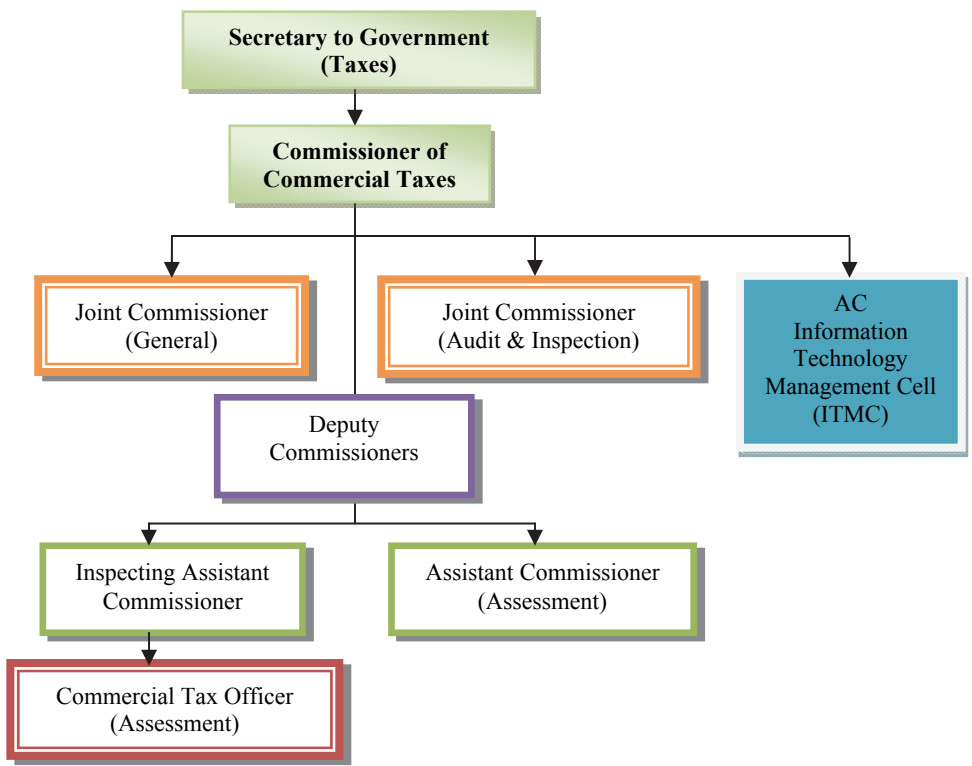


**CHAPTER-II**  
**TAXES/VAT ON SALES, TRADE ETC.**

**2.1 Tax administration**

Kerala General Sales Tax (KGST)/Kerala Value Added Tax (KVAT) laws and rules made thereunder are administered at the Government level by the Secretary, Taxes. The Commissioner of Commercial Taxes (CCT) is the head of the Commercial Taxes Department (CTD) who is assisted by Joint Commissioners (JCs), Deputy Commissioners (DCs), Assistant Commissioners (ACs) and Commercial Tax Officers. The assessment, levy and collection of tax are done by ACs and Commercial Tax Officers.

Organogram of the Department is given below:



Kerala General Sales Tax is leviable on sale of Ganja and opium, foreign liquor and certain petroleum products. KVAT is leviable on the intra-State sale of remaining commodities and Central Sales Tax (CST) on inter-State sales.

## 2.2 Internal audit

The Internal Audit Wing (IAW) in the Commercial Taxes Department commenced functioning from 1 June 2009. The wing headed by the Deputy Commissioner is assisted by 10 Assistant Commissioners and 17 Commercial Tax Officers along with subordinate staff. During 2016-17, the wing planned the audit of 63 units but audited only 58 units. Potential cases and collection fall cases are compulsorily checked by the wing. Out of an overall outstanding of 6,850 paras, only 939 paras (13.71 per cent) were cleared. This indicated the inadequate response of the CCT to the observations of the IAW and in enforcing clearance of the paras by addressing the shortcomings/deficiencies pointed out by the wing. The reason for low clearance of observations made by IAW, though called for (May 2017), was not furnished by the CCT (January 2018).

## 2.3 Results of audit

Test check of the records relating to KVAT/KGST and CST assessments and connected documents in 129 offices of the Commercial Taxes Department conducted during 2016-17 showed under-assessment of tax and other irregularities involving ₹ 583.07 crore in 1,048 cases, which fall under the following categories as given in **Table - 2.1**.

**Table - 2.1**  
**Details of cases and money value of draft paras**

(₹ in crore)			
Sl. No.	Categories	Number of cases	Amount
1	Performance Audit on Infrastructure facilities in the Commercial Taxes Department	1	7.43
2	Compliance Audit on Enforcement under KVAT Act	1	87.03
3	Short payment of tax due to escape of turnover from assessment	382	281.55
4	Short payment of tax due to excess availing of input tax credit/irregular exemption	241	24.42
5	Short payment of tax due to application of incorrect rate of tax	40	15.44
6	Others	383	167.20
<b>Total</b>		<b>1,048</b>	<b>583.07</b>

Source: Figures compiled by AG(E&RSA).

During the course of the year, the Department accepted under-assessment and other deficiencies involving ₹ 178.17 crore in 580 cases, which were pointed out in Audit. An amount of ₹ 16.04 crore was realised in 746 cases during the year 2016-17, of which, 94 cases involving ₹ 3.38 crore were pointed out in 2016-17 and the rest in earlier years.

In case of a draft paragraph, involving ₹ 5.78 lakh, the Department recovered the entire amount. A few Audit observations involving ₹ 149.03 crore are mentioned in the following paragraphs.

## **Value Added Tax**

### **2.4 Performance Audit on Infrastructure facilities in the Commercial Taxes Department**

#### **2.4.1 Introduction**

Infrastructure means the basic physical and organisational structure and facilities (e.g. buildings, roads, power supplies) needed for the operation of a society or enterprise that act as the foundation for economic activity and quality of life. The Commercial Taxes Department and the taxpayers are partners in the economic development of the State through the collection and payment of taxes. Basic infrastructure and amenities in the offices are important not only for developing an assessee friendly approach but also to create a conducive work environment in the offices.

The Commercial Taxes Department (Department) is a major source of revenue of the Government of Kerala accounting for more than three-fourth<sup>1</sup> of its tax revenues. After introduction of Goods and Services Tax (GST) in the country with effect from 1 July 2017, the name of the Department was changed to State Goods and Services Tax Department, Kerala (SGSTD)<sup>2</sup>. The Department catered to 2.66 lakh traders through 311 offices including check posts across the State during the administration of Kerala Value Added Tax (KVAT). The major functions of the Department included registration of dealers, assessment and collection of tax, recovery of arrears of tax, prevention and detection of tax evasion and disposal of appeals and revision petitions. On implementation of GST in the country, the Government of Kerala (GOK) in July 2017<sup>3</sup> classified the assessing authorities into three exclusive groups *viz.* (i) officers for amnesty scheme, (ii) officers dealing with amnesty scheme and GST roll out and (iii) officers for VAT cases.

KVATIS (Kerala Value Added Tax Information System) was the application software developed and deployed during 2007 and became operational from 2007-08 in a phased manner by the Department with a view to accelerate tax collection, augment voluntary tax compliance, reduce the frequent visits of traders to the commercial tax offices, deliver better services, etc. For the GST administration, the common GST Electronic portal ([www.gst.gov.in](http://www.gst.gov.in)) developed by the Goods and Services Tax Network (GSTN)<sup>4</sup> is functioning as the front-end of the overall GST IT eco-system which provides common registration, return and payment services to the tax payers. Kerala State decided to develop its own back-

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<sup>1</sup> Total tax revenue for the year 2016-17 : ₹ 42,176.37 crore; tax revenue collection in CTD: ₹ 33,453.49 crore (79.32 per cent).

<sup>2</sup> GO(P) No.89/2017/Taxes dated 13 July 2017.

<sup>3</sup> GO(Rt) No. 606/2017/Taxes dated 21 July 2017.

<sup>4</sup> A company with Central and State Government share of 49 per cent and non-government financial institutions share of 51 per cent which aims to provide common and shared IT infrastructure services for the implementation of GST.

end systems for handling the tax administration functions such as registration, approval, assessment, audit matter, adjudication, etc.

During the period from 2012-13 to 2016-17, total expenditure incurred by the Department was ₹ 1,075.84 crore. Out of this, expenditure incurred for infrastructure including its maintenance viz., building and computerisation was ₹ 52.35 crore<sup>5</sup>, the balance being establishment charges.

#### 2.4.2 Audit objectives

The Performance Audit (PA) was conducted to assess whether:

- IT infrastructure was developed timely and maintained effectively;
- manpower management and capacity building were effective; and
- Department had appropriate physical assets to deliver the services effectively.

#### 2.4.3 Scope and methodology of audit

The Performance Audit was conducted between May 2017 and August 2017 covering the period from 2012-13 to 2016-17. Audit selected 52 assessing offices and intelligence offices in six<sup>6</sup> out of the 15 tax districts in the State. Thiruvananthapuram and Ernakulam were selected being the highest revenue collection districts and three districts were selected based on probability proportional to size without replacement (PPSWOR) sampling method. Mattancherry tax district was selected on the suggestion of the Department in order to cover the entire Ernakulam revenue district.

The Performance Audit was conducted through the test check of records and files in the Taxes Department, Government Secretariat, office of the Commissioner of Commercial Taxes (CCT), offices of the Deputy Commissioners (DC), offices of the Inspecting Assistant Commissioners (Intelligence) (IACs (I)) and 52 assessment circles under the selected six tax districts. Information was also collected through joint physical inspection (JPI). The PA has also given due consideration to the implementation of GST with effect from 1 July 2017.

An Entry conference was held on 5 May 2017 with the Additional Secretary, Taxes Department wherein the objectives, scope and methodology adopted for the PA were explained. An Exit Conference was held on 14 November 2017 with the Secretary (Taxes) wherein the audit findings were discussed. Audit acknowledges the co-operation rendered by the CTD in providing records and other facilities.

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<sup>5</sup> ₹ 17.21 crore for building and ₹ 35.14 crore for IT.

<sup>6</sup> Ernakulam, Kasargod, Kozhikode, Mattancherry, Palakkad and Thiruvananthapuram.

#### **2.4.4 Audit Criteria**

The audit criteria were drawn from the following sources:

- I T Policy of Government of Kerala;
- The Kerala Financial Code;
- Stores Purchase Manual of Government of Kerala;
- Agriculture Income Tax and Sales Tax Manual.

#### **Audit findings**

Audit findings are categorised into three broad topics *viz.*, Information Technology (IT) infrastructure, human infrastructure and physical infrastructure as discussed below.

#### **2.4.5 IT infrastructure**

Kerala is the first State to implement 100 *per cent* e-filing of VAT returns. The tax administration was fully computerised with effect from 2009 using application software KVATIS. Timely procurement and maintenance of IT infrastructure is a vital pre-requisite to augment tax compliance and to provide better services to the stakeholders.

##### **2.4.5.1 Deficiencies in upgradation of IT infrastructure**

Para 1.3 of the Stores Purchase Manual stipulates that each Department should prepare appropriate time frame for each stage of procurement of stores in order to reduce delays and a Government servant who has to purchase stores (which included computer hardware and software) for public service should estimate the requirements for the year so far as they can be foreseen. Further, the Information Technology Policy, 2012 of Government of Kerala, also envisages that each Department of Government would publish on the website an annual action plan for their e-governance initiatives with service targets and milestones for completion of projects.

