CHAPTER II
VALUE ADDED TAX / SALES TAX

2.1 Tax administration

Assessment, levy and collection of sales tax, central sales tax and value added tax are governed by the erstwhile Tamil Nadu General Sales Tax Act, 1959 (TNGST Act) and the Rules made thereunder, the Central Sales Tax Act, 1956 (CST Act) and the Rules made thereunder, the Tamil Nadu Value Added Tax Act, 2006 (TNVAT Act) and the Tamil Nadu Value Added Tax Rules, 2007 (TNVAT Rules) respectively. Administration of the Department is vested with the Commissioner of Commercial Taxes (CCT). The State has been divided into 40 zones, comprising 334 Assessment Circles including four Large Taxpayers[4] units (LTUs) at Chennai and two Fast Track Assessment Circles (FTACs) at Coimbatore. Assessment, levy and collection of tax are done by the Assessing Authorities (AAs) in charge of the Assessment Circles. Monitoring and control at the Government level is done by the Principal Secretary, Commercial Taxes and Registration Department.

2.2 Internal audit

The Internal Audit wing is organised in each Zone and consists of an Assistant Commissioner (AC), Commercial Tax Officer (CTO) and two supporting staff. The assessments finalised and the refunds made in the preceding quarter were to be taken up for audit in the succeeding quarter.

The details of offices programmed for conduct of internal audit and the offices in respect of which internal audit was done during the year 2015-16 were not furnished by the Department. The year-wise break up of outstanding inspection reports was also not furnished by the Department, though 21,284 paragraphs involving ₹ 520.17 crore were stated to be pending for settlement as of 31 March 2016.

[4] Large taxpayers – Dealers whose taxable turnover for a year exceeds ₹ 200 crore.

2.3 Results of audit

Test check of records of departmental offices conducted during the period from April 2015 to March 2016 revealed under-assessment of tax and other irregularities amounting to ₹ 3,950.08 crore in 3,344 cases, which broadly fall under the following categories.

Table: 2.1

(₹ in crore)

Sl. No.	Category	No. of cases	Amount
1	Audit of Assessment, levy and collection of Value Added Tax on transfer of goods involved in the execution of works contracts	1	118.72
2	Audit of Tax Exemption to Industries	1	3,719.65
3	Incorrect exemption of tax	84	6.03
4	Incorrect rate of tax	220	12.74
5	Incorrect computation of taxable turnover	239	9.32
6	Non / short levy of tax	347	10.36
7	Non-levy of penalty / interest	215	7.39
8	Incorrect allowance of input tax credit	1,765	43.73
9	Others	472	22.14
	Total	**3,344**	**3,950.08**

During 2015-16, the Department accepted under-assessment and other deficiencies amounting to ₹ 23.64 crore in 572 cases; out of which, ₹ 5.58 crore involved in 181 cases were pointed out during the year and the rest in earlier years. Out of the above, an amount of ₹ 7.96 crore had been collected.

Audit of Assessment, levy and collection of Value Added Tax on transfer of goods involved in the execution of work contract, Audit of Tax Exemption to Industries and few illustrative cases involving ₹ 3,849.31 crore are discussed in the following paragraphs.

2.4 Audit of 'Assessment, levy and collection of Value Added Tax on transfer of goods involved in the execution of works contracts'

2.4.1 Introduction

The assessment, levy and collection of VAT on works contracts is governed by the Tamil Nadu Value Added Tax Act, 2006 (TNVAT Act) and the Tamil Nadu Value Added Tax Rules, 2007 (TNVAT Rules) made thereunder. "Works Contract" is defined to include any agreement made towards cash transactions, deferred payment or other valuable consideration, building construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.

The various stakeholders of works contract and their roles and responsibilities are given below.

Stakeholder	Role and responsibilities
Commercial Taxes Department	• Overall monitoring of the activities relating to assessment, levy and collection of VAT. • Establishment of a system to cross verify third party data to detect and prevent tax evasion.
Work Awarder	• Deduction of tax at source (VAT-TDS) (except in cases covered by Form-S[5]) at the time of making payments to the works contractors and deposit of the same to the prescribed authority within the prescribed time along with a Statement in Form-R[6]. • Issue of Certificate of deduction of tax in Form-T[7] to the works contractor and forwarding a copy of the same to the assessing authority (AA) having jurisdiction over the said works contractor.
Works Contractor	• Registration as a dealer with the jurisdictional Assessment Circle. • Filing of monthly returns along with proof of payment of tax.
TDS Circle and other assessment circles receiving VAT-TDS	• Monitoring deposit of VAT-TDS by the work awarders within the prescribed time alongwith the statement in Form-R. • Timely remittance of the VAT-TDS amount to the Bank. • Timely transfer of the credit particulars (Form-R) to the AAs having jurisdiction over the works contractors concerned.
Jurisdictional Assessment Circles where contractors are registered as assessees	• Performing street survey to identify unregistered works contractors • Conducting scrutiny of returns filed by the works contractors. • Monitoring adjustment of VAT-TDS credit. • Issue of Form-S and watching utilisation of Form-S.

[5] Form-S certificate is issued by the AA based on the application made by the works contractor to certify that the dealer had no liability to pay or had paid the tax under Section 5 of the TNVAT Act. The certificate shall be produced by the dealer to the work awarder, based on which VAT-TDS deduction would not be made.

[6] Form-R is the statement filed by the person making deduction of VAT-TDS to the prescribed authority along with the deposit of VAT-TDS.

[7] Form-T is the certificate of deduction of tax issued to the works contractor by the works awarder, a copy of which is also forwarded to the AA having jurisdiction over the works contractor.

Audit was conducted to ascertain the (i) adequacy of collection of third party data and effectiveness of its utilisation by the Department to detect tax evasion (Paras 2.4.2 to 2.4.4); (ii) correctness of deduction of VAT-TDS and timeliness of its remittance by the work awarders (Para 2.4.5); (iii) extent of compliance to the provisions of the Act, Rules, Notifications and instructions governing assessment, levy and collection of tax on works contract by the AAs (Para 2.4.7); and (iv) adequacy of internal controls and monitoring mechanism (Paras 2.4.5.2 and 2.4.6).

In order to ascertain whether the roles assigned to various stakeholders were duly fulfilled**,** we obtained third party data consisting of payments made to the contractors by various work awarders[8] during the years 2012-13 to 2014-15. Out of 79,729 payments involving ₹ 14,759.71 crore, 58,480 payments amounting to ₹ 12,093.28 crore were cross verified with the database of the Commercial Taxes Department (CTD) and followed up with necessary verification at the Assessment Circles concerned. We also collected Form-S certificates from the above work awarders, based on which tax was not deducted on payments made by them to the works contractors and cross verified the same with the records of CTD to ascertain the correctness thereof. The audit was conducted in 115 out of 336 Assessment Circles during the period from December 2015 to August 2016. The 115 Assessment Circles which had the highest incidence of irregularities found out during cross-verification, both in terms of value / numbers were selected. Apart from the above, the activities of TDS Circle situated at Chennai and other Assessment Circles, which also perform the role of TDS Circle, were also scrutinised.

Audit findings

Audit findings as a result of our examination of records of 115 out of 336 Assessment Circles are given in the succeeding paragraphs. Since these are the results of our test check of sampled Assessment Circles and assessees, Government may get the position examined in the whole State as this exercise is likely to yield considerable revenue for the State.

2.4.2 Inadequate mechanism of cross verification of details of works contractors

Regular and systematic cross verification of database of CTD with third party data can assist in identifying unregistered works contractors and suppression of turnover by the contractors. A white paper released on 17 January 2005, by the Empowered Committee of State Finance Ministers, constituted by the Ministry of Finance, Government of India, emphasised the importance of

[8] Public works Department (PWD) (Buildings Division), Ground Water Division and Water Resources Division), Highways Department, Local Bodies (Corporation of Chennai, Madurai and Coimbatore), Tamil Nadu Water Supply and Drainage (TWAD) Board, Chennai Metro Water Supply and Sewerage Board (CMWSSB), Airport Authority of India (AAI), Tamil Nadu Transmission Corporation (TANTRANSCO), Southern Railway, Chennai (Construction and Maintenance Divisions), Southern Railway (Chennai and Madurai Divisions), National Highways Authority of India (NHAI), Rail Vikas Nigam Limited (RVNL) and Chennai Metro Rail Limited (CMRL)

cross-checking of tax returns and other documents of the VAT system of the States and those of Central Excise and Income Tax, to help reduce tax evasion and growth of tax revenue. The Tamil Nadu Commercial Tax Manual (Volume III – Standing Order 225 c (iii) (2) prescribes for co-ordinating with other Departments / agencies to obtain information and make use of the same in detecting suppression and evasion of tax.

