded. Necessary controls also need to be built into the system to accept only Form 13A duly authorised by the Chartered Accountant. The system should also generate a demand if there is any increase in the tax liability of a dealer.

Audit extracted data and analysed the details of 40,981, 40,006 and 39,573 dealers who filed Form 13A along with their annual return during the years 2009-10, 2010-11 and 2011-12 respectively and found short reporting of accounted sales in 2,303 assessment files due to lack of inbuilt control in the system to match the figures in the return with that in Form No.13A. The resultant short levy worked out to ₹ 783.78 crore. The maximum penalty under Section 67 to be imposed on 2,303 cases would work out to ₹ 1,113 crore. Two illustrative cases noticed are as shown below:

(₹ in crore)

TIN	Assessment year	Sales turnover accounted	Sales turnover returned	Turnover escaped assessment	Short levy of tax
32010667312	2011-12	390.14	195.31	194.83	7.90
32070329842	2010-11	355.36	344.89	10.47	0.47

The Government stated (April 2014) in reply that though the suggestion of embedding this control in the system is welcomed, there would be practical difficulty to implement the recommendation due to the slow performance of the existing servers. Both annual returns and audit statements are filed online and is made available to the assessing officers while conducting scrutiny. The assessing officers will cross check the values furnished as per returns and as per audit statements and send defect notices to the concerned dealers and take remedial action. Government assured that the recommendation for inbuilt controls would be incorporated once the system is upgraded, replacing the existing servers.

Audit verified (May 2014) 52 cases out of the 2,303 cases with respect to the details available in KVATIS and found that in all the cases the dealers failed

[7] The turnover limit for filing Audit Report has been increased from ₹ 40 lakh to ₹ 60 lakh from 2010-11 vide Finance Act 2010.

to report the actual sale accounted in their certified annual accounts. This was not detected by the assessing officers. Thus the claim of the department is not correct. The short-remittance of tax in these 52 cases comes to ₹ 41.84 crore**.** Department/Government may take effective action to ascertain the cases of short-remittance in the remaining cases.

The adequacy of the manual control as stated in the reply is evidently ineffective, given the coverage of the control and the possibility of human errors.

4.7.2 Short reporting of interstate sale than that reported at check posts

Registered dealers upload the details of their interstate sales and stock transfer (out) of goods before the consignment reaches the checkposts. When the consignments are released from checkpost, the details of consignments transported as approved by the checkpost authorities are linked to the Return Processing Module through KVATIS. Audit found that 1,165[8] dealers had transported out goods worth ₹ 5,516.32 crore as interstate sale, interstate stock transfer (out) and consignment stock transfer (out) through various checkposts. However, the total value of interstate transaction (out) reported was only ₹ 2,737.12 crore (49.62 *per cent*).

Lack of process control in the system to integrate the interstate sales captured in the checkpost module with the interstate sales of the dealer in the Return Processing Module resulted in short reporting/non-reporting of interstate sales. Analysis of electronic data revealed that in 1,345 assessment files, interstate transaction (out) amounting to ₹ 2,779.20 crore escaped from assessment resulting in short levy of tax and interest of ₹ 189.88 crore. The maximum penalty under Section 67 to be imposed would work out to ₹ 310.77 crore. Two illustrative cases are given below:

TIN	Year	Value of goods reported at checkposts (₹)	Interstate sale returned (₹)	Interstate sale short reported (₹)	Tax due (₹)
32021102542	2011-12	3,20,66,845	2,95,13,300	25,53,545	1,03,163
32080829332	2011-12	4,64,47,810	99,97,785	3,64,50,025	16,26,540

On this being pointed, Government (April 2014) stated that the cross validations for the value of goods reported at the checkposts to the interstate sales turnover declared in the return filed is practically difficult since the volume of transactional invoices through checkposts to be consolidated are very high to arrive at the interstate sales turnover. This is impossible using the existing server capacity. Further, it was assured that once the system is upgraded by replacing the existing servers the audit recommendations can be incorporated.

4.7.3 Excess deduction of tax in respect of sales return

As per Section 41(1) read with Rule 9 and 59, if any taxable goods sold have been returned by the purchaser, the dealer effecting the sale shall issue to such

[8] Tax liability of goods transported (out) above Rupees one lakh only is taken.

purchaser a credit note in Form No.9[9]. Further Rule 59 provides that credit note claim shall be supported by debit notes issued by the purchaser in Form No.9.

Audit compared the output tax deducted by the sellers through credit notes issued by them and ITC reversed by purchaser through their debit notes for the years 2010-11, 2011-12 and 2012-13 and found a significant mismatch with a probable revenue impact.