Department planned upgradation of IT infrastructure by segregating it into four phases<sup>7</sup> and the project was titled as Business Continuity Plan and setting up of Disaster Recovery Site. But absence of time bound planning resulted in various deficiencies *viz.* non-utilisation of funds, delay in procurement of IT infrastructure and non-monitoring of IT assets as discussed in the succeeding paragraphs.

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<sup>7</sup> Phase-I: Current State Assessment of KVATIS, Phase-II: Assessment of future State requirements, Phase-III: Development of Business Continuity Plan Manual, Phase-IV: Programme Management Support.

- **Non-utilisation of central fund for computerisation**

Guidelines issued<sup>8</sup> by the Information Technology Department of Government of Kerala, envisaged that Government of India (GOI) funds should be tapped to the fullest extent for e-governance projects as far as possible.

The Ministry of Finance, Government of India, approved (26 March 2010) a Mission Mode Project for Computerisation of Commercial Taxes administration (MMPCT) with a total project cost of ₹ 41.25 crore, in which, the proposed Central share and State share was ₹ 29.85 crore and ₹ 11.40 crore respectively. The project was to be completed by 31 March 2014, after grant of extension by one year. Out of the Central share of ₹ 29.85 crore, ₹ 26.90 crore was released by the Government of India during the period from March 2010 to July 2012. The Department set off ₹ 15.53 crore as retrospective share being the expenses incurred for computerisation before March 2010 and utilised ₹ 6.89 crore against the prospective expenditure incurred for site preparation, hardware and software cost. The total fund utilised was ₹ 22.42 crore.

Audit observed that the central share of ₹ 7.43<sup>9</sup> crore out of ₹ 29.85 crore under Mission Mode Project for Computerisation of Commercial Taxes administration was not fully utilised due to non-completion of project activities within the stipulated period viz., non-setup of Disaster Recovery Site, non-procurement of IT assets, etc.

Further, Department did not claim under Mission Mode Project for Computerisation of Commercial Taxes Administration Scheme for the amount spent on purchasing 126 laptops for intelligence wing (November 2013) even though the project deadline was extended upto 31 March 2014.

Government stated (December 2017) that the Department procured 126 laptops for Intelligence wing for ₹ 45.23 lakh within the MMPCT timelines and the expenditure incurred was utilised from the Central Share. In order to verify the authenticity of the claim, records relating to the transfer of ₹ 45.23 lakh from the Central fund to the State fund were called for, but the same was not produced to Audit.

- **Non-installation of Disaster Recovery Centre**

Disaster Recovery Centre (DRC) is desirable for any organisation working under IT environment so that in case of *force majeure* i.e. earthquake, floods, etc., the data, which was backed up at DRC, could be recovered for the continued functioning of the organisation. It is a best practice to setup disaster recovery site in a different seismic zone.

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<sup>8</sup> GO (P) No. 24/2009/ITD dated 29 September 2009.

<sup>9</sup> ₹ 2.95 crore not released and ₹ 4.48 crore released but not expended.

Audit observed that the Government decided (October 2009) to develop a disaster recovery site at Data Centre of NIC, Hyderabad<sup>10</sup>, which was in a different seismic zone and prepared a detailed project report (December 2013) on hardware requirements for disaster recovery. But the same was not developed till implementation of GST (July 2017).

Government stated (December 2017) that the Technical Committee observed that in the GST scenario, there was no criticality for the State backend system and a few days downtime did not affect the tax administration since the GST dealers access only the central portal for availing services. Moreover, the Central GST portal maintains the data of all States which can at anytime be pulled by the State. Hence it decided that there was no need to set up Disaster Recovery Centre and suggested utilising the NIC facility to meet any contingency. As Kerala is a Model-1 State where all backend systems were developed by the State itself, installation of Disaster Recovery Centre was a necessity.

- **Upgradation of KVATIS**

To reduce slowdown in online services and to avoid difficulties faced by the traders while accessing the website for services like e-filing of returns, e-payment in peak days, etc., the project to upgrade with a cost of ₹ 6.78 crore was initiated in January 2012 and completed in October 2016 only.

Audit attributed that the reasons for delay as:

- Delay in appointment of consultant to develop current asset evaluation and performance improvement plan (from January 2012 to May 2013); and
- Delay in the tendering process for procurement of hardware (January 2014 to April 2016).

In spite of spending ₹ 6.78 crore for the above project, intended benefit of upgradation was not obtained by KVAT assesseees due to roll out of GST with effect from July 2017.

- **Delay in procurement of desktops and printers**

During the period of audit, the department purchased 778 desktops and 718 printers. Scrutiny of procurement files revealed that department was able to purchase 778 desktops and 718 printers in January 2015 after inordinate delay. The project was initiated in June 2013.

Delays were as follows: -

- project proposal (June 2013);

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<sup>10</sup> Thiruvananthapuram in seismic zone III and Hyderabad in seismic zone II.



- getting administrative sanction (January 2014); and
- completing tendering process (November 2014).

Government stated (December 2017) that in order to tackle the issues related to procurement planning, asset management, equipment analysis and avoidance of procurement delays, the Department in association with NIC rolled out the Hardware Monitoring System asset management system. The asset details of all offices of the Department were entered in Hardware Monitoring System and were in the final stage. Once the complete details are available in the central system, the Department would be in a better position to make procurement planning based on the analysis report using Hardware Monitoring System.

- **Non-use of IT assets**

The CCT directed<sup>11</sup> the DCs to ensure that no Information and Communication Technology (ICT) equipment should be kept idle due to defect or remain un-allocated to field offices. Further, Article 149 & 153 of the Kerala Financial Code Volume I (KFC), envisages that the head of an office should maintain stock account and conduct physical inspection of stores at least once a year. It also envisages the disposal of obsolete or unserviceable stores.

Joint physical inspection conducted by the Departmental officers in the presence of Audit in 64 offices revealed:

- Stock register of the hardware supplied was not maintained in 41 offices as per the provision of Kerala Financial Code;
- In the selected 64 offices, it was observed that 259 desktops out of 1,036 and 145 printers out of 376 were not in use due to malfunctioning. Audit could not ascertain the period from which these IT assets were not in use as the Department did not maintain records; and
- It was observed that 22 desktops and 20 printers were not entered in the Hardware Monitoring System<sup>12</sup> though it was stated that the entries were made in Hardware Monitoring System, which was not fully operationalised.

Government stated (December 2017) that the Department initiated implementing the Centralised Inventory Management System, Hardware Monitoring System in the Department, which would enable in inventory planning in a better way. Government also stated that the Department would constitute a special team of officers at each district under the control of the District Deputy Commissioner to conduct physical inspection of stores and verification of records once in a year as per schedule issued by the Commissioner and the Deputy Commissioner.

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<sup>11</sup> Letter No. B-11-6428/13/CT dated 4 February 2015.

<sup>12</sup> Hardware Monitoring System developed by NIC.

**Recommendation: The Department may prepare a time bound plan relating to e-governance activities and ensure funds utilisation by expediting the procurement of IT assets.**

#### **2.4.5.2 Maintenance of IT assets**

Proper maintenance of hardware and software is critical to business continuity and for the day to day functioning of the department. The maintenance of IT assets was carried out through Annual Maintenance Contracts (AMCs). Audit observed deficiencies in the maintenance of IT assets as discussed in succeeding paragraphs.

- **Maintenance of computers and peripherals**

The work relating to the annual maintenance contracts for computers and accessories in all the offices across the State was awarded to M/s HCL Info Systems Limited (HCL) for the period from 1 May 2010 to 30 April 2013. It was observed from the letter of CCT (January 2014) to the Secretary to the Government that during the non-annual maintenance contract period, the departmental officers were finding it difficult to maintain uninterrupted businesses, which affected the tax monitoring. M/s Accel Frontline Limited (ACCEL) was awarded annual maintenance contract with effect from 23 January 2015 to 22 January 2018 after a delay of nearly two years. Asset verification was conducted by ACCEL before entering into the annual maintenance contract and it was observed that 318 desktops, 91 printers, three scanners, 16 network switches and 450 Uninterruptible Power Supply (UPS) were defective and not in working condition and these were left out of annual maintenance contract.

Had the Department renewed or awarded annual maintenance contract on time, these assets would have been in working condition and could be included in annual maintenance contract.

Government stated (December 2017) that the Department initiated timely action and floated e-tenders and M/s Wipro became the L1 bidder. Accordingly, work order was issued to M/s Wipro, but did not come forward to execute the project within the timeline prescribed. Hence the work order was cancelled and the EMD furnished was forfeited. Thereafter, re-tender was conducted and identified M/s ACCEL Frontline as the annual maintenance contract service provider. On the observation regarding omission from annual maintenance contract of IT equipment, which were defective and not in working condition, Government stated that the cost of repair of those old equipment was found much high and it was economical to procure new equipment with five years' warranty.

- **Flaws in the Service Level Agreement**

- As per the guidelines issued<sup>13</sup> by the Information Technology Department, Government of Kerala, the scope of work of annual maintenance contract for computers and peripherals must include monthly inspection, clearing and quarterly preventive maintenance. However, Service Level Agreement (SLA) with the service provider did not contain the monthly inspection, clearing and quarterly preventive maintenance clauses.
- As per the service level agreement, the Department shall make payments on quarterly basis to the service provider and the payment claims shall be accompanied with service call and uptime/down time reports certified by the Deputy Commissioners of each district. Penalty, if any, shall be deducted from the quarterly payments. According to the IT Policy of the Department, the System Administrator under each DCs has to cross verify the SLA conformance reports of the service providers. Audit observed that fault call registers<sup>14</sup> were not maintained. Hence it was not possible for the Department to verify the genuineness of claims made by the service providers.

Government stated (December 2017) that prescribing monthly inspections would make the annual maintenance contracts costlier as the contractors have to factor in resources as per the preventive maintenance schedule. Further, Government in this regard also stated that the department included downtime penalty clauses, which would necessitate the contractor to conduct frequent inspections. It was also stated that the points recommended by Audit would be considered in all future Annual Maintenance Contracts.

- **Maintenance of Wide Area Network connectivity**

The annual maintenance contracts for maintenance of KVATIS Wide Area Network (KVATIS WAN) were awarded to M/s Frontier Business Systems Private Limited, Thiruvananthapuram (FBS) from 1 October 2012 to 31 May 2014 and to M/s KELTRON, Thiruvananthapuram from 1 June 2014 to 12 June 2017.

As per the service level agreement with the service provider, average uptime availability of 99 per cent and 95 per cent was to be ensured in List A Links<sup>15</sup> and List B Links<sup>16</sup> respectively. The service level agreement included maintenance of uninterruptible power supply also.

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<sup>13</sup> GO (P) No. 26/2005/ITD dated 24 December 2005.

<sup>14</sup> To record nature of failure, date and time of booking the complaint and clearing of complaint.

<sup>15</sup> List A Links-16 Links viz., offices required to work for 24 hours a day like commercial tax check posts and Commissionerate buildings.

<sup>16</sup> List B Links- 124 Links-Offices having normal working hours from 10 AM to 5 PM.