We observed during audit that the CTD did not have any system in existence for collection of third party data. A separate wing, Business Intelligence Unit (BIU) was formed for collection of data from various sources only in August 2014. BIU had obtained data from the Service Tax Department relating to the year 2013-14 and from the Municipal Corporation of Chennai for the periods 2013-14 and 2014-15. The same was hosted in intranet for use by the AAs. The several other additional sources[9] of third party data remained untapped by BIU. Also, the data uploaded by BIU in intranet was not utilised by the AAs.

After we pointed this out (January 2016), BIU stated (April 2016) that no norms had been evolved for obtaining data from work awarders. Government stated (November 2016) that efforts were made regularly to obtain details of works contracts but lack of co-operation by the Government Departments and Public Sector work awarders to furnish the details of contracts awarded by them was the primary reason for revenue leakage in the department.

The reply was not acceptable as the measures undertaken by the Department were not effective in obtaining details of works contracts, though more than nine years had passed since the introduction of VAT in the State. Further, we noticed that the details obtained by BIU were also not utilised by the AAs in the process of assessment of works contractors, due to which the turnover escaped assessment from levy of tax under the TNVAT Act**.**

Recommendation 1: We recommend that the Government may put in place an appropriate mechanism for obtaining details of contracts from major work awarders of the State, followed up by proper utilisation of the details by the AAs in the process of assessment of works contractors to prevent leakage of revenue and to ensure revenue augmentation.

2.4.3 Adequacy of collection of third party data and effectiveness of it utilisation in process of assessment

We obtained details from major work awarders of the State and after excluding payments in respect of which Taxpayers Identification Number (TIN) / Permanent Account Number (PAN) of the contractor was absent, we cross verified 58,480 payments amounting to ₹ 12,093.28 crore with the

[9] Public works Department (PWD) (Buildings Division, Ground Water Division and Water Resources Division), Highways Department, Local Bodies (Corporation of Madurai and Coimbatore), Tamil Nadu Water Supply and Drainage (TWAD) Board, Chennai Metro Water Supply and Sewerage Board (CMWSSB), Airport Authority of India (AAI), Tamil Nadu Transmission Corporation (TANTRANSCO), Southern Railway, Chennai (Construction and Maintenance Divisions), Southern Railway (Chennai and Madurai Divisions), National Highways Authority of India (NHAI), Rail Vikas Nigam Limited (RVNL) and Chennai Metro Rail Limited (CMRL)

database of CTD. Such a cross verification revealed the following deficiencies:

Table 2.2: Results of cross verification

(₹ in crore)

Nature of deficiencies	No. of contractors	No. of assessment circles	Payments made to contractors for execution of works	Amount of tax involved (after deducting TDS)
Execution of contract by dealers whose RCs were cancelled by CTD	104	73	120.31	1.63
Contractors whose RCs were cancelled by CTD subsequent to execution for works	130	86	187.34	2.89
Contractors who filed 'Nil' returns	592	189	672.46	10.09
Non-filing of returns by contractors	327	150	411.27	6.18
Filing of annual return by contractors	630	200	613.69	8.46
Total	1,783	698	2,005.07	29.25

We followed up with necessary verification at the Assessment Circles to ascertain the action taken, if any, by the AAs. The results of such verification are mentioned below:

2.4.3.1 Unregistered works contractors

As per Section 38 of the TNVAT Act, every dealer who purchases goods within the State and sells those goods within the State and whose total turnover in any year is not less than rupees ten lakh and every other dealer whose total turnover in a year is not less than rupees five lakh should be registered under the Act in the State with an appropriate authority.

(i) NHAI, Chennai had awarded a work to a Joint Venture (JV) firm, comprising of a company registered in Tamil Nadu (participant in JV with 65 *per cent* share) and a company based in Hyderabad (participant in JV with 35 *per cent* share). Our verification revealed that the JV and one of the constituent companies of the JV were not registered dealers in the State.

(ii) Cross-verification of Permanent Account Number of 103 contractors to whom payment of ₹ 80.58 crore had been made by five[10] work awarders, who remit VAT-TDS at four[11] Assessment Circles revealed the absence of matching TIN in CTD database.

(iii) Verification of TINs provided by Airport Authority of India, a work awarder who remits VAT-TDS in Nandambakkam Assessment Circle revealed

[10] CMWSSB, Southern Railways (Division) Chennai, Southern Railways (Division) Madurai, Southern Railways (Construction and Maintenance) Chennai and Rail Vikas Nigam Limited (RVNL)

[11] Alwarpet, Chintadripet, TDS Circle and West Veli Street Circle

that 26 works contractors to whom payments of ₹ 16.97 crore were made, were having either invalid TIN or it was not issued by the State Government.

After we pointed this out (August 2016), the AA of Chintadripet Assessment Circle (CMWSSB), Alwarpet Assessment Circle (Rail Vikas Nigam Limited) and West Veli Street (Railway Division Madurai) stated that notices would be issued to the work awarders demanding remittance of VAT-TDS in respect of contracts entrusted by them to contractors without valid TIN. The work awarder, Airport Authority of India stated that they do not verify the registration status of the works contractors with the CTD. Reply in respect of remaining cases was awaited (February 2017).

2.4.3.2 Non-levy of tax on contract receipts

As per Section 21 of the TNVAT Act, every registered dealer shall file return in the prescribed form showing the total and taxable turnover within the prescribed period and in the prescribed manner. Under the TNVAT Act, a works contractor can either pay tax on the transfer of property in goods involved in the execution of works contract or may opt to pay tax at compounded rates on total value of works contract executed by him in a year. The option so exercised shall be final for that financial year. Section 22(4) of the TNVAT Act empowers the AA to assess a dealer to the best of its judgment, where no return is submitted by the dealer for any period of the year or if the return filed is found to be incomplete or incorrect. Section 22(5) of the Act provides for levy of penalty of one hundred and fifty *per cent* of the difference of the tax assessed and the tax already paid as per the returns.

We noticed from the data obtained from work awarders that 442 works contractors had executed works during the period 2012-13 to 2014-15 and received payment of ₹ 1,042.04 crore. We noticed from the records of CTD that (i) the registration certificates (RCs) of 33 works contractors pertaining to 24[12] Assessment Circles were cancelled (between April 2007 and March 2014) prior to the execution of works, and (ii) 409 dealers of 79[13]Assessment

[12] Adyar, Arumbakkam, Chokkikulam, Cuddalore (Town), Dharapuram, KK Nagar, Koyambedu, Madurai Rural South, Munichalai Road, Nandambakkam, Nanganallur, Nethaji Road-Salem, NH Road, RG Street, Royapuram, Saligramam, Singanallur, Surapattu, Tallakulam, Thirumangalam, Tiruppur (Rural), Tondiarpet, Villivakkam and West Veli Street Circle

[13] Adyar, Alandur, Amaindakarai, Arisipalayam, Arumbakkam, Avanashi, Bazaar Street, Bhavani, Brough Road, Chidambaram-I, Chitrakara Street, Chidambaram II, Chokkikulam, Cholavaram, Cuddalore (Town), Dr. Nanjappa Road, Ekkatuthangal, Ganapathy, Gandhipuram, Guindy, KK Nagar, Kamarajar Salai, Kelambakkam, Kotturpuram, Koyambedu, Madipakkam, Madurai (Rural) (South), Mahal, Manali, Mandaveli, Melur, MMDA Colony, Munichalai Road, Mylapore, Nandambakkam, Nandanam, Nanganallur, Nethaji Road-Salem, NH Road, Omalur, PN Palayam, Palladam, Perundurai, Perur, Podanur, Pondy Bazaar, Purasawakkam, RG Street, Rasipuram, Royapettah, Royapuram, Saibaba Colony, Saidapet, Salem Rural, Saligramam, Sholinganallur, Singanallur, South Avani Moola Street, Suramangalam, Surapattu, T. Nagar, Tallakulam, Tamil Sangam Salai, Thirumangalam, Thiruparamkundram, Thiruvallikeni, Thiruvanmiyur, Thudiyalur, Tindivanam, Tiruppur Central-II, Tondiarpet, Trichy Road, Velachery, Velandipalayam, Villivakkam, Villupuram II, Virudhachalam, West Tower Street, and West Veli Street Circle

Circles, who received payments of ₹ 984.64 crore, either did not file returns or had filed 'Nil' returns / Annual returns not involving any tax liability. Since the details of work were not obtained by CTD and the AAs neither watched the filing of returns nor they undertook scrutiny of the returns filed by the dealers, the contract receipts escaped assessment from levy of tax. The amount of tax leviable, calculated at the rate of five *per cent* on 70 *per cent* of the contract receipts, after excluding 30 *per cent* towards labour and the amount of TDS already deducted by the works awarder worked out to ₹ 15.05 crore. Besides, penalty of ₹ 22.58 crore calculated at 150 *per cent* of the amount of tax was also leviable.

