



Chapter-II
Taxes/VAT on Sales,
Trade, etc.

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2.1 Tax Administration

Sales Tax/Value Added Tax (VAT) laws and Rules framed thereunder were administered at the Government level by the Additional Chief Secretary, Finance Department. The Commissioner of Commercial Taxes (CCT) was the head of the Commercial Taxes Department (CTD) who was assisted by 14 Additional Commissioners and seven Joint Commissioners (JCCTs). There were 13 Divisional VAT Offices (DVO), 13 Appeal Offices, eight Enforcement/Vigilance Offices and one Minor Acts Division in the State, managed by 35 JCCTs. There were 123 Deputy Commissioners (DCCTs), 321 Assistant Commissioners (ACCTs) and 526 Commercial Tax Officers (CTOs) in the State. At the field level, VAT was being administered through 118 Local VAT Offices (LVOs) and VAT Sub Offices (VSOs) headed by ACCTs and CTOs respectively. The DCCTs, ACCTs and CTOs were heading 266 Offices, where assessments/re-assessments were finalised by the Department.

2.2 Internal Audit

As per the information furnished by the Department, the Internal Audit Wing was functioning from the year 2011-12. During the year 2016-17, 344 Offices were due for audit, of which, 227 Offices were audited. The shortfall in coverage of Offices was due to the preparation for implementation of Goods and Services Tax. Year-wise details of the number of objections raised, settled and pending along with tax effect, as furnished by the Department, are given in **Table 2.1**.

Table 2.1
Year wise details of observations raised by IAW

Year	Observations raised		Observations settled		Observations pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
2012-13	3,814	189.00	1,122	57.75	2,692	131.25
2013-14	4,183	15.23	319	0.18	3,864	15.05
2014-15	6,742	22.00	1,046	4.13	5,696	17.87
2015-16	1,129	34.59	595	3.15	534	31.44
2016-17	500	104.85	10	0.03	490	104.82
Total	16,368	365.67	3,092	65.24	13,276	300.43

As seen from the Table, 13,276 observations involving ₹ 300.43 crore were pending settlement as on 31 March 2017. Early action may be taken to settle pending observations.

2.3 Results of Audit

In 2016-17, test check of the records of 146 Offices of the CTD relating to VAT, Entry Tax and Professions Tax showed underassessment of tax and other irregularities involving ₹ 154.39 crore in 878 paragraphs, which fall under the following categories as detailed in **Table 2.2**.

Table 2.2
Results of audit

			(₹ in crore)
Sl. No.	Category	No. of cases	Amount
	Value Added Tax		
1.	Non/short payment of tax	56	11.36
2.	Non/short levy penalty	160	15.82
3.	Non/short levy of interest	86	38.59
4.	Non-levy of tax on works contract receipts from Karnataka Residential Educational Institutions Society	67	20.06
5.	Non-levy of tax on sale of liquor	28	21.89
6.	Unacknowledged returns	35	5.67
7.	Incorrect/excess allowance of Input Tax Credit	98	4.59
8.	Excess carry forward of credit	54	3.91
9.	Excess refund	07	2.63
10.	Non/short levy of tax on purchases from un-registered dealers	22	1.98
11.	Other irregularities	242	27.08
	Total	855	153.58
	Tax on Entry of Goods		
12.	Non-demand of Entry Tax/interest	23	0.81
	Grand Total	878	154.39

During the course of the year, the Department accepted under-assessment and other deficiencies involving ₹ 48.59 crore in 158 paragraphs. In 251 paragraphs, an amount of ₹ 11.10 crore was also recovered as pointed out during earlier years.

A few illustrative cases of non/short realisation of VAT, penalty and interest involving ₹ 57.72 crore are discussed in the following paragraphs.