The status of number of links having less than the average uptime as per the service level agreement is as given in the **Table - 2.2**.

**Table - 2.2**  
**Details of links having less than the average uptime**

Name of service provider	Period checked by audit	List A – 16 Links	List B -124 Links
		No. of links having average uptime of less than 99 %	No. of links having average uptime of less than 95 %
M/s Frontier Business Systems Private Ltd (FBS)	January 2013	7	4
	February 2013	10	41
	March 2013	7	22
M/s KELTRON	13 December 2015 to 31 December 2015	8	11
	January 2016	9	5
	February 2016	9	5
	1 March 2016 to 12 March 2016	7	9

Source : SLA quarterly conformance Report by the service providers.

On a test check of the conformance reports, Audit observed that the uptime connectivity of more than 80 *per cent* was available, but it was below the uptime connectivity required (99 *per cent* and 95 *per cent*) as per the service level agreement as given in Table 2.2. The reasons cited for non-maintenance of connectivity by the service provider in some locations were malfunctioning of uninterruptible power supply for wide area network connectivity, delay in rectification of BSNL lines at check posts, etc. M/s KELTRON vide their letter dated 3 July 2014 informed the Commissioner of Commercial Taxes that uninterruptible power supply installed at 83 locations as part of wide area network were not working and needs to be replaced due to the non-availability of spares. Uninterruptible power supply was not installed at 10 locations. However, the Department did not take action to resolve the issues of uninterruptible power supply for wide area network by replacement or repair. Department also failed to take up the matter with BSNL at highest level for immediate service to achieve optimum network connectivity and therefore the issue remained unresolved till date (January 2018).

Government stated (December 2017) that steps were initiated for replacement of obsolete routers in all locations along with conversion of copper based leased line circuits to fibre optic circuits, which would enhance the service level of connectivity in all office.

**Recommendation: The Department may take steps for timely renewal of the annual maintenance contract for IT infrastructure and to make suitable clauses for preventive maintenance and closely monitor the annual maintenance contract service providers.**

### 2.4.5.3 Failure in ensuring continuous power supply

Efficient performance and better life expectancy of electronic equipment require continuous power supply.

Joint physical inspection conducted by the Departmental officers in the presence of Audit revealed that, out of test checked 52 assessing offices, in 47 offices uninterruptible power supply were not functional. As per the records of the Department, it was noticed that the staff was not able to use KVATIS during power failures due to non-functioning of uninterruptible power supply.

Government stated (December 2017) that steps were taken for installing Centralised uninterruptible power supply in all the offices covering all the IT equipment.

**Recommendation: The Department may take steps to ensure uninterruptible power supply to all the offices to facilitate smooth functioning by putting in place uninterruptible power supply in case of power failures from Electricity Board.**

### 2.4.6 Human Resource Management

An organisation needs to deploy and utilise its manpower effectively and optimally so as to achieve its goals. Effective manpower planning and deployment would entail regular review and revision of staffing norms, deployment of manpower as per the prescribed norms or actual needs and effective human resource systems to facilitate manpower planning and deployment.

The staff strength of the Department as on 31 March 2017 was 4,640. Observations on the manpower management are discussed in the following paragraphs.

#### 2.4.6.1 Staffing norms neither reviewed nor revised

During the administration of Kerala General Sales Tax Act 1963 (KGST Act), norms were fixed by the Government<sup>17</sup> in the matter of files<sup>18</sup> to be dealt with by an assessing authority. However, the Department did not review and revise the staffing norms consequent on the introduction of KVAT with effect from 1 April 2005 and on the computerisation of tax administration with effect from 1 January 2009. Though a Committee constituted by the CCT to study the restructuring of the Department submitted its report in January 2012, no action was taken on its recommendation, which *inter alia* included the fixation of staffing norms.

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<sup>17</sup> G.O (RT) 793/83/TD dated 8 December 1983.

<sup>18</sup> CTO should attend 300 assessment files and for an Assistant Commissioner, it was 250 assessments files.

Details of assessees *vis a vis* number of assessing officers in the selected six tax districts for the year 2016-17 are given in the **Table - 2.3**.

**Table - 2.3**  
**Details of average number of files per officer**

Tax District	No. of offices	No. of assessees	No. of assessing officers	Average No. of files per officer
Ernakulam	8	15,432	32	482
Kasaragod	2	5,496	7	785
Kozhikode	8	20,288	25	812
Mattanchery	9	19,079	29	658
Palakkad	8	13,960	25	558
Thiruvananthapuram	6	17,655	20	883

Source : Data from Commercial Taxes Department.

As per Government norms (December 1983), a Commercial Tax Officer should attend 300 assessment files. But on verification of the number of files of assessees in the six selected tax districts, it was observed that files assessed were in the range of 482 to 883. Thus, the workload was much beyond human capacity as per the prevailing norms.

Absence of regular review and revision of staff norms led to non-deployment of manpower as per the actual needs which may affect the tax monitoring and service delivery.

Government stated (December 2017) that in the backdrop of GST roll out, the Department already took up the matter and the proposals for restructuring each work were being formulated. As the division of files between Central and State Tax authorities was yet to be finalised, detailed proposal in this regard would be considered by Government, based on the need.

**Recommendation: The Department may update the Agricultural Income Tax and Sales Tax Manual and also review the staffing norms.**

#### **2.4.7 Physical infrastructure**

Infrastructure facilities like office buildings, vehicles, etc., are essential for efficient and effective functioning of the Department.

##### **2.4.7.1 Building**

As per the information furnished by the Department, out of 234 offices (excluding check posts), 59 (25.21 *per cent*) offices were functioning in rented buildings.

The Department has a vision (2011)<sup>19</sup> to move several offices in district headquarters to commercial tax complexes of ergonomic<sup>20</sup> designs to maintain a dust free environment conducive for paperless office, as they were moving ahead with e-governance.

Government stated (December 2017) that the Department initiated action and took maximum effort to accommodate the office of SGST Department functioning in rental buildings to Government buildings. Government is also taking up projects for construction of office buildings for the department under the Kerala Infrastructure Investment Fund Board and other schemes.

#### **2.4.7.2 Construction of commercial tax complexes**

Out of the 15 tax districts in the State, commercial tax complexes were not available in seven tax districts<sup>21</sup>. Out of these seven tax districts, land was identified in three districts<sup>22</sup> but was not acquired (July 2017) and in the remaining districts, land was not identified.

Government stated (December 2017) that land acquisition and shifting of offices functioning in rental buildings to Government facilities were in progress.

#### **2.4.7.3 Shifting of offices to Government or own buildings**

In order to verify the efficiency of the Department to shift the offices functioning in rented buildings to Government buildings or own buildings, Audit scrutinised two proposals already in existence in the selected tax districts and observed that the proposals for shifting the offices were affected by inordinate delays due to incomplete proposals, time taken for administrative sanction, etc., as discussed in the succeeding paragraphs.

- Estimate Committee directed (July 2016) Commercial Tax Office, Perambra, working in rented building to shift to Mini Civil Station within two weeks. However, the office was not shifted (December 2017) due to delay in installation of network connection.
- Administrative sanction was accorded (April 2005) for the construction of additional block adjoining the commercial tax complex, Ernakulam for shifting the five assessing offices functioning in a single rented building. However, Audit observed that the additional block was not constructed even after a lapse of more than 12 years due to the failure to prepare the detailed plan and estimate by the PWD.

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<sup>19</sup> Results Framework Document for Taxes Department, Government of Kerala for the year 2011-12.

<sup>20</sup> As per Oxford dictionary, ergonomic means 'Relating to or designed for efficiency and comfort in the working environment'.

<sup>21</sup> Alapuzha, Idukki, Kannur, Kasaragod, Malappuram, Pathanamthitta and Wayanad.

<sup>22</sup> Alapuzha, Kannur, Kasaragod.

Government stated (December 2017) that sanction was accorded in July 2017 to install LAN at Commercial Tax Office, Perambra. The office shall be shifted to the Mini Civil Station soon on completion of installation of LAN. Regarding construction of commercial tax complex at Ernakulam, Government stated that the construction was delayed due to the lack of sufficient fund allocation in the Budget provision.

#### **2.4.7.4 Lack of comprehensive scheme for modernisation of offices**

Though the Department has a vision (2011) for a dust free environment conducive for paperless offices, yet it neither formulated an integrated and comprehensive plan nor prescribed/adopted guidelines for implementation of the modernisation of offices involving introduction of functional lay out for office premises, creation of modern workstations with space for IT equipment, efficient file management and effective records management, etc.

Audit observed that

- out of the eight commercial tax complexes<sup>23</sup> in the State, the offices functioning in tax complexes at Kollam, Thrissur and Thiruvananthapuram only were having modern workstations.

Photograph taken during joint physical inspection highlighting the difference in modern and old offices is given below.



Office having modern workstation at  
Commercial Tax Complex, Thiruvananthapuram



Office without modern workstation at  
Commercial Tax Complex, Palakkad

- in none of the 52 offices test checked, a separate record section was available as envisaged in the Manual of Office Procedures (MOP) for systematic arrangement to keep the old records, to make them available for immediate reference. The old records were not kept in a systematic manner. This resulted in non-tracing of records, dumping of records and accumulation of dust.

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<sup>23</sup> Ernakulam, Kollam, Kottayam, Kozhikode, Mattancherry, Palakkad, Thrissur and Thiruvananthapuram.



Government assured (December 2017) that works for the remaining years would be expedited.

**Recommendation: The department may formulate a scheme with a time frame, for creation of modern workstations with space for IT equipment and paper work, efficient file management and space for effective records management.**

#### **2.4.8 Conclusion**

- Due to the deficiency in the planning, procurement of IT assets was delayed and Central funds were not utilised within the stipulated period. Instances of idling of IT assets like computers and printers were noticed across the selected assessing offices due to malfunctioning.
- There was lack of control over the annual maintenance contract service providers as the clauses in the annual maintenance contract were not adequate and not followed in some cases.
- Staffing norms were not reviewed appropriately as per changing environment in tax administration.
- The Department did not formulate an integrated and comprehensive scheme for modernisation of offices.

## **2.5 Compliance Audit on Enforcement under Kerala Value Added Tax Act**

### **2.5.1 Introduction**

The enforcement wing of the Commercial Taxes Department (CTD) is empowered to prevent/detect evasion of tax, surveillance and manning of border check posts and to register cases against errant dealers/persons. Collection and analysis of data in respect of the assessee, which is to be gathered from other departmental agencies/sources is also entrusted with the wing. The wing is also required to provide inputs to assessment wing for augmentation of revenue. The role of enforcement wing in curbing tax evasion assumes considerable importance in the Value Added Tax (VAT) scenario owing to its intrinsic character of placing reliance on self assessment by dealers.

The enforcement activities are conducted by intelligence and investigation wing, data mining wing and check posts of the Department. The enforcement activities of the State are under three<sup>24</sup> Deputy Commissioners (Intelligence) the jurisdiction being distributed zone wise. The check posts were under the control of DC(General) of the districts concerned.

Sections 43 to 52 of the Kerala Value Added Tax Act, 2003, (KVAT Act) and Rules 63 to 69 of Kerala Value Added Tax Rules, 2005, (KVAT Rules) deal with the functions relating to enforcement.