After we pointed this out (between April and July 2016), the AAs of 23[14] Assessment Circles issued notices in 84 out 442 cases between April and July 2016. Further action taken by the AAs after issue of notice and reply in respect of remaining cases was awaited (February 2017).

Government stated (December 2016) that the tax deduction authorities, *viz.*, work awarders had failed to deduct TDS as envisaged under Section 13 of the Act and that necessary instructions had been issued to take appropriate action as per the provisions of the TNVAT Act.

Reply was not acceptable as the audit observations were not regarding non-deduction of VAT-TDS by the work awarders. The audit observations related to (i) the failure of the CTD to instruct the work awarders to insist upon furnishing of TIN by the contractors before awarding contracts of work to them; and (ii) the failure of the AAs to watch the filing of returns and to undertake scrutiny of returns filed by the dealers. This resulted in contract receipts not being subjected to levy of tax under the TNVAT Act.

Recommendation 2: We recommend that the GoTN may make mandatory the furnishing of TIN by the contractors to the work awarders before awarding contracts of work to them. We further recommend that suitable instructions may be issued to the AAs to undertake scrutiny of the returns filed by the works contractors to avoid leakage of revenue.

2.4.4 Non-utilisation of data obtained from Service Tax Department

As per the Tamil Nadu Commercial Tax Manual (Volume III – Standing Order 225 c (iii) (2), the CTD is required to ensure co-ordination with other Departments / agencies to obtain information and make use of the same in detecting suppression and evasion of tax. The data relating to rebate claimed by the service providers of "works contract services" was obtained by BIU from the Service Tax Department and uploaded in intranet of the CTD for use by the AAs.

[14] Amaindakarai, Arisipalayam, Arumbakkam, Avanashi, Bazaar Street, Bhavani, Brough Road, Cuddalore (Town), Dr. Nanjappa Road, Ganapathy, K.K. Nagar, Koyambedu, Manali, MMDA Colony, Nanganallur, Perur, Purasawakkam, Saidapet, Salem Rural, Suramangalam, Tondiarpet, Villupuram-II and Virudhachalam

We noticed during scrutiny of records in 31[15] Assessment Circles that 40 works contractors, who had claimed rebate of ₹ 51.28 crore with the Service Tax Department towards cost of material during 2013-14, either did not file returns or filed 'Nil' returns / Annual return not involving tax liability. We further noticed that the RCs of seven works contractors were cancelled during or prior to 2013-14. The AAs neither watched the filing of returns nor did they undertake scrutiny of the returns filed by the dealers. Thus, the information uploaded in intranet of CTD was not utilised by the AAs. This resulted in the turnover of ₹ 51.28 crore escaping assessment and consequent non-levy of tax and penalty of ₹ 2.56 crore and ₹ 3.85 crore respectively in test checked Assessment Circles only.

After we pointed this out (between May 2016 and July 2016), the AA of Mettur Road Assessment Circle stated (July 2016) that the dealer had obtained RC only in August 2014 and action would be initiated after issue of notice to the dealer. The AAs of four[16] Assessment Circles issued notices to the dealers in four cases. Report regarding further action taken by the AAs after issue of notice and reply in respect of the remaining cases was awaited (February 2017).

Government stated (December 2016) that a proper system was put in place and the third party data uploaded in intranet was being utilised by the AAs. The Government, however, stated that the individual dealer specific observations would be processed by the AAs and replies would be furnished.

Thus, we observed that the data obtained by BIU was not utilised by the AAs in assessment process, which led to loss of revenue as indicated above. This indicated lack of monitoring system to ensure that the details uploaded in intranet by BIU were utilised by the AAs in the assessment process.

Recommendation 3: We recommend that an appropriate mechanism may be instituted by the Department to ensure utilisation of the data obtained by BIU by AAs while doing assessment work.

2.4.5 Deduction and remittance of VAT-TDS

As per Section 13 of the TNVAT Act, every person responsible for paying any sum to any dealer for execution of works contract shall, at the time of payment of such sum, deduct tax at source at the rate of two *per cent* in respect of civil works and civil maintenance works contract and at the rate of five *per cent* in respect of all other works contracts. As per the provisions of Section 13 of the TNVAT Act read with Rule 9 of the TNVAT Rules, no such deduction shall be made, where the dealer produces a certificate in Form-S from the AA concerned that he has no liability to pay or has paid the tax. Any person who fails to deduct VAT-TDS or fails to deposit the same, shall pay, in addition to

[15] Adyar, Alwarpet, Amaindakarai, Arni, Arumbakkam, Avarampalayam, Cuddalore (Taluk), Ganapathy, Gandhipuram, Kotturpuram, Mandaveli, Mettur Road, MMDA Colony, Mylapore, Nandanam, Pammal, Perur, Podanur, RS Puram (East), Royapettah, Royapuram, Salem Rural, Suramangalam, T. Nagar, Thiruvallikeni, Tiruvarur, Tondiarpet, Tuticorin-III, Velachery, Velandipalayam and Villupuram-II

[16] Arumbakkam, Cuddalore (Taluk), Ganapathy and Salem (Rural)

the amount required to be deducted and deposited, interest at one and a quarter *per cent* per month of such amount for the entire period of default.

We scrutinised the details of payments made by works awarders during the period 2012-13 to 2014-15 to the works contractors and also the remittances of VAT-TDS by the work awarders in the TDS Circle. We also obtained copies of Form-S certificates from the work awarders and cross verified the same with the records maintained in the Assessment Circles of the CTD. This audit exercise revealed the following deficiencies.

2.4.5.1 Non / short deduction of VAT-TDS

Scrutiny of records in test checked Assessment Circles revealed the following deficiencies in deduction of VAT-TDS in respect of payments made to works contractors.

Table 2.3: Non / short deduction of VAT-TDS

(₹ in crore)

Sl. No.	Nature of deficiency	Assessment circles	Number of work awarders	Year of payment	Payment made	Amount of VAT-TDS not deducted
1	Non-deduction of VAT-TDS despite non-production of Form-S Certificate	31[17]	273	2012-13 to 2014-15	271.85	9.70
Deduction of VAT-TDS in respect of dyeing contracts was not made on the basis of the letter issued by the CCT in November 2015 that where the cloth manufacturers were Proprietary concern, Partnership Firm and Hindu Undivided Family, VAT-TDS was not required to be insisted on payments made to dyeing contractors. The clarification was not in order as the term 'Person' mentioned in Section 13 is an inclusive definition. Deduction of VAT-TDS would not result in double taxation since VAT-TDS can be adjusted against the tax liability of the works contractor. The AAs of Avanashi, Sathy Road and Tiruppur Bazaar Assessment Circles issued (July 2016) notices to the dealers. Further action taken in this regard and reply in respect of the remaining cases was awaited (February 2017).						
Sl. No.	**Nature of deficiency**	**Assessment circles**	**Number of work awarders**	**Year of payment**	**Payment made**	**Amount of VAT-TDS not deducted**
2.	Non-deduction of VAT-TDS based on Form-S Certificates not issued to the works contractors	Nandanam	1	2012-13 to 2015-16	319.06	6.38
The work was awarded by NHAI to a Joint Venture (JV) firm. VAT-TDS was not deducted on the strength of Form-S certificate issued in favour of one of the constituent companies of the JV firm, which was not in order. After we pointed this out (May 2016), the AA replied that one of the constituent companies of the JV had executed the entire work and hence, the said dealer had obtained two Form-S certificates from the AA, Nandanam Assessment Circle for this work. The reply of the AA was not acceptable since the allotment of work and payments thereof were made to the JV firm. In the absence of Form-S certificate being furnished by the JV firm, VAT-TDS was required to be deducted. Further report was awaited (February 2017).						