Year	OPT deducted by sellers through credit notes (₹)	ITC reversed by purchaser through debit notes (₹)
2010-11	42,09,30,775	15,81,29,502
2011-12	50,13,91,709	20,56,45,832
2012-13	15,59,43,284	6,16,20,273

It was observed that there are no fields in the system to capture the essential details such as, Seller/ Purchaser TIN, the invoice number and date, the date of return of the goods, tax amount, etc., in Form No.9. In the absence of such fields, it is not possible to detect from whom the goods are received back, whether the goods received back are within the time limit fixed, whether corresponding debit notes are issued for all credit notes, etc. These details are all mandatory requirements for allowing deduction of output tax (OPT) for sales return. Non mapping of the requisite business rules into the system leave a significant risk of revenue loss.

Similar case was pointed out in Paragraph 2.16.1 (Item 5 of Table) in Audit Report 2013.

Government stated (April 2014) that the system of verification of above aspects are done manually by the assessing officers while scrutiny of returns. The officers had already taken remedial measures in the cases where irregularities were noticed. It was further stated that specific cases had not been pointed out in the observation. The statistics of scrutiny of returns and additional demands raised by the Department was shared to show that remedial measures had already been taken and there may not be any revenue loss as alleged by audit.

The reply is not acceptable since the statistical data furnished by the Department was not relevant to the points raised by Audit. Better data capture will only obviate the need for manual control, and improve effectiveness of tax administration. In absence of the details as pointed out in the observation, it was not possible to draw conclusions on individual cases. Moreover, during exit conference, the Department assured that filing of credit note and debit note would be made online and necessary controls would be put into the system to check the tax credit taken for sales return by integrating the details of credit and debit notes. Further report has not been received.

[9] Form No.9- The form stipulated for filing both credit note by seller and debit note by purchaser.

4.7.4 Failure to remit the collected tax

4.7.4.1 Failure to pay the collected tax as reported by the dealer through the details of his sales invoices

As per Rule 41(1) of KVAT Rules 2005, where a registered dealer collects tax under Section 30, he shall pay it over to Government and as per sub Rule 2 to Rule 41(1), if the assessing officer is satisfied that any amount collected by way of tax have not been paid by the dealer to the Government, he shall issue notice to the dealer specifying the amount withheld by him and the dealer shall pay such sum within the time prescribed along with interest.

The system should be designed in such a way that it had necessary controls to cross verify the periodic returns of the dealers with the details of sales invoices uploaded by dealer to ensure that the entire amount collected by way of tax, after adjusting the eligible ITC, was paid to the Government. Audit cross checked the details of sales invoices uploaded by the dealers with their returns filed and cases were noticed that dealers withheld a portion of the amount collected by them, by way of tax without remitting it to the Government. Illustrative examples are given below:

TIN	Collected tax as per invoices (₹)	Output tax as per return (₹)	Collected tax withheld by the dealer (₹)
32010125354	5,27,19,481	5,23,95,981	3,23,500
32081490808	32,94,031	29,04,125	3,89,906

Audit noted that the self assessments were not reopened in respect of 2,480 assessments files on which tax to the tune of ₹ 632.59 crore was short remitted by dealers withholding the tax collected through their invoices. The maximum penalty under Section 67 leviable in these cases would work out to ₹ 1,082.55 crore. On this being pointed out, Government stated (April 2014) that the incorporation of necessary controls to check the returns of the dealers with the details of the sales invoices uploaded by dealer to ensure that the entire amount collected by way of tax after adjusting the eligible ITC was paid to the Government involves high volume of data. It is impossible to incorporate the suggestion in real time using the existing server capacity as the system would get choked and would become inaccessible for availing e-services. Government assured that the observation would be taken care of once the system is upgraded, replacing the existing servers.

Audit test checked (April 2014) 31 cases and found that in 17 cases invalid data was recorded in the column concerned. In the remaining 14 cases there was actual short remittance of tax collected which amounted to ₹ 39.23 crore. Department/Government may take effective action to ascertain the cases of short remittance in the remaining cases and collect the balance tax due in all cases.

4.7.4.2 Failure to pay the collected tax by the dealers as reported in the details of the purchase invoices by their purchasing dealers

Audit compared the details of purchase invoices uploaded by the purchasing dealers with the returns filed by the selling dealers and found that 8,746[10] selling dealers in 12,574 assessment files withheld a portion of the amount collected by them by way of tax from the persons who purchased goods without paying it to the Government. Lack of process controls in the system to detect collected tax details uploaded by the purchasing dealers and it's cross check with the return filed by the selling dealer enabled the selling dealer to withhold a portion of the collected tax without remittance to Government. In such cases the system should generate a demand notice for any shortfall in the payment of collected tax