The audit was conducted between April 2016 and August 2016, May 2017 and June 2017 covering the period 2013-14 to 2016-17 so as to ascertain whether the provisions of KVAT Act and Rules are utilised to detect evasion of tax and that remedial measures were taken to prevent such evasion, if any. Audit selected 25<sup>25</sup> out of 104 units based on random sampling method. An entry conference was conducted on 2 May 2016 with the Special Secretary (Taxes) wherein the scope and methodology adopted for the audit were discussed. An exit conference was held on 14 November 2017 with the Secretary (Taxes) wherein the Audit findings were discussed.

### **Audit findings**

The Audit findings are categorised on the basis of the four major activities of the enforcement wing *viz.*, intelligence and investigation, economic intelligence, data mining and check post.

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<sup>24</sup> Ernakulam, Kozhikode and Thiruvananthapuram.

<sup>25</sup> Government Secretariat, Commissionerate of Commercial Taxes, DC (I) Ernakulam, Kozhikode and Thiruvananthapuram, Inspecting Assistant Commissioners (I) Kasargode, Kollam, Malappuram, Mattancherry, Palakkad and Thiruvananthapuram, Inspecting Assistant Commissioners (IB) Ernakulam, Kozhikode, Palakkad and Thiruvananthapuram, Commercial Tax Check Posts (Amaravila, Aryankavu, Bangra Manjeswaram, Kumily, Muthanga and Walayar), Railway checking station at Ernakulam and Thiruvananthapuram, Facilitation Centres at Kochi and Kollam.

## 2.5.2 Intelligence and Investigation wing

Intelligence and Investigation wing was entrusted with the conduct of survey in order to find out dealers who were not registered with the Department and get them registered, shop inspection/verification in suspected tax evasion cases, vehicle checking to ensure that the goods transported within the State are accompanied by proper documents, finalise the crime/offence cases registered, physical verification of goods brought into the State for own use, etc. Intelligence and Investigation wing was required to utilise the available information and also those gathered from other sources to generate revenue.

### 2.5.2.1 Ineffective mechanism to trace unregistered dealers

- **Survey/cross verification with database available in other Departments**

Section 43 of KVAT Act, empowers officers not below the rank of Commercial Tax Officer to conduct surveys to identify those who were liable for registration. Section 15A of the Act provides that where a dealer liable to be registered under this Act failed to inform the registering authority of his liability to be registered, the registering authority, after conducting such surveys, inspection or enquiry, as may be prescribed, proceed to register such person as a dealer under this Act and thereupon all the provisions of this Act and Rules made thereunder shall be binding on such person. However, such dealer shall not be entitled to any benefits accruing from such registration. Further, Rule 17A of KVAT Rules, stipulates that the persons who were given compulsory registration under Section 15A, shall be given a registration number under a separate district-wise series. The Rule also envisages that any person who was granted registration under this Rule and subsequently applies for registration under Section 15 of the Act may be granted registration under that Section on fulfilling the condition prescribed after cancelling the registration granted under Section 15A. Similarly, Section 15C of the KVAT Act, stipulates that any person who intends to establish an industrial unit may get himself registered under this Section.

Audit collected the data relating to the surveys conducted by Intelligence Squad during the period 2013-14 to 2016-17 as detailed in **Table - 2.4**.

**Table - 2.4**  
**Details of surveys conducted**

Name of the office	Year	No. of surveys conducted	No. of dealers registered based on survey conducted
Deputy Commissioner (I), Ernakulam	2013-14	0	0
	2014-15	0	0
	2015-16	27	206
	2016-17	223	305
Deputy Commissioner (I),	2013-14	374	276

Name of the office	Year	No. of surveys conducted	No. of dealers registered based on survey conducted
Kozhikode	2014-15	714	377
	2015-16	583	89
	2016-17	573	23
Deputy Commissioner (I), Thiruvananthapuram	2013-14	0	0
	2014-15	0	0
	2015-16	0	0
	2016-17	21	0

Source: Report from Deputy Commissioners.

Though the Deputy Commissioners (Intelligence) Ernakulam and Kozhikode furnished a statistics showing that enough surveys were conducted and considerable dealers were brought to tax net as a result of the same, they did not furnish any further documents proving the conduct of surveys and subsequent registrations.

In order to check the veracity of the reply, Audit collected data pertaining to the period from 2013-14 to 2016-17 in respect of dealers engaged in the business of aluminium fabrication and roller shutters from four<sup>26</sup> district offices of the Directorate of Industries and Commerce, Government of Kerala and dealers engaged in the business of software received from Software Technology Parks of India, Department of Electronics and Information Technology, Government of India and cross verified the same with the registration module in Kerala Value Added Tax Information System (KVATIS) and observed that 1,453 dealers were not registered with the Department even though the Act stipulates so, as detailed in **Table - 2.5**.

**Table - 2.5**  
**Details of industries registered with DICs**

Sl. No.	Name of the office	Nature of industry	Number of dealers registered in DIC/ software technology parks	Number of dealers registered in CTD	Number of dealers who were not registered in CTD
1	District Industries Centre, Ernakulam	Roller shutters	498	64	434
		Aluminium fabricators	39	8	31
2	District Industries Centre, Kannur	Roller shutters	614	15	599
3	District Industries Centre,	Aluminium	36	4	32

<sup>26</sup> Ernakulam, Kannur, Kollam and Thrissur.

Sl. No.	Name of the office	Nature of industry	Number of dealers registered in DIC/ software technology parks	Number of dealers registered in CTD	Number of dealers who were not registered in CTD
	Kollam	fabricators			
4	District Industries Centre, Thrissur	Roller shutters	291	8	283
5	Software Technology Parks of India, Department of Electronics and Information Technology, Government of India	Software	150	76	74
<b>Total</b>			<b>1,628</b>	<b>175</b>	<b>1,453</b>

Source: Report from DICs/STP.

Data in Table shows that the Intelligence and Investigation Wing was not doing survey properly and not obtained requisite details about dealers registered in District Industries Centre/Software park.

A joint inspection conducted at Thrissur district revealed that three out of five dealers test checked were actually carrying on business without registering under KVAT Act.

Audit observed from records that the Department collected data from other Government agencies<sup>27</sup> to trace unregistered dealers. However, the above table and joint inspection point out the necessity to extend the search area by Intelligence wing and its further utilisation to bring more dealers into the tax net.

Government stated (January 2018) that 1,196 dealers were identified and out of which, 85 dealers were found to be not liable to be registered. The reply was not acceptable as they are manufacturing units and hence liable to get registered irrespective of the turnover under Section 15C of the KVAT Act.

- **Non-tracing of unregistered dealers**

Section 15 of the KVAT Act, stipulates that every dealer whose total turnover is not less than rupees five lakh up to 31 March 2013 and ₹ 10 lakh thereafter shall get himself registered. Further, as per Section 6 (1) of the Act, a dealer is liable to pay tax if the total turnover is not less than ₹ 10 lakh. The assessing authorities are required to scrutinise the transaction of dealers to ensure whether any of the unregistered dealers have crossed the threshold limit for registration and to bring them into the tax net.

<sup>27</sup> Kerala State Pollution Control Board, Town Planning Office, Department of Fire and Rescue Services, Mining and Geology Department, Kerala Financial Corporation, etc.

Audit test checked the returns of plywood dealers in three Commercial Tax Offices (CTOs)<sup>28</sup> as available in KVATIS for the period from 2013-14 to 2016-17 and observed that huge purchases of softwood were effected from unregistered dealers. A compilation of the purchases from unregistered dealers revealed that 412 dealers crossed the threshold limit for registration and were liable for payment of tax as their turnover exceeded ₹ 10 lakh. The assessing officers or the Intelligence and Investigation wing failed to bring these dealers into the tax net, resulting in non-registration of 412 dealers and non-levy of tax amounting to ₹ 35.25 crore as detailed in **Table - 2.6**.

**Table - 2.6**  
**Details of purchase of registered dealers from unregistered dealers**

(₹ in crore)				
Sl. No.	Name of the assessee/TIN (M/s)	Assessment Year	No. of dealers liable for tax	Non-levy of tax
1	Arkay Traders 32151311368	2014-15	1	0.05
		2015-16	59	4.09
		2016-17	68	5.86
2	Impress Plywood 32151284728	2014-15	17	1.43
		2015-16	22	2.69
		2016-17	36	2.61
3	Oscar Woods 32151314035	2013-14	21	2.13
		2014-15	66	4.28
		2015-16	16	0.84
4	Sharpwood Enterprises 32151480186	2014-15	5	0.72
		2016-17	24	1.93
5	Star Timbers 32151229705	2013-14	2	0.11
		2014-15	31	2.84
		2015-16	44	5.67
<b>Total</b>			<b>412</b>	<b>35.25</b>

Source : Kerala Value Added Tax Information System.

The details of sales and purchases of dealers available in the KVATIS were not utilised either by the intelligence wing or by the assessing authorities. Thus, the data available with the Department itself was not made use of resulting in non-registration of dealers and loss of revenue to Government which was indicative of the fact that the Departmental officers did not perform their assigned duties in a vigilant manner due to which unregistered dealers could not be brought under tax net leading to loss of revenue.

<sup>28</sup> CTO, I Circle, Perumbavoor, CTO, II Circle, Perumbavoor and CTO, Special Circle, Perumbavoor.

Government's reply (January 2018) was not relevant to the context of the audit observation, which was on bringing unregistered softwood dealers under tax net so as to avoid loss of revenue.

- **Non-levy of security deposit in respect of offences registered**

Section 47 of the KVAT Act stipulates that if any officer has reason to suspect that the goods are transported without proper/with defective documents, the goods shall be detained and released only on furnishing security for double the amount of tax sought to be evaded. A test check of the registers maintained by enforcement wing of the Department revealed that during the period from 2013-14 to 2016-17, security deposit was not realised in 273 cases, though offences were recorded. Non-levy of security deposit in 273 cases test checked amounted to ₹ 1.89 crore as detailed in **Table - 2.7**.

**Table - 2.7**  
**Details of pending offence cases**

(₹ in crore)			
Sl. No.	Name of the office	Number of cases	Amount of security deposit due
1	IAC(I), Ernakulam	118	1.33
2	IAC(I), Mattancherry	18	0.14
3	IAC(I), Palakkad	22	0.13
4	IAC(I), Thiruvananthapuram	115	0.29
<b>Total</b>		<b>273</b>	<b>1.89</b>

Source : Offence register of Intelligence squad.

The intelligence officers failed to realise security deposit as provided in the Act, resulting in undue benefit to the dealers. On an analysis, Audit observed that delay in realisation of security deposit was between six months to 12 months in 33 cases, 12 months to 24 months in 53 cases, 24 months to 36 months in 87 cases and 36 months to 48 months in 100 cases.

At the instance of audit, action was initiated by the Government (January 2018) in 133 cases. However, the actual amount of realisation on the action taken cases was not furnished to Audit.

- **No follow up on offences registered**

Section 44 of the KVAT Act envisages that while inspecting any place of business, if it is found that goods are not accounted for by the dealer in his accounts, the dealer shall be liable to pay penalty. A test check of the records of selected squads in seven selected offices revealed that during the period 2013-14 to 2016-17, even though crime cases were recorded, no further action was taken in respect of 477 cases to impose penalty as detailed in **Table - 2.8**.