[17] Avanashi, Arisipalayam, Avarampalayam, Bhavani, Brough Road, Chithode, Erode (Rural), Mannargudi, Mettur Road, Nethaji Road, Omalur, Palladam, Park Road, Peelamedu (North), Perundurai, Perur, Rasipuram, RS Puram (East), RS Puram (West), Saligramam, Sathy Road, Tiruppur (North), Tiruppur (Rural), Tiruppur (South), Tiruppur Bazaar, Tiruppur Central-I, Tiruppur Central-II, Tiruppur Kongu Nagar and Tiruppur Lakshmi Nagar

Sl. No.	Nature of deficiency	Assessment circles	Number of work awarders	Year of payment	Payment made	Amount of VAT-TDS not deducted
3.	Non-deduction of VAT-TDS based on invalid Form-S Certificate	Five[18]	6	2012-13 to 2014-15	696.96	13.94

The CCT had issued instructions in March 2011 that Form-S certificate shall be issued only for the contract specified and the Form-S certificate will be valid only for the financial year in which it was issued. In all the cases, Form-S did not pertain to the year during which payments were made to the contractors and therefore, the non-deduction of VAT-TDS on the basis of the said Form-S certificates was not in order.

After we pointed this out (between June and August 2016), the AA of LTU Assessment Circle stated (August 2016) that the turnover in respect of the contract covered by Form-S was already reported by the dealer and since the contract had already been completed, deduction of tax does not arise. The reply of the AA was not acceptable since the provisions governing deduction of VAT-TDS were different from the assessment procedure and the responsibility to deduct VAT-TDS lies with the work awarder. The AA of Guindy assessment circle issued (July 2016) notice to the work awarder. Further report regarding action taken after issue of notice and reply in respect of the remaining cases was awaited (February 2017).

Sl. No.	Nature of deficiency	Assessment circles	Number of work awarders	Year of payment	Payment made	Amount of VAT-TDS not deducted
4	Non-deduction of VAT-TDS on the payments made towards cost escalation	Mylapore Brough Road	2	2012-13 and 2013-14	7.43	0.34

The above payment was made towards cost escalation, which was not covered by the Form-S certificate since the cost escalation was decided at a later date.

After we pointed this out (May / July 2016), the AA of Brough Road Assessment Circle had issued notice to the dealer. Further action after issue of notice and reply in respect of the remaining case was awaited (February 2017).

Sl. No.	Nature of deficiency	Assessment circles	Number of work awarders	Year of payment	Payment made	Amount of VAT-TDS not deducted
5	Short deduction of VAT-TDS	Nine[19]	46	2012-13 to 2014-15	219.37	2.82

The rate of VAT-TDS in respect of "all other work contracts" was increased from four *per cent* to five *per cent* with effect from 10 March 2012. Scrutiny of the statement in Form-R filed by the work awarders in TDS Circle along with deposit of VAT-TDS and analysis of data obtained from various work awarders revealed that VAT-TDS was deducted at incorrect rates. In respect of four payments, the work awarders had erroneously deducted VAT-TDS at the rate of two *per cent* applicable to civil works contracts, though the contracts related to electrical works, for which deduction of VAT-TDS was required to be made at the rate of five *per cent*. In the other cases, VAT-TDS was deducted at four *per cent* instead of at five *per cent*.

After we pointed this out (between June and August 2016), the AA of Saidapet Assessment Circle reported collection of ₹ 0.42 lakh. Reply in respect of the other cases was awaited (February 2017).

Government stated (November 2016) that the failure on the part of the work awarders / tax deduction authorities to comply with the provisions of the TNVAT Act had resulted in the discrepancies. The reply was not acceptable

[18] Amaindakarai, Guindy, LTU-II, Mylapore and Namakkal (Town)

[19] Chintadripet, Nandambakkam, N.H.Road, Royapettah, Saidapet, Tallakulam, TDS Circle, T.Nagar and West Veli Street Circle

as the department should have instituted a requisite system to monitor and ensure due adherence to the provisions of the TNVAT Act by the work awarders / tax deduction authorities as regards deduction and deposit of VAT-TDS.

Recommendation 4: The audit observation regarding non / short deduction of VAT-TDS is only in respect of test checked circles. We, therefore, recommend that the Department may take necessary steps to ensure due adherence to the provisions regarding deduction of VAT-TDS in all the 336 Assessment Circles.

2.4.5.2 Absence of system to verify the genuineness of Form-S

We observed that based on Form-S certificates produced by the contractors for ₹ 3,070.77 crore, deduction of VAT-TDS of ₹ 25.34 crore was not made by the work awarders in respect of payments of ₹ 1,266.79 crore made by them during the period from 2012-13 to 2014-15. We, however, noticed that entries for issue of the said Form-S certificates were not available in the registers maintained in five[20] Assessment Circles concerned. Further, scrutiny of registers maintained in the Deputy Commissioner's offices concerned also revealed absence of entries therein for having recommended the issue of Form-S certificates.

After we pointed this out (between April 2016 and September 2016), the AAs of three[21] Assessment Circles replied that 12 Form-S certificates for ₹ 452.44 crore produced by four dealers had not been issued by the Assessment Circles. The AAs further stated that the work awarders had been requested to take further action. The AA, Royapettah Assessment Circle stated (July 2016) that the authenticity of Forms would be verified. Based on these certificates, VAT-TDS of ₹ 5.67 crore was not deducted by the work awarders in respect of payment of ₹ 283.25 crore made by them during 2012-13 to 2015-16. Reply from the other AAs was awaited (February 2017).

The above cases indicated the absence of a system to verify the genuineness of the Form-S certificates.

The Government, during Exit Conference stated that necessary action for filing of bogus Form-S would be taken after obtaining a report from the field offices. Based on the audit observation, notices were issued by the AAs of Brough Road and Erode (Rural) Assessment Circles to the works contractors; to which the works contractors have replied that the sales tax consultants engaged by them were responsible for the filing of bogus Form-S. Since these consultants had expired, further progress on the police complaint registered by the works contractors was not feasible. The AAs had issued notices calling for production of accounts by the works contractors to ensure the proper accounting of contract receipts. Further report in this regard was awaited (February 2017).

[20] Amaindakarai, Brough Road, Erode (Rural), Omalur and Royapettah

[21] Brough Road, Erode (Rural) and Royapettah

Recommendation 5: We recommend that action may be taken in all cases to ascertain the genuineness of Form-S certificates and also to ensure that the contract receipts covered by the Form-S certificates were duly reported by the contractors in the monthly returns filed by them with CTD and do not escape assessment from levy of tax.

2.4.5.3 Failure to follow prescribed procedures in issue of Form-S

The CCT had instructed (March 2011) that application for issue of Form-S shall be entered in a common register maintained by the Head of the Assessment Circle. The AA, after making necessary checks and if satisfied that Form-S can be granted, shall send the same to the Deputy Commissioner (CT) concerned for approval. Form-S shall be issued only on receipt of approval of the Deputy Commissioner. A register shall also be maintained by the Deputy Commissioner in the prescribed format.

We examined the extent of adherence to the procedures prescribed for issue of Form-S certificate and observed the following.

- Form-S issue register and Form-S approval register were not maintained in four[22] Assessment Circles of Coimbatore division and in the offices of the Territorial Deputy Commissioners respectively. Further, entries for issue of eight Form-S for ₹ 2.77 crore were not available in the registers maintained in four[23] Assessment Circles. Hence, the genuineness of 19 Form-S certificates for ₹ 21.69 crore furnished to work awarders by the contractors of the Assessment Circles concerned could not be ensured.

- The Form-S approval register in the office of the Deputy Commissioner (CT) Namakkal did not contain entries for having accorded approval for issue of seven Form-S certificates for ₹ 3.19 crore by the AAs of Attur (Rural) and Omalur Assessment Circle.

- The Form-S approval register of Deputy Commissioner (CT) Namakkal for the period from April 2012 to December 2013 was not produced. We therefore, could not ascertain the adherence to the procedure of obtaining prior approval of Deputy Commissioner before issue of Form-S by the AA of Tiruchengode (Rural) Assessment Circle in respect of 14 Form-S certificates for ₹ 55.23 crore issued during 2012-13 and 2013-14.