Audit noted that self assessments were not reopened in respect of 12,102 assessments files on which tax to the tune of ₹ 959.45 crore was short remitted by dealers withholding the tax collected as per their purchaser's invoices. The maximum penalty under Section 67 to be imposed on 12,102 files would work out to ₹ 1,650.31 crore**.** Two illustrative cases are given below:

TIN of the seller	No of purchasing dealers from whom collected tax withheld	Tax collected by seller as per the invoices of purchasers (₹)	Corresponding VAT collected as per seller invoices (₹)	Collected tax short reported by seller (₹)	Tax paid without uploading invoices by seller (₹)	Collected tax withheld by the dealer (₹)
32070314384	31	11,32,981	7,72,556	3,60,425	35,172	3,25,252
32070455144	12	47,73,946	35,37,162	12,36,784	9,80,389	2,56,395

On this being pointed out, the Government stated (April 2014) that the volume of invoices to be uploaded being very high it is impossible to incorporate it using the existing server capacity. The cross verification of purchase and sale invoices could be done by the assessing officers manually. Once the system is upgraded the above details could be incorporated.

4.8 Short accounting of opening stock of a year as compared to the closing stock of the previous year

Accounting of stock and its corresponding sales has a direct bearing on the payment of tax, the system should be designed in such a way that the opening stock of a year should be automatically generated from the closing stock of the previous year rather than giving an option to input the values of opening stock by the dealer.

Audit extracted data of the 'accounted stock' from the statement of particulars filed in Form 13A for the years 2009-10, 2010-11 and 2011-12 and found that 517 dealers in 2010-11 and 465 dealers in 2011-12 accounted lesser opening stock than their accounted closing stock of the previous year. Out of these cases the short accounting of stock by 223 dealers, who had tax liability of over ₹ one lakh was to the tune of ₹ 654.37 crore.

Tax evaded by these 223 dealers in 225 assessment files including interest worked out to ₹ 47.53 crore. The maximum penalty under Section 67 leviable

[10] Amount withheld more than Rupees one lakh is taken.

on them would work out to ₹ 76.56 crore. Two illustrative cases are given below:

TIN	Opening stock current year (₹)	Closing stock previous year (₹)	Stock difference (₹)
32030463407	7,368,398	73,368,398	66,000,000
32071308535	97,251,571	54,823,755	42,427,816

On this being pointed out, Government stated (April 2014) that the cross verification of opening stock with the closing stock of the preceding year has been facilitated to the assessing officer during scrutiny of return manually. During this verification if any irregularities are reported they proceed to "best judgment assessment"[11]. All the assessment files where audit reports have been filed may have been physically subjected to audit by the assessing officers. Hence, the loss of revenue arrived at by the Audit without verification of physical records is not sustainable. The reply is not acceptable. We collected the details of all assessments completed during the audit period and found that best judgment assessments were done only in less than five percentage of files to which we found discrepancies. Hence the claim of 100 *per cent* scrutiny is not acceptable

Audit verified (April 2014) 14 cases out of the 225 cases where dealer had filed audit report. There was mismatch found between opening stock and closing stock values. Audit found that in seven cases the value recorded in the column concerned was invalid. In the remaining seven cases actual short levy including interest amounted to ₹ 12.13 crore. Department may take necessary action to verify remaining 213 cases pointed out and take effective action to make good the short levy.

4.9 Scrutiny of Returns of Presumptive tax dealers

4.9.1 Non-demand of schedule rate of tax from Presumptive tax dealers who imported goods into the State

As per Section 6(5), a registered dealer who is not an importer[12] or other dealers specified therein and whose turnover is below ₹ 50 lakh/₹ 60 lakh may pay at his option tax at the rate of half *per cent* of the turnover of sale of taxable goods as presumptive tax instead of paying tax under Section 6(1)[13].

Necessary input control should have been made in the system where a presumptive dealer effects any interstate transaction, the system should recalculate the tax due on the turnover of sale as if the sale was effected by a regular tax payer. Audit found that 369 presumptive dealers had transported goods from outside the State through various checkposts. Lack of proper validation controls and checks in the system resulted in 369 dealers in 430 assessment files paying presumptive tax instead of at the schedule rate. Short levy of tax including interest in this regard works out to ₹ 24.81 crore[14].

---

[11] Assessment completed under Section 22 (3) of the Act by reopening of self assessments in case of defective filing of return

[12] Person who obtains or brings goods from any place outside the State or country

[13] The liability to pay tax and the rate of tax are derived from Section 6(1) of Act

[14] Tax liability of more than Rupees one lakh

The maximum penalty under Section 67 leviable on them would work out to ₹ 42.52 crore.