**Table - 2.8**  
**Details of crime cases pending**

Sl. No.	Name of the office	Number of cases
1.	Inspecting Assistant Commissioner(I), Ernakulam	79
2.	Inspecting Assistant Commissioner (I), Kollam	53
3.	Inspecting Assistant Commissioner (IB), Kozhikode	147
4.	Inspecting Assistant Commissioner (I), Malappuram	16
5.	Inspecting Assistant Commissioner (I), Mattancherry	24
6.	Inspecting Assistant Commissioner (I), Thiruvananthapuram	77
7.	Inspecting Assistant Commissioner (IB), Thiruvananthapuram	81
<b>Total</b>		<b>477</b>

Source : Crime register of Intelligence squad.

Audit observed that delay in taking action was between six months and 12 months in 212 cases, 12 months and 24 months in 117 cases, 24 months and 36 months in 102 cases and 36 months and 48 months in 46 cases.

The crime cases registered were followed up with imposition of penalty and the Intelligence and Investigation wing was required to forward these inputs to the assessment wing for generating additional revenue, which was not adhered to. Inaction of the assessment wing to follow up the offences registered led to loss of revenue.

At the instance of audit, action was initiated by the Government (January 2018) in 181 cases. However, the actual amount of realisation on the action taken cases was not furnished to Audit.

- **Non-utilisation of inputs of the enforcement wings**

Section 25 of the KVAT Act stipulates that where for any reason the whole or any part of the turnover of business of a dealer escaped assessment, the assessing authorities may proceed to determine, to the best of its judgment, the turnover, which escaped assessment. Audit observed that during the period from 2013-14 to 2016-17, the inputs of the enforcement wings were not utilised for assessment in 648 cases in selected assessment circles. Scrutiny of follow up action register of six assessment circles revealed that action was not taken in respect of 648 cases involving an amount of ₹ 31.54 crore as detailed in **Table - 2.9**.



**Table - 2.9**  
**Cases pending follow up**

(₹ in crore)			
Sl. No.	Name of the office	Number of cases	Amount involved
1	CTO, Special Circle I, Ernakulam	153	10.17
2	CTO, Special Circle II, Ernakulam	163	4.55
3	CTO, Special Circle III, Ernakulam	88	5.39
4	CTO, Special Circle, Kollam	58	6.48
5	CTO, Special Circle, Malappuram	54	1.74
6	CTO, Special Circle, Palakkad	132	3.21
<b>Total</b>		<b>648</b>	<b>31.54</b>

Source : Follow up action register of assessing authority.

Audit observed that delay in taking action was between six months and 12 months in 350 cases, 12 months and 24 months in 195 cases, 24 months and 36 months in 84 cases and 36 months and 48 months in 19 cases.

Non utilisation of inputs of the Intelligence and Investigation wing, which was a vital source of information for completion of assessment in VAT scenario resulted in non-realisation of additional revenue. Proper follow up or monitoring on these cases did not exist either by the intelligence or the assessment wings.

Though a register was maintained to record the cases forwarded from Intelligence wing, it was observed that a periodical review of the register was not done by the assessing authority to ensure that all the potential cases were considered for completing the assessment in a timely manner.

At the instance of audit, action was initiated by the Government (January 2018) in 244 cases. However, the actual amount of realisation on the action taken cases was not furnished to Audit.

**Recommendation: The Government should fix time frame for the assessment of cases received from intelligence and investigation wing to avoid delays.**

### 2.5.3 Data Mining Centre

With the advent of KVATIS and successful implementation of e-filing, the Department was handling huge volumes of digitised data. Hence, a data mining centre was established (April 2010) by the CCT invoking the powers under Section 3(2)(b) of the KVAT Act to utilise the data to identify the trends in tax performance, to devise policies and initiatives, to fine tune the tax administration and augment tax revenue.

Audit observed that despite specific directions of CCT to identify the evasion prone commodities, no criteria was adopted for selection of such cases for

scrutiny. The Department was of the view that fixing a criterion will restrict the analysis of data mining centre and also from having a broad view of the transactions occurring in the domain. The reply of the Department was not tenable because an analysis of 3,127 cases extracted during the four years revealed that more than 36 *per cent* of the cases related to those, which could easily be detected by the assessing authorities themselves, as detailed in **Table - 2.10**.

**Table - 2.10**  
**Details of cases detected by data mining centre**

Sl. No.	Nature of cases	No. of cases
1	Non-payment of cess	113
2	Non-filing of returns	157
3	Non-payment of turnover tax	317
4	Huge stock	33
5	Mistake in audit statement	62
6	Short payment of tax/compounded tax	268
7	Wrong compounding tax	167
<b>Total</b>		<b>1,117</b>

Source : Kerala Value Added Tax Information System.

The above table shows that the functioning of data mining centre needs streamlining, as the intention of the formation of the wing was to detect suspected trends of evasion, which will enable the Department to devise policies and initiatives to fine tune the tax administration and not to focus merely on the cases, which were easily detectable by the assessing authorities themselves.

Government stated (January 2018) that, there are 439 DMC cases pending completion as on 31 December 2017. The reply was not to the point raised by Audit.

**Recommendation: The Government should initiate steps to streamline the activities of data mining centre so as to detect suspected trends of evasion which will enable the Department to device policies and initiatives.**

#### **2.5.4 Economic Intelligence Wing**

The Joint Commissioner (I) was assigned with the duties and powers to co-ordinate, supervise and monitor the inter-State intelligence operations. Based on assurance by the Hon'ble Finance Minister of the State in the Budget speech for the year 2012-13, an Economic Intelligence Wing was established (October 2013) with creation of two posts of Assistant Commissioners and four posts of Commercial Tax Officers for collecting effective market intelligence to study, identify and detect tax evasion practised in the State.

#### **2.5.4.1 Collection of data from other Departments and cross verification not effective**

Audit collected the data of import of cashew by dealers from Director General of Systems and Management, Central Excise and Customs, New Delhi and cross checked the import details furnished by the cashew dealers in Kollam District and observed that 27 dealers imported cashew amounting to ₹ 1,967.83 crore against which ₹ 729.44 crore only was disclosed in their returns by the assesseees. The difference of import purchase worked out to ₹ 1,238.39 crore as detailed in **Appendix V**. The Department did not take effective steps to complete the assessments utilising the data shared by Audit during May 2016. Thus, the Economic Intelligence Wing failed to perform the duties assigned to it in terms of its mandate.

Government stated (January 2018) that, the dealers have branch business in Tamil Nadu, Karnataka, Andhra Pradesh, etc., and the goods taken delivery at the branches were not seen reckoned by the Audit while computing the turnover of imported raw cashew nuts. Further, it is also stated that the assessable value conceded in customs data consists of Cost Insurance Freight value (CIF) whereas the import value accounted by the dealer was excluding insurance and freight. The Customs Department considers common exchange rate for a month as per instructions from RBI, whereas bank considers the composite exchange rate as prevailing on the date of clearance of import vouchers. The reply was not acceptable for the reason that, there were no records to prove that these goods were taken delivery at the branches or no certified reconciliation statement showing the value of goods imported and delivered at branches outside the State were furnished by the dealers. The argument of Government that the variation was due to difference in import value and CIF value cannot be accepted as the quantum of import difference pointed out was huge.

#### **2.5.4.2 Inter-State intelligence operations**

Audit observed that no inter-State investigations were conducted during 2013-14 and 2014-15. During 2015-16, only one case relating to investigation of credit notes was conducted by the wing.

Government stated (January 2018) that 2,101 bogus 'C' Form cases involving money value of ₹ 2,084.35 crore in respect of Arecanut dealers were detected during 2017-18. Government reply was silent about the investigations conducted during the period pointed out by Audit.

#### **2.5.5 Failure to monitor transit pass**

Section 48 of the KVAT Act stipulates that if a vehicle carrying goods from any place outside the State and bound for any place outside the State passes through the State, the owner or consigner of such goods or person in charge of such vehicle shall obtain a transit pass in Form 7B from the first check post after his

entry into the State and deliver it to the last check post before his exit from the State. Further, Sub Section (2) of Section 48 of the Act provides that if such vehicle fails to surrender the transit pass at the last check post, it shall be presumed that such goods have been delivered within the State for sale.

Audit observed that during the period of audit, 473 transit passes were issued from three Commercial Tax Check Posts (CTCPs) involving goods amounting to ₹ 42.11 crore but these were not surrendered at the exit check post indicating that the goods were delivered and sold in the State. This resulted in loss of revenue amounting to ₹ 18.35 crore including tax, interest and penalty as detailed in **Table - 2.11**.

**Table - 2.11**  
**Details of transit passes pending exit**

(₹ in crore)

Sl. No.	Name of the check post	No. of transit passes not surrendered	Amount involved in such transit pass	Tax involved including penalty and interest
1	CTCP, Walayar	188	24.24	7.80
2	CTCP, Bangra Manjeswaram	164	12.97	5.38
3	CTCP, Muthanga	121	4.90	5.17 <sup>29</sup>
<b>Total</b>		<b>473</b>	<b>42.11</b>	<b>18.35</b>

Source : Kerala Value Added Tax Information System

The Inspecting Assistant Commissioners/Commercial Tax Officers who issued the transit passes failed to monitor whether the goods had crossed the border of the State. In two cases<sup>30</sup> the officers in charge of the CTCPs forwarded the details of transit pass to the CTOs<sup>31</sup> who was assigned with the follow up of such cases. A verification of the records of the CTOs concerned revealed that effective steps were not taken for proper follow up of the cases, resulting in 473 cases of non-surrender of transit passes remaining unattended.

On analysis of vehicles, which did not surrender the transit passes, it was revealed that instances were there in which same vehicles<sup>32</sup> used to transport goods throughout the State without surrendering the transit pass. It was also observed in another instance a vehicle<sup>33</sup> surrendered transit pass at an internal check post 499 times during the period from June 2015 to September 2016 for transporting gold coins/jewellery worth ₹ 230 crore to other State through Calicut International Airport, which was situated 20 kms away from the CTCP Feroke. Despite huge money value involved in this case, Department did not check the veracity of the

<sup>29</sup> Beer and IMFL.

<sup>30</sup> CTCPs Bangra Manjeswaram and Walayar.

<sup>31</sup> CTO, Kasargode, CTO, III Circle, Palakkad.

<sup>32</sup> KL-11-AE-2329 (seven times), AP-02-TB-1566 (two times), KA-02-AB-5663 (two times).  
WB-57-A-3298 (two times).

<sup>33</sup> KL-43-G-8094.

transaction. Thus, the officials concerned did not monitor the issue and collection of transit passes, which was part of their mandate.

At the instance of audit, action was initiated by the Government (January 2018) in 377 cases. However, the actual amount of realisation on the action taken cases was not furnished to Audit.

#### **2.5.6 Conclusion**

- The system of monitoring of the enforcement/intelligence activities of the Department was not adequate.
- Adequate efforts were not taken to finalise assessments in respect of potential cases identified by enforcement wing in a timely manner.