2.4 Non-levy of tax due to non-declaration of works contract receipts from the Karnataka Residential Educational Institutions Society

According to Section 4 (1) (c) of the Karnataka Value Added Tax (KVAT) Act, 2003, tax shall be levied in respect of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract at the rates specified in the Sixth Schedule of the Act. Section 15 (1) (b) of the KVAT Act, 2003, provides that a dealer who executes works contract may elect to pay in lieu of the net amount of tax payable by him under this Act by way of composition at the specified rate on the total consideration for the works contract executed. Rate of tax on works contract for composition and regular dealer was four *per cent* and 14.50 *per cent* respectively for the years 2012-13 to 2015-16. Further, Section 9-A of the KVAT Act, 2003, provides for deduction of tax at source from the amounts payable to a dealer in respect of any works contract executed to the Central Government or State Government or an industrial, commercial or trading undertaking of the Central or State Government or local authority or a statutory body, etc.

The Karnataka Residential Educational Institutions Society (KREIS) was constituted by the Government of Karnataka in 2000¹ to establish, maintain, control and manage all residential educational institutions in the State. Since then, KREIS has been awarding works contract to construct Schools/Colleges. KREIS sought clarification from the CTD on deduction of tax from the payments made to the contractors, to which it was clarified that KREIS being a 'Society' is not authorised/required to deduct tax at source. Therefore, KREIS was not deducting tax from payments made to the contractors in respect of the works executed.

During the period from 2012-13 to 2015-16, KREIS made payments towards works contracts worth ₹ 1,425.30 crore to various dealers. Cross-check of such payments (May 2017) by Audit with the returns filed by the dealers revealed short/non-declaration of turnover in the returns filed in 23 LVOs, three VSOs and 10 Audit Offices in 17 Districts² as mentioned below:

- (a) In respect of 31 dealers (under composition scheme), consideration of works contracts received from KREIS was ₹ 108.96 crore, of which only an amount of ₹ 34.16 crore was declared by these dealers, resulting in understatement of turnover of ₹ 74.80 crore. Non-levy of tax at the rate of four *per cent* on the turnover of ₹ 74.80 crore amounted to ₹ 2.99 crore.
- (b) In respect of 14 dealers (under regular VAT), the works contract consideration received from KREIS was ₹ 119.97 crore, of which only an amount of ₹ 26.40 crore was declared by these dealers, resulting in understatement of turnover of ₹ 93.57 crore. Non-levy of tax at the rate of 14.50 *per cent* on the turnover of ₹ 93.57 crore (after allowing deduction of labour and like charges at 30 *per cent*) amounted to ₹ 9.50 crore.
- (c) Nine dealers who were de-registered in the records of CTD had received consideration of ₹ 32.90 crore towards works contracts from KREIS. Since, these dealers were de-registered, no returns were filed and tax of ₹ 1.32 crore applicable on the consideration received was not paid.

Thus, total non-levy of tax on works contracts received from KREIS was ₹ 13.81 crore. Further, penalty and interest leviable under the KVAT Act, 2003 amounted to ₹ 1.38 crore and ₹ 4.60 crore respectively. Total short levy of tax including penalty and interest worked out to ₹ 19.79 crore. The CTD's action of not authorising KREIS to deduct tax at source, though being a work executing agency like Public Works Department, Karnataka Housing Board, National Highway Authority of India, etc. led to non-declaration of works contract turnover and consequent non-levy of tax.

Audit referred these cases to the CCT and the Government during May and June 2017. The Government replied (August and October 2017) that ₹ 17.33 lakh was collected in four cases and order demanding tax dues was passed by the Department in one case. Further, in one case, it was replied that tax on the

¹ Government Order No. Saka E 532 S.E.W 96 dated 06 October 1999 and KREIS started its activities from 03 February 2000.

² Ballari, Bengaluru (Urban), Bengaluru (Rural), Bidar, Chikkamagaluru, Dharwad, Gadag, Hassan, Kalaburgi, Kolar, Koppal, Mysuru, Raichuru, Shivamogga, Tumakuru, Vijayapura and Yagdir.

turnover of KREIS was paid, however, payment particulars were not furnished to Audit. Reply in respect of remaining cases is awaited (November 2017).