2.4.5.4 Follow up of Form-S certificates issued to works contractors

The CCT instructed in March 2011 that the utilisation of Form-S certificates by the applicant must be verified immediately by the AA and doubtful cases should be communicated to the Enforcement Wing for investigation. If any dealer fails to submit monthly returns after issue of Form-S certificate, then the AA shall take immediate action to cancel the Form-S and inform the same to the concerned work awarder to recover VAT-TDS for the entire contract value from the payments to be made.

We observed as under as a result of examination of records:-

---

[22] Dr. Nanjappa Road, Ganapathy, Gandhipuram and Thudiyalur

[23] Arisipalayam, Namakkal (Rural), Omalur and Rasipuram

- In three[24] Assessment Circles, 12 works contractors, who were issued 13 Form-S certificates for ₹ 44.98 crore during 2010-11 to 2014-15 had either not filed return or had filed 'Nil' return. The works contractors had received ₹ 9.45 crore during 2012-13 to 2014-15 without deduction of VAT-TDS. The AAs failed to watch the utilisation of Form-S Certificates. Thus, non-adherence to the instructions regarding watching the utilisation of Form-S by the AAs and failure to refer cases of non-filing of return and filing of 'Nil' return to the Enforcement wing for investigation resulted in contract receipts escaping assessment from levy of tax. Tax and penalty leviable on the contract receipts not disclosed to CTD works out to ₹ 33.07 lakh and ₹ 49.61 lakh respectively.

We pointed this out in May / June 2016. Reply was awaited (February 2017).

- In Erode (Rural) Assessment Circle, the RCs of three contractors, who had obtained Form-S certificates for ₹ 6.20 crore were cancelled subsequently due to non-filing of returns. Thirty one works contractors, who had not filed monthly returns during the year 2012-13 were issued Form-S certificates for ₹ 21.63 crore. A contractor, who had filed 'Nil' return during 2014-15 was issued Form-S certificate for ₹ 74.89 lakh on 31 March 2015.

After we pointed this out (July 2016), the AA replied (July 2016) that notices would be issued to the dealers. Report regarding further action taken after issue of notice was awaited (February 2017).

Government stated (November 2016) that there existed proper mechanism in the department for issue of Form-S certificate and Form-S was issued after obtaining proper approval of the Territorial Deputy Commissioners and a register was also being maintained in this regard. The reply was not acceptable as we found out that the prescribed registers were not maintained in four[25] Assessment Circles. The audit observations also indicated non-adherence to procedures prescribed for issue of Form-S certificate.

Recommendation 6: We recommend strict adherence to the prescribed procedures for issue of Form-S and the follow up action which was required to be taken after issue of Form-S to prevent leakage of revenue to Government. We also recommend that as in the case of furnishing of Form-R and Form-T in proof of deduction of tax, the work awarders may also be required to furnish to the AAs concerned, details of Form-S produced by the contractors, so that the genuineness of the said certificates can be ensured by the AAs with reference to the registers maintained by them.

2.4.5.5 Irregular remittance of VAT-TDS

As per Section 13(2) of the TNVAT Act read with Rule 9(1) of the TNVAT Rules, the amount of VAT-TDS shall be deposited with the AA having jurisdiction over the person or to any other authority authorised to receive such payment on or before the 20th day of the succeeding month in which the deduction was made with a statement in Form-R. Section 13(5) of the

[24] Madurantakam, Omalur and Royapettah

[25] Dr. Nanjappa Road, Ganapathy, Gandhipuram and Thudiyalur

TNVAT Act provides that default in deposit of VAT-TDS shall attract interest at one and a quarter *per cent* per month of such amount for the entire period of default.

We observed delay in remittances of VAT-TDS by the Municipal Corporations of Salem, Erode and Madurai. VAT-TDS of ₹ 4.31 crore pertaining to the period from April 2012 to December 2013 was deposited by Municipal Corporation of Madurai with delay ranging from one day to 363 days. The belated deposit of VAT-TDS attracted payment of interest of ₹ 13.95 lakh, which was required to be collected from the Municipal Corporation of Madurai.

After we pointed this out during April / May 2016, the AAs of the concerned Assessment Circles promised to initiate action for ensuring timely deposit of VAT-TDS and for levy of interest in respect of belated deposit of VAT-TDS. Further report was awaited (February 2017).

This indicated that timely deposit of VAT-TDS by the work awarders was not being monitored by the AAs with whom such deposits were required to be made.

Government admitted (November 2016) that the lapses were due to failure on the part of work awarders / tax deduction authorities to comply with the statutory provisions regarding deposit of VAT-TDS.

The reply of the Government was not acceptable as the Department should have ensured compliance to provisions of the TNVAT Act and should have taken action for levy of interest prescribed under Section 13 (5) of the TNVAT Act in cases, where there was delay in remittance of VAT-TDS.

2.4.6 Statement in Form-R and Certificate in Form-T

As per Section 13(2) of the TNVAT Act read with Rule 9(1) of the TNVAT Rules, any person making deduction of VAT-TDS under Section 13 of the Act, shall deposit the sum so deducted to the AA having jurisdiction over the person authorised to receive such payment, on or before the 20th day of the succeeding month in which the deduction was made along with a statement in Form-R. The person, shall, within fifteen days of such deposit, issue to the said dealer, a certificate in Form-T for each deduction separately, and send a copy of the certificate of deduction to the AA having jurisdiction over the said dealer.

We observed the following deficiencies relating to submission of Form-R / Form-T.

- State Government Departments, which remit VAT-TDS by way of book adjustment were neither submitting the statement in Form-R nor were sending a copy of the certificate in Form-T to the AA concerned. Thus, in the absence of Form-R and Form-T, the adjustment of credit claimed by the works contractors in the monthly returns, against the tax liability of the contractors by the AAs was not in accordance with the provisions of Section 13(4) of the TNVAT Act, which provide that the AA, shall, on receipt of the certificate of

deduction in Form-T, adjust the amount deposited towards the tax liability of the dealer.

- Since the functioning of TDS circle was yet to be computerised, the circle maintains records manually. Although it was stated that TDS particulars were intimated to the Assessment Circles concerned in which the contractors were registered through territorial Joint Commissioners, this aspect could not be verified in the absence of relevant records. The CCT observed in November 2014 that there was huge pendency in transfer of credits by TDS circle to the Assessment Circles concerned and stressed that steps should be taken immediately to transfer pending credits then and there.

- The statement in Form-R mentioned in Rule 9(1) of the TNVAT Rules specifies that the same should, *inter-alia*, contain details of name, complete address of the registered place of business / residence, assessment year, TIN / PAN of the dealer. We noticed that statements in Form-R involving payment of ₹ 93.76 crore made by 122 work awarders were retained in the TDS circle. These statements suffered from deficiencies like absence of PAN / mentioning of incorrect PAN, absence of TIN, absence of name and address of the contractor, etc. Thus, they were not forwarded to the Assessment Circles. We also noticed that Nandambakkam and Royapettah Assessment Circles, which had received deposit of VAT-TDS from two work awarders did not send the details to the Assessment Circles of the contractors. After we pointed this out (April 2016) the AA of Royapettah Assessment Circle stated that the instructions relating to transfer of returns / statements would be adhered to in future. Reply from AA of Nandambakkam Assessment Circle was awaited (February 2017).

Government stated (November 2016) that the lapses were due to failure on the part of work awarders / tax deduction authorities in not furnishing the details of tax deductions, contractor-wise in Form-Rs and individual Form-Ts. The reply was not acceptable as the work awarders are governed by the provisions of the TNVAT Act and the Department should have taken steps to ensure due compliance to the statutory provisions.

Recommendation 7: We recommend that responsibility may be fixed on part of work awarders / tax deduction authorities who fail to furnish the details of tax deduction to the Assessment Circles concerned. We further recommend that the Department may take steps to ensure that the details of Form-R are communicated to the Assessment Circles concerned, so that the AAs may utilise the same in the assessment of works contractors falling within their jurisdiction.