## **2.6 Short payment of tax due to escape of turnover from assessment**

- **CTO, Special Circle, Thiruvananthapuram**

**Under Section 25(1) of KVAT Act, 2003, where for any reason the whole or any part of the turnover of business of a dealer escaped assessment to tax in any year or return period, the assessing authority may, at any time within five years from the last date of the year to which the return relates, proceed to determine, to the best of its judgment, the turnover, which escaped assessment to tax, after issuing a notice on the dealer and after making such enquiry as it may consider necessary.**

**According to explanation V below Section 2(xliii) of KVAT Act, 2003, a transfer of right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration shall be deemed to be a sale. Under Section 6(1)(c) of the Act, in the case of transfer of right to use any goods for any purpose whether or not for a specific period, tax shall be levied at all points of such transfer. The rate of tax was four *per cent* up to 31 March 2012 and at five *per cent* from 1 April 2012 (Finance Act 2012).**

**Motor spare parts are taxable at the rate of 14.5 *per cent* vide entry 99 of list of goods notified<sup>34</sup> under KVAT Act. Under Section 7 of KVAT Act, where a dealer allows any trade discount or incentive in terms of quantity in goods in relation to any sale effected by him, the quantity so allowed as trade discount or incentive, shall be deemed to be a sale by the dealer.**

**The Commissioner of Commercial Taxes (CCT) in October 2014 directed<sup>35</sup> the assessing officers to cross verify the annual returns with the audited statements of Trading, Profit and Loss Account of the assessee covered under the KVAT Act.**

Verification of assessment records (October 2016) of M/s Kerala State Electricity Board Limited (KSEBL) and M/s Kerala State Road Transport Corporation (KSRTC) revealed that the income received by KSEBL towards rental charges collected from consumers for use of energy meters for the period 2012-13 to 2014-15 and the income received by KSRTC from advertisement on bus bodies for the period 2011-12 to 2014-15, were not disclosed in the annual returns filed. Both the income come under transfer of right to use and assessable to tax. Non-levy of tax by the respective Assistant Commissioners on these escaped turnovers resulted in short payment of tax and interest of ₹ 33.23 crore as detailed in **Table - 2.12.**

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<sup>34</sup> SRO 82/2006 dated 21 January 2006.

<sup>35</sup> Circular 27/2014 dated 8 October 2014.

Table - 2.12

(₹ in crore)								
Sl. No.	Name of Office	Name of assessee	Year	Nature of income	Amount	Tax due	Interest	Total short-levy
1.	CTO, Special Circle, Thiruvananthapuram	Kerala State Electricity Board Limited/ 32010103675	2012-13 to 2014-15	Income received from the supply of meters to consumers	502.97	25.15	7.66	32.81
2.	CTO, Special Circle, Thiruvananthapuram	Kerala State Road Transport Corporation/ 32010179714	2011-12 to 2014-15	Income received from advertisement on bus bodies	6.74	0.32	0.10	0.42
<b>Total</b>					<b>509.71</b>	<b>25.47</b>	<b>7.76</b>	<b>33.23</b>

On this being pointed out (March 2017), Government stated (September 2017) that assessment was completed in respect of KSRTC and KSEBL creating additional demand of ₹ 0.43 crore and ₹ 46.73 crore respectively. Further report about realisation of tax amount was not received (January 2018).

- **CTO Special Circle I, Ernakulam**

Verification of assessment records revealed that income of ₹ 1.39 crore received by M/s Archana Motors Private Limited, Thrissur against warranty spares supplied were not returned by the assessee in the annual return filed, though this income was disclosed in the Profit and Loss Account for the year ended 31 March 2015. The Hon'ble Supreme Court of India held<sup>36</sup> that payment received by the assessee from the manufacturer on account of replacement of defective parts as a result of the warranty agreement between manufacturer and customer is sale of goods and liable to tax. Non-compliance of the provisions of the Act resulted in short-levy of tax and interest of ₹ 23 lakh.

On this being pointed out (February 2017), Government stated (December 2017) that assessment was completed creating additional demand of ₹ 75.07 lakh and the assessee paid tax amounting to ₹ 12.61 lakh. The assessee filed appeal before DC (Appeals) which was pending for disposal.

## 2.7 Short-levy of tax due to incorrect exemption

- **CTO, Special Circle, Thiruvananthapuram**

**According to Section 2(xliii) of KVAT Act, 2003, "Sale" with all its grammatical variations and cognate expressions means any transfer whether in pursuance of a contract or not of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or for other valuable consideration. Explanation VII to Section 2(xliii)**

<sup>36</sup> M/s Mohammed Ekram Khan & Sons Vs Commissioner of Trade Tax of UP in 12 KTR 572(SC).

**stipulates that any transfer, delivery or supply of any goods referred to in this clause shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply.**

Verification of assessment records and exempted turnover details furnished by M/s Kerala State Poultry Development Corporation (KEPCO), a Government of Kerala Undertaking, dealing in chicken and poultry, revealed that during the years from 2010-11 to 2014-15, the assessee claimed irregular exemption of ₹ 34.13 crore being the turnover on supply of pullets<sup>37</sup> to beneficiaries of various Government schemes, for which funds were allotted by the Government. Though the turnover exempted was shown in the annual return, it was not taken into account, which resulted in short-levy of tax including cess and interest of ₹ 6.53 crore<sup>38</sup>.

On this being pointed out (March 2017), Government stated (September 2017) that assessment was completed creating additional demand of ₹ 6.77 crore. Further report about recovery was not received (January 2018).

## **2.8 Non-levy/short remittance of surcharge**

- **Three CTOs<sup>39</sup>**

**According to Section 3(1A) of the Kerala Surcharge on Taxes Act, 1957 (KST Act), in the case of national or multi-national companies functioning in the State as retail chains or direct marketing chains who import not less than 50 per cent of their stock from outside the State or country and not less than 75 per cent of whose sales are retail business, and whose total turnover exceeds five crore rupees per annum, tax payable under Section 6 of KVAT Act, 2003, shall be increased by a surcharge at the rate of ten per cent. Commissioner of Commercial Taxes (CCT) in July 2015<sup>40</sup> directed the assessing authorities to examine the cases of omission to levy surcharge under Section 3(1A) of KST Act meticulously while scrutinising the returns/records and utilise the same for assessment.**

Audit observed that in three CTOs, three big retail chain companies engaged in retail business did not pay surcharge at the rate of 10 per cent on the output tax payable, though the purchase and sales turnover returned by them clearly exhibit the liability as stipulated under the provisions of KST Act. The Department did not examine this aspect while scrutinising the assessment records as directed by the CCT, which resulted in non-levy of surcharge and interest of ₹ 5.78 crore as detailed in **Table - 2.13**.

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<sup>37</sup> Day old chicks.

<sup>38</sup> (Yearwise turnover exempted) x (Rate of tax) + (Cess @ 1% of tax) = Total tax due (Total tax due) x (Rate of interest @ 12% annually) = Total short-levy of tax and interest thereon.

<sup>39</sup> CTO, III Circle, Ernakulam, CTO, Special Circles I & III, Ernakulam.

<sup>40</sup> Circular No.20/2015 dated 29 July 2015.



Table - 2.13

(₹ in crore)							
Sl. No.	Name of Office	Name of the assessee/TIN	Year	Nature of business	Output tax paid	Surcharge at the rate of 10 per cent	Surcharge and interest due
1	CTO, Special Circle I, Ernakulam	M/s Joy Alukkas India Private Limited/32070242395	2013-14	Dealer in gold, bullion, watches, clocks, fancy and gift articles	15.82	1.58	2.09
			2014-15		14.05	1.41	1.68
2	CTO, III Circle, Ernakulam	M/s Kalanikethan Fashions Private Limited/32071797472	2014-15	Readymade garments and textiles	0.84	0.08	0.10
3	CTO, Special Circle III, Ernakulam	M/s RP Telebuy Skyshop Private Limited/32071398401	2010-11 to 2014-15	Kitchen fittings, cosmetics, electrical goods and readymade garments	15.46	1.54	1.91
<b>Total non-levy of surcharge</b>							<b>5.78</b>

On this being pointed out (April 2017), Government stated (November 2017) that assessments were completed in all three cases creating additional demand of ₹ 6.10 crore. M/s RP Telebuy Skyshop Private Ltd paid surcharge of ₹ 15.46 lakh. M/s RP Telebuy Skyshop Private Ltd. and Kalanikethan Fashions Private Ltd. filed writ petitions against the assessment before the Hon'ble High Court of Kerala which were pending for disposal.

## 2.9 Short-levy of compounded tax due to under-reporting of number and jaw size of crushing machines

- **Nine CTOs<sup>41</sup>**

**Section 8(b) of Kerala Value Added Tax Act, 2003, stipulates that any dealer producing granite metals and/or manufactured sand with the aid of mechanised machines may, at his option, instead of paying tax under Section 6 of the Act, pay tax at the compounded rates prescribed under the Act. The compounded tax for secondary crushers is fixed based on the number and jaw size of the crushing machines. The rate applicable to primary crushers shall be at fifty per cent of the aggregate of tax payable on secondary crushers.**

**According to proviso under Section 8(b) *ibid* of the Act, dealers having vertical/horizontal shaft impactor (VSI/HSI) or similar machines along with jaw crushers/cone crusher shall pay only 60 per cent of the relevant rate of compounded tax for each of such VSI/HSI machines or similar machines, in addition to the tax on crushing machines, as compounded tax.**

<sup>41</sup> CTO Aluva, Ettumanoor, Pala, I Circle Palakkad, Payyannur, Perinthalmanna, Thiruvalla, Tirur and Special Circle Kottarakkara.

**The Commercial Taxes Department (CTD) issued<sup>42</sup> instructions directing assessing officers to gather information from local bodies, Kerala State Electricity Board Limited (KSEBL), Kerala State Pollution Control Board (KSPCB) and Mining and Geology Department and utilise the same for assessment.**

Verification of the assessment records (from February 2016 to March 2017) of 11 metal crushing units in nine assessment circles revealed that none of the assessing officers cross verified the assessment records furnished by the assessee during the years from 2012-13 to 2014-15 with the details of consent to operate sanctioned by respective Pollution Control Board Offices as directed by the Commissioner of Commercial Taxes (CCT). This resulted in under-reporting of number and size of the machines and consequent short-levy of tax and interest of ₹ 1.66 crore as detailed in **Appendix VI**.

Audit conducted joint physical inspection from July 2016 to January 2017 along with departmental officers in nine units and confirmed the under-reporting of jaw size and number of machines.

On this being pointed out (March 2017), Government stated (October 2017) that assessments were completed in all the cases creating additional demand of ₹ 2.85 crore. Five assessees remitted a total amount of ₹ 27.34 lakh. Of the 11 cases, in seven cases the assessees preferred appeal/writ petitions and four cases were advised for revenue recovery. Further progress report in the matter was not intimated to Audit (January 2018).

## **2.10 Non-remittance of collected tax**

- **CTO, I Circle, Thiruvananthapuram**

**According to Section 20(1) of KVAT Act, 2003, every registered dealer and every dealer liable to be registered under this Act shall submit to the assessing authority such return or returns before such dates and in such manner and accompanied by such documents as may be prescribed.**

**Section 22(3) of the Act stipulates that if any dealer fails to submit any return as provided under sub-section (1) of Section 20 or files incorrect return and fails to file a fresh return as provided under sub-section (2), the assessing authority shall estimate the turnover of the return period and complete the assessment to the best of its judgment.**

**As per Section 29(1) of the Act, where any business carried on by a firm is discontinued or where a firm is dissolved, the assessing authority shall make an assessment of the taxable turnover of, and determine the tax payable by, the firm as if no such discontinuance or dissolution had taken place, and all**

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<sup>42</sup> Circular No.11/2007 dated 28 February 2007.