2.5 Short levy of tax on sale of liquor by CL-9 licensees

According to Section 4(1)(a)(ii) of the KVAT Act, 2003, every registered dealer shall be liable to pay tax on his taxable turnover at the rate of five and one half *per cent* on sale of goods mentioned in Third Schedule of the Act. Under Section 5(1) of the KVAT Act, 2003, tax shall be exempt for the sale of goods specified in First Schedule of the said Act. As per First Schedule of the KVAT Act, 2003, tax payable on sale of liquor including beer, fenny, liqueur and wine was exempted.

The Government vide Notification³ of 28 February 2014 removed exemption of tax payable on sale of liquor and introduced VAT at the rate of five and one half *per cent* on sale of liquor by CL-9 licences⁴ i.e. Bar and Restaurants situated in areas coming under Bruhat Bengaluru Mahanagara Palike, City Municipal Corporation, City Municipal Council and Town Municipal Council or Town Panchayath with effect from 1 March 2014.

During test check of records in 16 LVOs and two VSOs in four⁵ Districts between December 2016 and April 2017, Audit noticed that:

- (a) In respect of 76 dealers (Bar and Restaurants situated in urban areas), the turnover of sale of liquor for the period from March 2014 to March 2016 was ₹ 180.91 crore. Tax payable at the rate of five and one half *per cent* amounted to ₹ 9.95 crore, of which only ₹ 42 lakh was paid. This resulted in short levy of tax of ₹ 9.53 crore;
- (b) In respect of 20 dealers (Bar and Restaurants situated in urban areas), tax payable on sale of liquor for the years 2014-15 and 2015-16 was determined by Chartered Accountant/Sales Tax Practitioner in Form VAT-240⁶ as ₹ 3.55 crore, of which only ₹ 1.46 crore was paid. This resulted in short levy of tax of ₹ 2.09 crore.

Hence, total short levy of tax on sale of liquor by 96 dealers was ₹ 11.62 crore. Further, penalty and interest leviable under Sections 72(2) and 36 of KVAT Act, 2003, amounted to ₹ 1.16 crore and ₹ 2.87 crore respectively. Total short levy of tax, including penalty and interest, works out to ₹ 15.65 crore.

Though the tax on sale of liquor by Bars and Restaurants situated in urban areas was to be levied with effect from 1 March 2014, the Department did not take action in raising timely demands for collection of tax.

Audit referred these cases to the CCT and the Government during April and May 2017. The Government replied (August 2017) that ₹ 11.94 lakh was collected

³ Notification No.FD 21 CSL 2014 (II) dated 28 February 2014.

⁴ CL-9 licence is given by the Excise Department for sale of liquor in Bar and Restaurants.

⁵ Bengaluru Urban, Bengaluru Rural, Bidar and Chikkaballapura.

⁶ VAT-240 is a form used for filing Annual Audited Statement prepared by Chartered Accountant or a Sales Tax Practitioner. It is a comparative statement of dealer's liability to tax and his entitlements for input tax/refund as declared in the monthly returns (VAT-100), and the corresponding correct amount determined on audit.

from three dealers and notices were issued by the Department in respect of nine dealers. Reply in respect of remaining cases is awaited (November 2017).

2.6 Non-levy of penalty under Section 72 (1) of the KVAT Act

According to Section 35 (1) of the KVAT Act, 2003, every registered dealer shall furnish a return 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.

Section 72 (1) of KVAT Act, 2003, states that 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 ₹ 50 whichever is higher, if the default is not for more than 10 days, and
- b) ten *per cent* of the tax due, if the default is for more than 10 days.

During test check of records of 32 LVOs/VSOs in fifteen⁷ Districts between December 2015 and December 2016, Audit noticed that 274 assesseees had filed returns for the years 2012-13 to 2014-15 and paid tax of ₹ 100.21 crore belatedly, i.e. beyond 20 days after the expiry of the applicable tax period. Though all these cases attracted penalty under Section 72(1) of the Act, they were neither paid by the assesseees nor any effort was made by the Officers concerned to impose the same. This has resulted in non-levy of penalty of ₹ 6.81 crore.