On this being pointed out, Government stated (April 2014) that the status of the dealer can be verified at the checkpost through KVATIS and if it is found that the consignment into the state by PIN dealers checkpost officials may collect security deposit for the release of vehicle, the details of which can be ascertained from the manual registers maintained at the checkposts. Further, it was stated that the value of goods transported from outside the state by the presumptive dealers was meagre and there is no restriction in the statute for a presumptive dealer to transport goods for own use by paying CST.

The reply is not acceptable since it is not relevant to the points raised by Audit. Audit extracted data from interstate transaction of trading goods and not from goods meant for own use and the statute clearly mentions that an importer, irrespective of the value of goods imported, is not permitted to pay tax at presumptive rate.

Audit verified (May 2014) 22 assessment files with respect to the returns and checkpost transactions and found that all these presumptive dealers effected interstate purchase. Short remittance of tax by these dealers worked out to ₹ 6.03 crore. Hence, necessary validation should be made into the system to change automatically the presumptive status of the dealer and demand tax at schedule rate.

4.9.2 Non-demand of schedule rate of tax from Presumptive tax dealers whose turnover crossed the threshold limit in the previous year

As per the third proviso below Section 6(5) of KVAT Act, a dealer shall not be eligible to opt for payment of presumptive tax if his total turnover had exceeded the threshold limit during the year preceding the year to which such option relates. Further, Rule 18 (31) stipulates that a presumptive dealer who is likely to become ineligible for the payment of tax under that Section shall intimate the fact to the registering/assessing authority at least thirty days prior to the date from which he expects to so become ineligible and he shall be liable for payment of tax under Section 6(1) or (2) from the date on which he has become ineligible. Audit found that 48 dealers in 37 assessment circles continued to pay presumptive tax though their total turnover crossed the limit specified in the Act.

Non-mapping of business Rules into the system to change automatically the status when the turnover of the dealer for the previous year crossed the threshold limit[15] had resulted in 48 dealers in 56 assessment files short paid tax including interest of ₹ 3.20 crore. Since the dealers, who are liable to switch over to regular tax payer status as and when their turnover crossed the threshold limit, paid tax at presumptive rate even after their turnover crossed the limit, penalty of ₹ 5.43 crore was leviable under Section 67.

On this being pointed out, Government stated (April 2014) that the data mining team of the department had already listed out the cases of presumptive

[15] Threshold limit- ₹ 50 lakh total turnover up to 2010-11 and thereafter ₹ 60 lakh

dealers crossing the threshold limit and forwarded to the respective assessing officers for remedial action. Based on the report the assessing authorities had already taken necessary steps to convert the PIN to TIN. Verification result of one of the cases pointed out indicated that the levy and conversion of status was applied correctly. It further stated that the short levy worked out had no basis and the audit is not sustainable.

The reply is not acceptable. The departmental reply relates to crossing of threshold limit in the current assessment year whereas Audit objection relates to turnover crossing threshold limit in the previous year. Audit verified (April 2014) 12 cases and found that in the above cases though turnover of the previous year crossed the threshold limit PIN was not converted to TIN. The tax effect involved in these cases amounted to ₹ 1.23 crore and maximum penalty leviable amounted to ₹ 2.08 crore**.** Department may verify the physical records in respect of the remaining cases.

4.10 Conclusion

- Audit observed that the Return Processing System Module developed for automation of the manual procedures in filing of returns and scrutiny of returns is not fully effective due to the following:
  - The business Rules regarding the filing and scrutiny of returns were not properly mapped into the system.
  - Lack of proper input and process controls in the system to detect and rectify all possible tax evasion.
  - The validation checks and cross linking of each modules inbuilt in the system is not adequate for the effective administration of tax.
  - The data available in various modules were not utilised by the Assessing Officers for effective tax administration.
- Though the system provides a platform for detailed scrutiny of returns, the low percentage of scrutiny of returns filed by the dealers through KVATIS shows that the departmental officers are not giving adequate attention/priority to scrutinize the returns filed.

Thus, due to the above shortcomings, the benefit of Return processing system module, such as, online processing of data available, scrutiny of returns through cross verification of invoices, generation of various demand notices, generation of return defaulters etc rendered unutilised.

4.11 Recommendations

- Department may ensure that all business Rules are mapped to the system properly, that the system provide all necessary input and that there exists adequate process controls and validation checks to detect shortfalls in payment of tax.
- Government may consider strengthening KVATIS for monitoring the scrutiny of returns through it.

- The Department may incorporate a provision in the KVATIS to ensure that the closing stock shown in the certified accounts in Form 13-A of a year is correctly taken as the opening stock of the succeeding year.
- Proper controls be built into the system so that the system can scrutinise returns collecting details from different databases.
- Department/Government may initiate early action for the upgradation of the present server which would be cost effective in terms of improvement of revenue realisation it would fetch.