**the provisions of this Act, including the provisions relating to levy of penalty or any other amount payable under any provisions of this Act, shall apply, so far as may be, to such assessment and determination.**

**As per Section 31(5) of the Act, if the tax or any other amount assessed or due under this Act is not paid by any dealer or any other person within the time prescribed therefore in this Act or in any rule made thereunder and in other cases within the time specified therefore in the notice of demand, the dealer or the person, shall pay simple interest at the rate of twelve *per cent per annum* and in the case of tax collected by dealers from persons who had purchased goods from him, at the rate of thirty six *per cent per annum* on the tax or other amount defaulted.**

**Under Section 67(1) of the Act, if any authority empowered under this Act is satisfied that any person, has failed to submit any return as required by the provisions of this Act or the rules made there under, such authority may direct that such person shall pay, by way of penalty, an amount not exceeding twice the amount of tax or other amount evaded or sought to be evaded.**

Verification of purchase details of M/s Kerala State Electronic Development Corporation (KELTRON) from the database of Kerala Value Added Tax Information System (KVATIS) revealed that M/s Webex Systems and Networks Private Limited, Thiruvananthapuram, a dealer in electronic goods, parts and accessories, strength testing machines and appliances and weighing machines, and an assessee registered on the rolls of CTO, I Circle, Thiruvananthapuram, raised invoices against their sales to KELTRON and KELTRON paid ₹ 67.90 lakh towards VAT on the purchases effected during the period from March 2012 to August 2014. The assessee, M/s Webex Systems and Networks Private Limited, neither paid this collected tax to Government nor filed returns. The Commercial Tax Officer without conducting an enquiry regarding his business, cancelled the registration citing the reason as ‘stoppage of businesses’ and the Commercial Tax Officer neither conducted an enquiry nor assessed the tax due while cancelling and restoration of the registration. The cancellation and subsequent restoration of registration was done by the Commercial Tax Officer without assessing and demanding the tax due or initiating penal provision for the wilful evasion of tax. The inaction on the part of Commercial Tax Officer in exercise of his statutory functions resulted in non-remittance of tax and interest of ₹ 1.46 crore<sup>43</sup>. The maximum penalty payable for non-submission of returns was ₹ 1.36 crore<sup>44</sup>.

On this being pointed out (March 2017), Government stated (December 2017) that assessment up to the year 2015-16 was completed creating additional demand

<sup>43</sup> (Yearwise tax evaded) x (Rate of interest @ 36 *per cent per annum*) = Tax evaded and interest thereon.

<sup>44</sup> Twice the tax evaded i.e. ₹ 67,89,644 x 2 = ₹ 1,35,79,288.

of ₹ 2.07 crore and penalty of ₹ 1.93 crore imposed. Further details of recovery were not reported (January 2018).

## 2.11 Short-levy of tax on income received towards bottling charges

- Two CTOs<sup>45</sup>

According to Section 25(1) of KVAT Act, 2003, where for any reason the whole or any part of the turnover of business of a dealer has escaped assessment to tax in any year or return period or has been under-assessed, the assessing authority may, at any time within five years from the last date of the year to which the return relates, proceed to determine, to the best of its judgment, the turnover which has escaped assessment to tax or has been under assessed, after issuing a notice on the dealer and after making such enquiry as it may consider necessary. Rule 11(2) of the Kerala Foreign Liquor (Compounding, Blending and Bottling) Rules, 1975 stipulates that, in the case of spirits released for consumption within the State the strength of spirits shall not be lower than 25 degree U.P<sup>46</sup>. De-mineralised water was liable to be taxed at 12.5 per cent during 2010-11 and 2011-12, 13.5 per cent in 2012-13 and 14.5 per cent in 2014-15 vide entry 99 of list of goods notified<sup>47</sup> under KVAT Act, 2003.

Four distilleries<sup>48</sup> engaged in the manufacture of Indian Made Foreign Liquor (IMFL) using Extra Neutral Alcohol (ENA) provided by other distilleries on job work basis had to use demineralised water (DM water) required for the manufacture of IMFL. Verification of assessment records (between November and December 2016) revealed that the assessee received income towards bottling/conversion charges during the years 2010-11 to 2014-15, which included the cost of DM water used. The assessing officers while finalising the assessments, incorrectly computed the quantity of DM water content in IMFL as 50 per cent of total production of IMFL instead of 57.14 per cent as prescribed under the KFL (C,B&B) Rules. Moreover, in the case of three distilleries, the assessing officers did not assess the income received towards bottling/conversion charges in certain years as detailed in Table - 2.14.

Table - 2.14

Sl. No.	Name of Office	Name of the assessee/ TIN	Years in which tax short assessed
1	CTO, Special Circle, Palakkad	M/s Empee Distilleries Ltd./32090206645	2010-11 to 2014-15

<sup>45</sup> Special Circles, Kannur and Palakkad.

<sup>46</sup> Liquor of 75° proof strength (which is also 25° U.P. strength) contains  $(75^\circ \times 4/7) = 42.86$  per cent of alcohol by volume.

<sup>47</sup> SRO 82/2006 dated 21 January 2006.

<sup>48</sup> Empee Distilleries Ltd., Imperial Spirits Ltd., SDF Industries Ltd., Sreedharan and Company Private Ltd.

Sl. No.	Name of Office	Name of the assessee/ TIN	Years in which tax short assessed
2		M/s Imperial Spirits Ltd./32090282425	2010-11 to 2014-15
3		M/s SDF Industries Ltd./32090257462	2010-11 to 2014-15
4	CTO, Special Circle, Kannur	M/s Sreedharan and Company Private Ltd./32120204725	2011-12

This resulted in short-levy of tax and interest of ₹ 58.86 lakh as detailed in **Appendix VII**.

On this being pointed (March 2017), Government stated (December 2017) that assessments were completed in all the cases and additional demand of ₹ 61.41 lakh created. Against this, in two cases the assessee preferred appeal and one assessee filed writ petition in the Hon'ble High Court of Kerala which are pending for disposal.

## 2.12 Non-reversal of input tax credit

- **CTO, Special Circle II, Ernakulam**

**According to Section 11(7) of KVAT Act, 2003, if goods in respect of which input tax credit has been availed of are subsequently used, fully or partly, for purposes in relation to which no input tax credit is allowable under the section, the input tax credit availed of in respect of such goods shall be reverse tax. Under Section 11(8), reverse tax as determined shall be deemed to be an amount due under KVAT Act.**

Verification of assessment records of M/s Savex Technologies Private Limited, Kochi, an assessee engaged in the business of computer systems and peripherals, telephone and telephone equipment, revealed that during the year 2014-15, the assessee effected local purchase of computer systems, peripherals and parts amounting to ₹ 845.01 crore. Out of this, the assessee returned goods worth ₹ 18.11 crore to relevant dealers, on which, input tax credit of ₹ 90.55 lakh availed of had to be reversed, but the assessee, reversed input tax credit of ₹ 68.22 lakh only. This resulted in short reversal of input tax credit and interest thereon amounting to ₹ 26.57 lakh.

On this being pointed out (April 2017), Government stated (December 2017) that assessment was completed creating additional demand of ₹ 27.24 lakh. The assessee filed writ petition before the Hon'ble High Court of Kerala, which was pending for disposal.

• Two CTOs<sup>49</sup>

According to proviso under Section 11(3) of KVAT Act, 2003, where any goods purchased in the State are subsequently sent to 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 inter State trade, the input tax credit shall be limited to the amount of input tax paid in excess of five *per cent* on the purchase turnover of such goods sent outside the State. As per explanation below Section 13(2)(v) of the Act where input tax is paid on the purchase of Duty Entitlement Pass Book (DEPB) or any similar license for the import of any goods and goods so imported are used, consumed or disposed of in the manner specified in this sub-section, the input tax paid on the purchase of such DEPB or any similar license shall for the purpose of this Section and Section 11, be deemed to be the input tax paid on the goods imported.

M/s Volvo Auto India Private Limited, Ernakulam in 2014-15 and M/s Shri Ganesh Enterprises, Mattancherry during the period 2013-14 and 2014-15 effected inter-State stock transfer outwards of goods imported utilising the DEPB license purchased locally. Verification of assessments records revealed that the assessee failed to reverse the proportionate input tax credit availed in respect of the goods stock transferred outside the State. This resulted in short-levy of tax and interest of ₹ 0.19 crore as detailed in **Table - 2.15**.

**Table - 2.15**

(₹ in crore)

Sl. No.	Name of office	Name of the assessee/TIN	Nature of business	Year	Interstate Stock Transfer (Out)	Input Tax credit	Short-levy of tax with interest
1	Special Circle I, Ernakulam	M/s Volvo Auto India Pvt Ltd./ 32070227499	Automobiles	2014-15	5.6	2.61	0.14
2	Special Circle III, Ernakulam	Shri Ganesh Enterprises/ 32071292752	Chemicals, DEPB license sale, rubber latex and sheets of all kinds	2013-14	3.07	0.75	0.05
				2014-15	0.74	1.97	
<b>Total</b>							<b>0.19</b>

Though the Department issued guidelines<sup>50</sup> to cross verify the details of annual returns with the audited statements of trading, profit and loss accounts, the Assistant Commissioners did not comply with the guidelines.

<sup>49</sup> Special Circles I and III, Ernakulam.

<sup>50</sup> Circular 27/2014 dated 8 October 2014.

On this being pointed out (April 2017), Government stated (September 2017) that assessment in respect of M/s Volvo Auto India Private Limited was completed creating additional demand of ₹ 64.53 lakh. Reply in respect of Sri Ganesh Enterprises was not received (January 2018).

### 2.13 Short payment of tax due to misclassification

**Under Section 25(1) of KVAT Act, 2003, where for any reason the whole or any part of the turnover of business of a dealer has escaped assessment to tax in any year or return period or has been under assessed or has been assessed at a rate lower than the rate at which it is assessable, the assessing authority may, at any time within five years from the last date of the year to which the return relates, proceed to determine, to the best of its judgment, the turnover which has been under assessed or has been assessed at a rate lower than the rate at which it is assessable, after issuing a notice on the dealer and after making such enquiry as it may consider necessary. EDXRF Spectrometer<sup>51</sup> is an item not specified in any of the schedules to the KVAT Act and is assessable at the rate of 14.5 per cent vide entry 103<sup>52</sup> of the list of goods notified under the Act. Margarine is taxable at the rate of 14.5 per cent vide entry 64(8) of list of goods notified<sup>53</sup> under KVAT Act. Though the Department had issued directions<sup>54</sup> to the assessing officers to examine the cases of misclassification of margarine meticulously while scrutinising the returns/records and utilise the same for assessment, the Commercial Tax Officer did not comply with the directions.**

- **CTO, Special Circle, Thrissur**

M/s Redlands Ashlyn Motors PLC, Thrissur, is a dealer in harvester, measuring devices and electronic goods. Verification of assessment records for the years 2013-14 and 2014-15 revealed that the assessee sold EDXRF Spectrometer worth ₹ 12.94 crore and ₹ 10.54 crore respectively and the same was assessed to tax at the rate of five per cent vide entry 69 (123) of third schedule under “IT products Spectrum Analyzers having HSN code 9030”, instead of 14.5 per cent as specified in entry 103 of list of goods notified under KVAT Act. The application of incorrect rate of tax resulted in short-levy of tax including interest of ₹ 1.37 crore in 2013-14 and ₹ 1.16 crore in 2014-15.