2.4.7 Role of jurisdictional Assessment Circles

2.4.7.1 Identification of works contractors by conducting survey

We sought details from the office of the CCT of the measures taken to identify unregistered works contractors and to bring them into the tax net. The Department stated that detailed instructions had been issued in November 2014 and street survey was being periodically done by circle officers and unregistered works contractors are brought under tax net. On a scrutiny of the registers maintained in the Assessment Circles, we, however, observed that no

works contractors were identified during the surveys in six[26] Assessment Circles.

Government stated (November 2016) that instructions were issued reiterating that street surveys should be conducted periodically to identify prospective works contractors.

2.4.7.2 Scrutiny of returns by the AAs

The CCT had issued instructions in November 2014 that all works contract dealers shall be subject to detailed scrutiny of accounts without omission, once a year. It was emphasised to obtain the full list of works contract activities carried out by the works contractors, to conduct input-output analysis and to carry out expenditure scrutiny. It was also emphasised to carry out various checks relating to deduction of TDS and issue of Form-S certificates. However, the AAs of 15[27] Assessment Circles replied that scrutiny of returns was not conducted in respect of works contractors. Reply from the remaining Assessment Circles was awaited (February 2017).

Independent scrutiny of returns by audit revealed the following deficiencies.

Incorrect adjustment of TDS credit

As per Section 13(4) of the TNVAT Act, the AA, shall, on receipt of the certificate of deduction in Form-T, adjust the amount deposited towards the tax liability of the dealer.

We noticed that 58 dealers assessed in six Assessment Circles, had adjusted ₹ 5.89 crore towards VAT-TDS in the monthly returns relating to the years 2012-13 to 2014-15. Verification of assessment records revealed that the dealers had not enclosed corresponding Form-T certificates in support of their claim. We ascertained that the Assessment Circles had not received any Form-T certificates from the work awarders and had also not received the statement in Form-R from the respective Assessment Circles, where the VAT-TDS had been deposited. Further, no correspondence had been sent from these Assessment Circles calling for the TDS credit particulars.

Thus, the credit claimed by the dealers towards VAT-TDS was allowed by the AAs without verification of remittance of TDS into Government Account, which is in violation of the provisions of Section 13(4) of the TNVAT Act.

Recommendation 8: We recommend that the Department may take necessary action to enforce production of Form-T by the dealers as proof for adjustment of TDS. We further recommend that instructions may be issued to AAs that adjustment of VAT-TDS against the tax liability of the dealer shall be made only on the furnishing of Form-T by the dealer along with the monthly return.

---

[26] Erode (Rural), Omalur, Perur, Royapettah, Tallakulam and Velachery

[27] Kongu Nagar, Madipakkam, Medavakkam, N.H.Road, Coimbatore, Palladam, Podanur, Singanallur, Tiruppur Central-I, Tiruppur Central-II, Tiruppur Lakshmi Nagar, Tiruppur (North), Tiruppur (Rural), Tiruppur (South), Trichy Road and Velandipalayam

Non / short levy of Purchase tax

As per Section 12 of the TNVAT Act, every dealer, who in the course of his business purchases from a registered dealer or for any other person, any goods (the sale or purchase of which is liable to tax under the Act) in circumstances in which no tax was payable by the registered dealer on the sale price of such goods under this Act and consumes or uses such goods in or for the manufacture of other goods for sale, shall pay tax on the turnover relating to the purchase at the rate specified in the schedule to the Act. The CCT had clarified in December 2013 that purchase of raw materials such as blue metal, sand and bricks from unregistered dealers and use in works contract would attract levy of purchase tax.

During scrutiny of records in three[28] Assessment Circles, we noticed that 24 dealers had purchased bricks, blue metal, steel, timber, cement, etc. from unregistered dealers during the years 2012-13 to 2014-15 and used the same in civil works contracts. These goods were purchased without payment of tax and were utilised in the execution of works contracts. The purchase of commodities for ₹ 219.81 crore without payment of tax and their use in civil works contract attracted levy of purchase tax of ₹ 10.71 crore. The AAs, however, levied purchase tax of ₹ 5.90 lakh. Thus, the AAs failed to enforce the provisions of Section 12 of the TNVAT Act regarding levy of purchase tax, resulting in short realisation of tax of ₹ 10.65 crore.

After we pointed this out (between April and June 2016), the AAs of Brough Road and Erode (Rural) Assessment Circles replied that the deemed sale turnover includes the purchase turnover of goods effected from unregistered sources. The reply was not acceptable since levy of purchase tax is governed by Section 12 and levy of tax on deemed sale value of material is governed by Section 5 of TNVAT Act. Reply in respect of the remaining cases was awaited (February 2017).

Recommendation 9: We recommend that instructions may be issued to the AAs to ensure strict adherence to the provisions of the TNVAT Act regarding levy of purchase tax, so that any lapse on the part of the AAs does not result in loss of revenue to Government Exchequer.

Short payment of tax

Under the TNVAT Act, tax in respect of works contract can be paid either on the transfer of goods involved in the execution of works contract at the rates applicable to such goods or at compounded rates of two or five *per cent* on the total value of works contract executed by a dealer in a year. The option to pay tax at compounded rate is subject to the condition that the dealer does not purchase goods from interstate.

During check of records in 19[29] Assessment Circles we noticed that 21 contractors had effected purchase of goods from interstate and utilised the

[28] Brough Road, Erode (Rural) and Tallakulam

[29] Adyar, Amaindakarai, Avarampalayam, Ganapathy, Gandhipuram, Mandaveli, Mylapore, Nandanam, Podanur, Pondy Bazaar, RS Puram (East), Saidapet, Saligramam, Surappattu, T. Nagar, Thiruvallikeni, Thudiyalur, Velandipalayam and Velachery

same in works contract during the years 2012-13 to 2014-15. Since the dealers had utilised goods from interstate in the execution of works, they were not eligible for payment of tax at compounded rate. Though the details regarding interstate purchase were available in intranet of CTD, the AAs failed to utilise the information and ensure due adherence to the provisions of the Act. The amount of tax which was payable by the dealers on the contract receipts of ₹ 76.60 crore, after allowing deduction of 30 *per cent* towards labour charges from the contract receipts and adopting the minimum rate of tax of five *per cent* worked out to ₹ 2.68 crore. The dealers, however, had paid tax of ₹ 1.20 crore. Thus, there was short payment of tax of ₹ 1.48 crore.

We pointed this out to the department between May and July 2016. Reply was awaited (February 2017).

Recommendation 10: We recommend that the AAs may be instructed to make use of available information to ensure due adherence to the provisions of the Act regarding payment of tax at concessional rate by the works contractors.

Short levy of penalty

As per Section 27(3)(c) of the TNVAT Act, the AA may, if it is satisfied that the escape from assessment is due to wilful non-disclosure of assessable turnover by the dealer, direct the dealer, to pay, in addition to the tax assessed on the turnover which had escaped assessment, by way of penalty, a sum which shall be one hundred and fifty *per cent* of the tax due on the assessable turnover that was wilfully not disclosed, if the tax due on such turnover is more than fifty *per cent* of the tax paid as per the return.

We noticed that the assessment of a dealer for the year 2012-13 was revised by the AA of T.Nagar (East) Assessment Circle in April 2014 based on the proposals received from the Enforcement Wing of the CTD. The proposals involved levy of tax of ₹ 2.16 crore, calculated at the rate of 14.5 *per cent* on the deemed sale value of goods of ₹ 14.87 crore pertaining to non-disclosure of interstate purchase of goods by the dealer. The dealer was assessed to tax of ₹ 1.77 crore as per the original deemed assessment. The tax due on the suppressed turnover was more than fifty *per cent* of the tax paid as per return and therefore, penalty was leviable at the rate of 150 *per cent* of such tax. However, penalty was levied at the rate of 50 *per cent* of such tax. This had resulted in short levy of penalty of ₹ 2.16 crore.

We pointed this out to the department in June 2016. Reply was awaited (February 2017).

Non-reversal of Input Tax Credit

As per Section 19(2)(i)of the TNVAT Act, input tax credit (ITC) shall be allowed for the purchase of goods made within the State from a registered dealer, for the purpose of use as inputs in manufacturing or processing of goods in the State. As per Section 19(5), no ITC shall be allowed in respect of exempted sales under Section 15. As per Section 19(8) of the TNVAT Act, no ITC shall be allowed to any registered dealer in respect of any goods purchased by him for sale, but given away by him by way of free samples or

goods consumed for personal use. The CCT had clarified in March 2011 that any dealer, who pays tax under Section 5 of TNVAT Act shall be eligible for exemption under Section 15 on the deemed sale of goods to Special Economic Zones (SEZ). Hence, the corresponding ITC shall be reversed.