It is pertinent to note here that basic checks such as verification of returns to ascertain timely payment of tax, issuing notices for belated payment of tax, etc. were not exercised by the Department due to which the belated payments went unnoticed, escaping levy of penalty.

Audit referred these cases to the CCT and to the Government between February and March 2017. The Government replied (June and August 2017) that ₹ 51.51 lakh was collected from 25 assesseees, notices were issued in respect of 26 assesseees for recovery of penalty and orders levying penalty were issued in respect of six assesseees.

Further, the Government (September 2017) stated that 13 assesseees (out of 274 assesseees), applied for *Karasamadhana* Scheme⁸ by paying 10 *per cent* of penalty (₹ 4.30 lakh) and balance 90 *per cent* of penalty (₹ 38.69 lakh) was waived by the Department.

Reply in respect of the remaining cases was awaited (November 2017).

⁷ Bengaluru, Ballari, Belagavi, Chikkaballapura, Chikkamagaluru, Chitradurga, Davanagere, Dharwad, Hassan, Kalaburgi, Kodagu, Mysuru, Raichuru, Shivamogga and Yadgir.

⁸ Government of Karnataka vide Gazette Notification No. 323 dated 31.03.2017 introduced *Karasamadhana* Scheme whereby 90 *per cent* of penalty and interest would be waived on payment of 10 *per cent* of penalty and interest within 31 May 2017.

2.7 Non-payment of differential tax liability declared in audited statement of accounts

According to Section 31(4) of the KVAT Act 2003, every dealer whose total turnover in a year exceeds a prescribed amount⁹ 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 the audited statement of accounts in Form VAT-240 and other documents as prescribed in the Act.

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 a difference between them, the auditor is to 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 13 LVOs and one VSO in eight¹⁰ Districts between December 2015 and March 2017, Audit noticed that 24 dealers in their audited accounts in Form VAT 240 had declared additional tax liability of ₹ 3.67 crore over and above the tax liability declared in the monthly returns for the years from 2013-14 to 2015-16. For non-payment of additional tax liability, penalty and interest was also leviable as per the provisions of KVAT Act, 2003. The dealers concerned, however, neither paid the dues on their own while filing the audited accounts, nor were the dues demanded by the LVOs concerned. This resulted in non/short payment of tax of ₹ 3.67 crore. Further, penalty and interest leviable amounted to ₹ 0.45 crore and ₹ 1.14 crore respectively. Total non-payment works out to ₹ 5.26 crore. The Department has not put in place a mechanism to flag automatically any tax declared in excess by the dealer in Form VAT 240 vis-à-vis the amount paid by him in the monthly returns. Hence, inaction on the part of the Department to raise timely demands resulted in amounts declared payable by the dealers themselves to be shown as pending realisation to the Government.

After these cases were brought to the notice of the CCT and to the Government between January and April 2017, the Government replied (June and September 2017) that ₹ 19.27 lakh was collected in seven cases. Reply is awaited in the remaining cases (November 2017).

2.8 Non-follow-up of pending tax liabilities declared in the returns by Commercial Tax Department

Under Section 35(1) of the KVAT Act 2003, every registered dealer shall furnish a return in the prescribed form and shall pay the tax due on such return within 20 days (or 15 days in the case of dealers assessed under composition of tax) after the end of the tax period.

Test check of returns between February 2016 and March 2017 in 25 LVOs in six¹¹ Districts revealed that for 399 returns pertaining to tax periods between April 2011 and March 2016 filed by 178 assesseees, the respective tax liabilities

⁹ ₹ 40 lakh till 31 March 2010, ₹ 60 lakh from 1 April 2010 to 31 March 2011 and ₹ 1 crore thereafter.

¹⁰ Ballari, Belagavi, Bengaluru, Dharwad, Kalaburgi, Mysuru, Raichur and Vijayapura.

¹¹ Bengaluru, Ballari, Bidar, Kalaburgi, Mysuru and Raichur.

amounting to ₹ 3.55 crore were not discharged. Penalty and interest as applicable worked out to ₹ 35.51 lakh and ₹ 1.22 crore respectively. Total amount realisable worked out to ₹ 5.13 crore.