On this being pointed out (February 2017), Government stated (November 2017) that assessment was completed for the years 2013-14 and 2014-15 creating additional demand of ₹ 1.62 crore and ₹ 1.16 crore respectively. Further progress report was awaited (January 2018).

<sup>51</sup> EDXRF Spectrometer having HSN code 9027/9022 is an instrument used for measuring the purity of gold using X-ray fluorescence method.

<sup>52</sup> SRO 82/2006 dated 21 January 2006.

<sup>53</sup> SRO 82/2006 dated 21 January 2006.

<sup>54</sup> Circular 20/2015.

- **CTO, I Circle, Ernakulam**

Verification of assessment records of M/s Promise Trading Company, Kochi, a dealer in edible oil, food preservatives, milk products and margarine, revealed that during the period 2013-14, the assessee misclassified the sales turnover of margarine worth ₹ 151.47 lakh as that of 'Goods coming under second schedule not specified' and assessed to tax at one *per cent*. Margarine was purchased and sold by the assessee either by omitting the word 'Margarine' from or adding the word 'Vanaspathi' to the brand name in its purchase bills. This misclassification resulted in short-levy of tax including interest of ₹ 23.52 lakh as detailed in **Appendix VIII**.

On this being pointed out (March 2017), Government stated (December 2017) that assessment for the year 2013-14 was completed creating additional demand of ₹ 24.58 lakh and the assessee paid ₹ 4.09 lakh. The assessee filed writ petition before the Hon'ble High Court of Kerala which was pending for disposal.

#### **2.14 Short fixation/levy of compounded tax**

- **CTO, Koothuparamba**

**According to Section 8(f)(i) of KVAT Act, 2003, any dealer in ornaments or wares or articles of gold, silver or platinum group metals including diamond may at his option, instead of paying tax in respect of such goods in accordance with the provision of Section 6, pay tax at one hundred and fifty *per cent* of the highest tax payable by him as conceded in the return or accounts or tax paid by him under the Act, whichever is higher, for a year during any of the three consecutive years preceding that to which such option relates in case their annual turnover for the goods for the preceding year exceeded rupees one crore. As per explanation 7 below Section 8(f)(i) of the Act, tax payable as conceded in the accounts includes the tax payable on suppressed turnover subsequently detected also.**

Verification of assessment records of M/s Muscat Jewellery, Mattannur, revealed that while computing the compounded tax payable for the year 2012-13 and 2013-14, the Commercial Tax Officer omitted to reckon the tax paid towards suppressed turnover detected by the Intelligence Officer during the year 2011-12 along with the net tax payable. This resulted in short-levy of compounded tax including interest of ₹ 12.38 lakh<sup>55</sup> for the subsequent years 2012-13 and 2013-14.

On this being pointed (March 2017), Government stated (October 2017) that assessment for the years 2012-13 and 2013-14 was completed by creating additional demand of ₹ 8.89 lakh and ₹ 8.31 lakh respectively including interest.

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<sup>55</sup> For arriving compounded tax for 2012-13 - 150 *per cent* of the highest tax paid during the three years from 2009-10 to 2011-12 i.e. ₹ 7,47,628 paid during 2011-12 was the highest. For the year 2013-14, 125 *per cent* of the compounding tax paid during 2012-13. Interest at the rate of 25 *per cent* for 2012-13 and 13 *per cent* for 2013-14.



The assessee paid ₹ 8.89 lakh due for the year 2012-13. For the year 2013-14, the assessee remitted ₹ 2.15 lakh and the balance amount was under revenue recovery.

### 2.15 Excess abatement of output tax

#### • CTO, Special Circle, Thrissur

According to Section 41(1) of KVAT Act, 2003, where subsequent to any sale of taxable goods effected by a dealer the purchaser has returned the goods covered by the tax invoice fully or partly, within the period permitted by this Act or the Rules made there under, the dealer effecting the sale shall issue, forthwith, to the purchaser a credit note containing such particulars as may be prescribed. Rule 10(b) of KVAT Rule stipulates that all amounts allowed to purchasers in respect of goods returned by them to the dealer within a period of ninety days from the date of delivery of the goods shall be deducted from the total turnover, where the goods are taxable on the amount for which they have been sold, provided that the accounts show the date on which the goods were returned and the date on which and the amount for which refund was made or credit was allowed to the purchaser and the deduction is claimed during the year in which the sale was effected.

Verification of assessment records (September 2016) of M/s Panopharm, Thrissur a dealer in medicines and health drinks, revealed that the assessee availed abatement of output tax of ₹ 37.86 lakh during the period from 2011-12 to 2013-14 on the sales return of goods worth ₹ 10.69 crore. But as per the Profit and Loss Accounts for the period from 2011-12 to 2013-14 the value of sales return of goods within the permitted period of 90 days under the Act was only for ₹ 5.01 crore involving tax element of ₹ 29.50 lakh. Though the details were available with the assessment records submitted, the Department did not utilise those details, which resulted in excess abatement of output tax of ₹ 11.38 lakh including interest as detailed in Table - 2.16.

Table - 2.16

(₹ in lakh)

Credit Note details as shown in the annual returns			Accounted (within time 90 days)		Excess abatement and amount due			
Year	Amount involved	Tax element	Amount involved	Tax element	Sales turnover of irregular claim	Excess abatement of tax	Interest <sup>56</sup>	Total excess abatement including interest
2011-12	424.40	11.75	193.70	10.09	230.70	1.66	0.87	2.53
2012-13	280.43	12.94	156.44	10.60	123.98	2.34	0.93	3.27
2013-14	363.71	13.17	151.34	8.81	212.37	4.36	1.22	5.58
<b>Total</b>	<b>1,068.54</b>	<b>37.86</b>	<b>501.48</b>	<b>29.50</b>	<b>567.05</b>	<b>8.36</b>	<b>3.02</b>	<b>11.38</b>

<sup>56</sup> Under Section 31(5) of KVAT Act, 2003 simple interest at the rate of 12 per cent per annum on the tax or other amount defaulted.

On this being pointed out (February 2017), Government stated (January 2018) that assessments for the years 2011-12 to 2013-14 were completed creating additional demand of ₹ 3.45 crore.

### **2.16 Short payment of tax due to application of incorrect rate of tax**

- **CTO (WC & LT), Palakkad**

**Under Section 8 (a)(ii) of KVAT Act, 2003, works contractors registered under the provisions of Central Sales Tax (CST) Act, 1956 or an importer, when opted for payment of compounded tax, are liable to pay tax at three per cent of the contract amount after deducting the purchase value of goods excluding freight and gross profit element consigned into the State on stock transfer or purchased from outside the State and for the purchase value of goods so deducted shall pay tax at the scheduled rate applicable to such goods.**

M/s Metro Systems and Projects (I) Private Limited, Palakkad, a works contractor having CST registration opted for payment of tax at compounded rate. Audit observed from the assessment records of the assessee that from 2010-11 to 2013-14, the assessee did not pay tax at the prescribed rates on the purchase value of goods consigned into the State which was purchased from outside the State and transferred to the work during the above years. This resulted in short-levy of tax and interest of ₹ 9.16 lakh as detailed in **Table - 2.17**.

**Table - 2.17**

(₹ in lakh)

Assessment year	Contract amount received	Inter-State purchase	Tax due including cess	Tax paid as per annual return	Short-levy of tax including interest
2010-11	48.63	23.49	2.03	1.81	0.34
2011-12	5.00	17.66	2.16	0.38	2.60
2012-13	202.92	208.23	20.98	16.59	5.88
2013-14	12.39	27.35	0.82	0.54	0.34
<b>Total short-levy including interest</b>					<b>9.16</b>

On this being pointed out (March 2017), Government stated (November 2017) that assessments for the years 2010-11 to 2013-14 were completed by creating additional demand of ₹ 9.99 lakh. The amount was advised for revenue recovery.

### **2.17 Irregular payment of tax at compounded rate**

- **CTO, I Circle, Ernakulam**

**Rule 11(1A)(a)(i) of KVAT Rule, 2005, stipulates that along with the application for exercising option for payment of compounded tax under Section 8, every dealer shall furnish a copy each of the agreement executed**

by the contractor with the awarder and the work schedule. Commissioner of Commercial Taxes in October 2014 directed<sup>57</sup> the assessing officers to verify the monthly return of all dealers at least once in three months and analyse and compare the trade results.

Verification of assessment records of M/s H&J Estates Private Limited, Kochi, a works contractor, revealed that the application for payment of tax at compounded rate filed by the assessee for the year 2013-14 was not accepted by the assessing officer due to non-submission of copy of agreement executed by the contractor with the awarder and the work schedule as stipulated in the Rule. Even though the application was rejected by the assessing officer, the dealer paid tax at the compounded rate of three *per cent* instead of paying tax under Section 6(1) of the Act and the Department did not demand tax under the said Section by verifying the return as directed by the Commissioner of Commercial Taxes (CCT). Non-compliance of the Departmental directions resulted in short-levy of tax including interest of ₹ 5.31 lakh<sup>58</sup>.

On this being pointed out (March 2017), Government stated (September 2017) that assessment was completed creating additional demand of ₹ 5.40 lakh and the assessee paid ₹ 4.66 lakh. The assessee filed appeal before the KVAT Appellate Tribunal, which was pending disposal.

## 2.18 Irregular refund of input tax credit

### • CTO, Pattambi

**According to Section 11(4) of the KVAT Act, 2003, dealers paying compounded tax under Section 8 shall not be eligible for input tax credit. Under Section 11(7) of the Act, if goods in respect of which input tax credit has been availed of are subsequently used, fully or partly, for purposes in relation to which no input tax credit is allowable under the Section, the input tax credit availed of in respect of such goods shall be reverse tax.**

M/s Dubai Gold and Diamonds, Pattambi, a dealer in gold jewellery started business in March 2013. Audit observed in June 2015 that the excess input tax credit of ₹ 10.84 lakh relating to closing stock value of ₹ 16.39 crore remaining unadjusted as on 31 March 2014 was refunded to the assessee by Commercial Tax Officer in April 2015. The assessee opted for the scheme of compounded tax during 2014-15 under Section 8(f)(i) of the KVAT Act. Since the assessee opted to pay tax under the compounding scheme during 2014-15, the goods in respect of which input tax credit availed of in 2013-14 and subsequently used by the assessee fully for the purposes in relation to which no input tax credit was allowed was to be reversed. The Commercial Tax Officer, instead of reversing the input

<sup>57</sup> Circular 27/2014 dated 8 October 2014.

<sup>58</sup> (Taxable turnover) x (Rate of tax @14.5 *per cent*) – (ITC eligible and tax paid) = Net tax due  
Add: Interest @ 14 *per cent*.

tax credit, refunded it. This resulted in irregular refund of input tax credit of ₹ 10.84 lakh. Interest under Section 31(5) of the Act worked out to ₹ 1.52 lakh.

On this being pointed out (March 2017), Government stated (December 2017) that assessment was completed and demanded the assessee to remit back the refunded amount of ₹ 10.84 lakh along with interest of ₹ 1.74 lakh and the assessee paid ₹ 2.17 lakh. The assessee filed appeal before DC (Appeals), which was pending for disposal.