- In Velachery Assessment Circle, though a dealer had effected sale of goods to developers of SEZ for ₹ 8.83 crore during the years 2012-13 to 2014-15, the corresponding ITC of ₹ 62.24 lakh was not reversed.

- Two works contractors of Erode (Rural) Assessment Circle, who claimed ITC of ₹ 23.25 crore, had utilised the goods for construction of temporary sheds at works sites for self-use. The proportionate ITC of ₹ 11.07 lakh attributable to such use of goods was not reversed. A works contractor, who claimed ITC of ₹ 9.80 lakh during the years 2012-13 to 2014-15 on purchase of goods had utilised the same for contract work executed in other country. Thus, ITC of ₹ 9.80 lakh was required to be reversed.

We pointed this out to the department in June 2016. Reply was awaited (February 2017).

Incorrect computation of taxable turnover

As per Section 5 of the TNVAT Act, every dealer shall pay, for each year, a tax on his taxable turnover, relating to his business of transfer of property in goods involved in the execution of works contract, either in the same form or some other form, which may be arrived at in such manner as may be prescribed, at such rates as specified in the First Schedule.

Scrutiny of the statement of audited accounts in Form-WW filed by a dealer of Erode (Rural) Assessment Circle for the years 2012-13 to 2014-15 revealed that the dealer had paid tax on the deemed sale value of materials involved in the execution of works contract by adoption of the uniform profit margin of 15 *per cent*. Verification of the Annual Accounts, however, revealed that the profit margin was higher than 15 *per cent* during those years. Thus, the failure to adopt the correct profit margin while arriving at the deemed sale value of goods for the purpose of payment of tax resulted in incorrect computation of taxable turnover and resultant short payment of tax of ₹ 7.91 lakh.

We pointed this out to the department in June 2016. Reply was awaited (February 2017).

Thus, there were inadequacies in the system of scrutiny of returns due to which many incorrect / incomplete returns escaped assessment.

Recommendation 11: The Department may take necessary action to enforce proper scrutiny of returns by the AAs so as to avoid loss of revenue due to filing of incorrect / incomplete returns by the works contractors.

2.4.8 Conclusion

Audit of 'Assessment, levy and collection of Value Added Tax on transfer of goods involved in the execution of works contract' indicated that (i) the failure of CTD to institute a well established system of inter-departmental collection of data and (ii) the failure of the AAs to make use of the available information, resulted in not only contractors being out of the tax base but also the receipts

of contractors having escaped assessment. Absence of mechanism to verify the genuineness of Form-S certificate filed by the dealers was also observed. The correctness of the amount of VAT-TDS claimed by the dealers in the monthly returns was not susceptible of verification due to failure to forward the statement of deduction in Form-R and certificate in Form-T to the AAs of the concerned Assessment Circles. The failure of the AAs to conduct scrutiny of returns had resulted in underassessment of tax. Our audit exercise revealed that transactions involving tax including penalty amounting to ₹ 118.72 crore had escaped assessment.

2.5 Audit of 'Tax Exemption to Industries'

2.5.1 Introduction

Government of Tamil Nadu (GoTN) has been evolving industrial policies with a view to promote industries, thereby to increase investment and employment generation. The liberalised scheme of grant of deferral or waiver of sales tax introduced in the year 1990 in respect of new industries set up in most backward taluks of the State was later extended (1992) to other areas of the State with emphasis being on the amount of investment. The offer of new incentive based on sales tax for industries was discontinued with effect from 23 January 2000, except for industries in pipe line. With the introduction of New Industrial Policy (NIP) in the year 2003 and 2007, the concept of structured package of assistance (SPA) encompassing tax incentives, capital subsidies, etc. was offered to investors based on the scale of investment. State Industries Promotion Corporation of Tamil Nadu Limited (SIPCOT) acts as a nodal agency of the State Government for implementing and monitoring the SPA scheme.

The investors apply to GoTN along with a proposal for setting up industries in Tamil Nadu. After scrutiny of the proposal, if required, Memorandum of understanding (MoU) is entered into, between the Company and the Government, and the Government issues Order (GO) incorporating the conditions of the MoU including the tax exemption / deferral by way of SPA, viz., industrial promotion subsidy (IPS) or soft loan (SL). On making necessary investments in eligible fixed assets[30] (EFA) as prescribed in the GO, and as soon as the project is ready to commence commercial production, the Company submits the application for SPA to SIPCOT. SIPCOT issues the eligibility certificate (EC) to the Company for disbursement of IPS or SL, after being satisfied about the investments made by the Company by undertaking necessary checks including inspection of the premises to physically verify the assets. The EC specifies the conditions governing the grant of IPS / SL, the time period for grant of incentives and the maximum eligible amount of IPS / SL. The Company pays tax on sales every month along with the monthly returns submitted to the jurisdictional Assessment Circle of the Commercial Taxes Department (CTD). The MoU Cell of the CTD headed by a Joint Commissioner (CT), which is established in SIPCOT, upon receipt of details of tax paid by the Company from the assessing authority (AA) of the concerned Assessment Circle of CTD, issues tax payment certificate / tax certificate (TC) to SIPCOT for disbursement of IPS / SL.

Audit was conducted to ascertain (i) the correctness and timeliness of repayment of deferred tax; (ii) the correctness of the issue of EC by SIPCOT in respect of companies, which had applied for SPA; (iii) the correctness of the issue of TC by MoU Cell of CTD; and, (iv) the adequacy of the internal control and monitoring mechanism.

[30] Eligible fixed assets include building, machinery related to production, research and development, training, testing and quality control.

We covered the activities of Industries Department, SIPCOT and CTD (MoU Cell and concerned Assessment Circles), relating to tax exemption extended to industries (covering the present and previous scenario) during the years 2012-13 to 2014-15. Further, wherever necessary, the transactions relating to previous years were also covered in order to provide context and extent of non-compliance.

Audit Findings

Deferral cases under erstwhile Tamil Nadu General Sales Tax Act

2.5.2 Failure to comply with the provisions of GO (Ms) No.80

The Industries Department, GoTN issued an Order in March 2008 that in order to make the existing schemes of incentives to industries compatible with Value added tax (VAT) regime, wherever the Unit was availing deferral, the Unit would be required to pay the tax amount to CTD and upon such payment, the Unit would be paid investment promotion soft loan equivalent to the amount of VAT paid. The payment of soft loan was required to be made from the budget of the Industries Department on receipt of necessary certificates of payment of tax from the MoU Cell of CTD. The soft loan carried a nominal interest rate of 0.1 *per cent* per annum.

During scrutiny of deferral registers in seven Assessment Circles[31], we observed that six dealers continued to avail the facility of deferred tax, though the GO issued by the Industries Department provided that subsequent to introduction of VAT in the State, tax was required to be paid by the units to CTD and after the collection of the amount, such tax was to be given as soft loan from the Industries Department. The failure of the CTD to implement the GO issued by the Industries Department resulted in non-realisation of deferred tax of ₹ 1,637.61 crore relating to the period from January 2007 to September 2013 as mentioned in **Annexure 2** from the units and to give soft loan to them.

After the matter was referred to the Government (October 2016), Government stated (December 2016) as follows:

(i) As per Section 32 of the TNVAT Act, the Government could defer the payment of tax by an industrial unit in pipeline. Thus, the industries which were availing deferral under the erstwhile Tamil Nadu General Sales Tax Act (TNGST Act) were automatically eligible for deferral.

(ii) The facility of deferred tax was extended to the dealer as per the provisions of the Section 17-A of TNGST Act and as per the MoU signed between the Government and the dealer and hence, cannot be curtailed.

(iii) The Government had committed to extend interest free loan, based on which, the dealer had established the manufacturing unit in the State. Therefore, the same cannot be converted as loan with interest.

[31] Karur (East), Mettupalayam Road, LTU-I, LTU-II, LTU-IV, Sriperumbudur and Thudiyalur. One dealer was assessed in Sriperumbudur upto 2010-11 and at LTU-IV since then.

(iv) No GO was issued by the CTD in this regard. Further, no instructions / notification were issued regarding the industries, who were availing deferral in the erstwhile Interest free sales tax scheme under TNGST Act and were still continuing the facility under VAT regime.