Even though the 'e-VARADI¹²' system for online filing of returns clearly indicates a status of 'Not Acknowledged' against all returns where the tax liability is not discharged in full, the Officers concerned failed to follow up on these cases and ensure timely recovery.

After these cases were brought to the notice of the CCT and to the Government between March and April 2017, the Government replied (June and August 2017) that an amount of ₹ 7.80 lakh was collected in 11 cases and notices were issued in 14 cases. In respect of one dealer¹³, the Government replied that the tax was paid to the Department. The reply is not acceptable as the payment details furnished by the Department for having paid the tax could not be traced in Electronic Filing System (eFS). Reply in respect of the remaining dealers is still awaited (November 2017).

Audit had pointed out similar lapses of non-follow up of tax liability worth ₹ 10.97 crore in respect of 491 assesseees in 1,103 returns in the previous three Audit Reports¹⁴. However, the Department failed to devise suitable checks to prevent the same.

2.9 Non/short levy of interest

Under Section 36(2) of the KVAT Act, 2003, every dealer who fails to pay any amount of tax or additional tax declared in the returns or furnishes a revised return more than three months after the tax becomes payable, shall be liable to pay simple interest. As per Section 37(1) of the above Act, the rate of interest leviable was 1.25 *per cent* per month (up to 31 March 2011) and 1.5 *per cent* per month (with effect from 1 April 2011) from the date on which any amount was due for payment under the Act.

During test check of VAT-100 returns, annual audited accounts filed in VAT-240 and re-assessment orders in 36 Offices (22 LVOs/VSO and 14 Audit Offices) in nine¹⁵ Districts between February 2016 and February 2017, Audit noticed that there was a delay in payment of tax amounting to ₹ 70.50 crore for the tax period between 2006-2007 and 2014-2015 by 81 dealers. The tax due was either against original returns or against additional tax liabilities arising from re-assessments/revised returns/annual audited accounts filed in VAT-240. Though the belated payment of tax in all these cases attracted payment of interest under Section 36(2) of the Act, it was either not levied or levied short. The total non/short levy of interest for the tax periods between April 2006 and March 2015 worked out to ₹ 5.08 crore. Though there is a provision in the annual audit statement (VAT-240) and monthly returns (VAT-100 and VAT-120) for

¹² E-Varadi or 'VAT Return and Data through Internet', is a facility provided to the dealers to submit tax returns electronically.

¹³ M/s. Himalaya Surveillance and Solutions Private Limited.

¹⁴ Paragraph Nos. 2.7, 2.9 and 2.5 of Audit Reports for the year ended 31 March 2014 (Report No.7 of 2014), 31 March 2015 (Report No.3 of the year 2015) and 31 March 2016 (Report No.5 of the year 2016) respectively.

¹⁵ Bengaluru, Ballari, Chikkaballapura, Chikkamagaluru, Davanagere, Kalaburgi, Mysuru, Raichur and Shivamogga.

payment of interest for delay in payment of tax, the Department failed to monitor compliance to this provision which resulted in the non/short levy of interest. Audit had recommended¹⁶ automation of levy of interest on delayed payments through Electronic Filing System; however, the same was not complied with by the Department which resulted in repeated occurrences of delayed payments without levy of interest.

After these cases were brought to the notice of the CCT and to the Government between February and April 2017, the Government stated (June and August 2017) that interest of ₹ 50.15 lakh was collected in nine cases, notices demanding interest were issued in five cases, order levying interest was passed in one case and the matter was referred for re-assessment in one case.

Further, the Government (September 2017) stated that two dealers (out of 81 dealers), applied for *Karasamadhana* Scheme by paying 10 *per cent* of interest (₹ 0.30 lakh) and balance 90 *per cent* of interest (₹ 2.72 lakh) was waived by the Department. Reply in respect of the remaining dealers was awaited (November 2017).

¹⁶ Recommendation No.11 under Paragraph No.2.8.18 of Report No.1 of 2014.