The reply was not acceptable for the following reasons.

(i) The decision to convert deferral into soft loan with nominal interest of 0.1 *per cent* per annum was taken to make the then existing scheme of incentives to the industries compatible with VAT regime.

(ii) The GO was issued by the Industries Department after due consultation with CTD, which had also concurred to the conversion of the amount of deferred taxes into soft loan. The GO issued by the Industries Department in January 2009 prescribing the guidelines for implementation of Structured Package of Assistance also contained a provision that the unit availing deferral would be paid industry promotion soft loan equivalent to the amount of value added tax paid by it. But VAT amounting to ₹ 1,637.61 crore was not collected by the CTD and consequently soft loan was not given to the said units.

(iii) The grant of incentives is always governed by GOs issued by the Industries Department. Hence, separate issue of GO by CTD was not warranted**.** Moreover, in the case of a dealer, who was availing waiver under the TNGST Act, instructions were issued to the Commissioner of Commercial Taxes (CCT) to scrupulously follow the GO issued by the Industries Department while refunding the sales tax collected and paid by the dealer for the unexpired period of waiver from 1 January 2007 to 31 August 2007.

Further, the reply furnished by the Government was only an afterthought for having failed to implement the GO issued by the Industries Department as the reasons specified therein were existing even as of March 2008 when the GO was issued by the Industries Department. The Secretary to the CTD had then concurred to the arrangement for payment of deferred tax and obtaining the same as soft loan from the Industries Department.

SPA in present scenario

2.5.3 Incorrect fixation of base sale volume

The guidelines issued by the Industries Department in January 2009 for implementation of SPA under NIP 2007 provide that an expansion project would be eligible for incentive only after achieving Base Production Volume (BPV) and for sales taking place from the expansion unit in excess of the Base Sales Volume (BSV). BPV represents the average of production from the existing units in the State during the last three financial years immediately before the commencement of commercial production or the capacity of existing units, whichever is higher. BSV is the average sales made during the last three financial years, preceding the date of commercial production of the expansion unit.

During scrutiny of files relating to the issue of EC by SIPCOT, we observed (February / March 2016) that in six cases, the fixation of BSV was made in terms of value instead of in volume, though in the case of expansion undertaken by Saint Gobain Glass India Limited and Hyundai Motor India Limited, BSV was fixed on the basis of on quantity / volume of sales.

Scrutiny of data relating to wholesale price index of commodities published by Office of the Economic Adviser, Department of Industrial Policy & Promotion, Government of India, Ministry of Commerce & Industry indicated that as of March 2016, the price of commodities dealt with by the dealers had registered an increase ranging from 17 to 61 *per cent* since the issue of GO granting incentives to the dealers. As increase in prices of commodities results in achievement of BSV upon lesser quantum of sale of goods, we suggested that quantity based BSV would be the correct adoption than the value based adoption, in order to protect the past revenue of the Government.

During Exit Conference, the Principal Secretary to Government, Industries Department stated that after examining the implication of fixation of BSV in terms of value in respect of two cases, suitable amendment to GO to provide for fixation of BSV in terms of quantity in respect of future cases would be considered. Further report was awaited (February 2017).

Recommendation 1: We recommend that decision regarding fixation of BSV in terms of quantity may be taken at the earliest to protect the past revenue of the Government, taking into consideration the increase in prices of commodities.

2.5.4 Disbursement of soft loan without fulfillment of conditions of Government Order

The guidelines issued by the Industries Department under NIP 2003 and NIP 2007 prescribed that SIPCOT shall be the implementing and monitoring agency for sanction of structured package of assistance to the industries. The guidelines further prescribed that SIPCOT has to ensure fulfillment of investment obligation prescribed in the GO governing grant of incentives before issue of eligibility certificate. At the end of the investment period, SIPCOT was required to make assessment of the fulfillment of all the obligations of the investing company and in case, all the obligations have not been fulfilled, the structured package would be made inoperative and a report sent to the Government immediately.

As per para 72(b)(ii) under Chapter VI of the Secretariat Office Manual, amendment / modification to a GO is to be issued as a GO. We, however, observed that in the following two cases, the quantum of investment specified in the GO was subsequently reduced through issue of clarification / letter. This was not in order as the Tamil Nadu Secretariat Manual provides that any amendment or modification to a GO is to be issued in the form of GO and it has to be issued by an officer not below the designation of the officer by whom the original order was issued.

- By an Order issued by the Industries Department in March 2006, SPA was sanctioned to TVS Motors Company Limited under NIP 2003 upon investment of ₹ 309 crore being made over a period of three years. Though SIPCOT determined the investment in EFA as ₹ 196.36 crore, based on letter of the Principal Secretary to Government, Industries Department clarifying (February 2011) that the total investment of ₹ 309 crore may be taken into account but the amount of soft loan may be restricted to 80 *per cent* of the investment in EFA, SIPCOT issued (March 2011) amended EC for issue of soft loan of ₹ 157.08 crore.

We noticed that entire soft loan of ₹ 157.08 crore was disbursed to the Company upto February 2015 though the investment in EFA was less than the prescribed amount of ₹ 309 crore.

- By an Order issued in October 2008, the Industries Department sanctioned SPA to Madras Cement Limited upon investment of ₹ 997 crore being made in EFA. Subsequently, based on a representation made by the Company that the expanded scope of project resulted in increase of project cost, Government, by an Order issued in February 2011, modified the investment to ₹ 1,090 crore. Though SIPCOT determined the investment made in EFA as ₹ 1,040.54 crore, which was below the prescribed investment obligation of ₹ 1,090 crore, based on clarification issued by the Principal Secretary, Industries Department that the investment obligation shall be taken as ₹ 997 crore, EC was issued by SIPCOT on 22 November 2012 for grant of soft loan of ₹ 832.43 crore to the Company.

We noticed that soft loan of ₹ 129.37 crore relating to the period 2009-10 to 2014-15 was disbursed to the company during January 2013 to August 2015 though the investment in EFA was less than the obligation prescribed in the GO issued in February 2011.

After we pointed this out in March 2016, SIPCOT replied (June 2016) that the action of SIPCOT was as per the direction of the Government. The Additional Chief Secretary to Government, Industries Department replied (June 2016) that the letter was only a clarification to the earlier GO. The reply was not acceptable as the Tamil Nadu Secretariat Manual prescribes that any amendment or modification to a GO is to be issued in the form of GO and by an officer not below the designation of the officer by whom the original order was issued. In the above two cases, the said procedure was not followed and quantum of investment contained in the GO was reduced on the basis of clarification issued by the Secretary, Industries Department.

Recommendation 2: We recommend that the instructions contained in the GO governing grant of SPA may be followed and any relaxation of conditions contained therein, if required, be made by following the procedure prescribed in the Tamil Nadu Secretariat Manual.

2.5.5 Issue of Tax certificate by MoU Cell

2.5.5.1 Incorrect determination of achievement of Base Volumes resulted in issue of TC for excess amount

The guidelines issued by the Industries Department in January 2009 for implementation of SPA under NIP 2007 provide that an expansion project would be eligible for incentive only after achieving Base Production Volume (BPV) and for sales taking place from the expansion unit in excess of the Base Sales Volume (BSV). BPV represents the average of production from the existing units in the State during the last three financial years immediately before the commencement of commercial production or the capacity of existing units, whichever is higher. BSV is the average sales made during the last three financial years, preceding the date of commercial production of the expansion unit.

On a scrutiny of the TCs issued by MoU Cell based on the tax payment details furnished by the AAs, we observed that in order to determine the month of achievement of BPV and BSV, the Department had first considered the entire production / sales of the existing unit, to which the production / sales of the expansion unit were added, instead of simultaneously considering the production / sales of the existing and expansion unit every month. Due to the incorrect method adopted by the Department, BPV / BSV was determined as having been achieved earlier and incentives were granted to the units, though the actual achievement was registered later. An illustrative case of Bannariamman Spinning Mills Limited is mentioned below**:**

Table 2.4: Determination of achievement of BPV

Base production volume – 57,37,433 kgs

Month	Production in existing unit	Production in expansion unit	Total production	Total cumulative production
	(in kgs)			
April 2008	4,37,949	10,02,121	14,40,070	14,40,070
May 2008	4,77,827	11,09,599	15,87,426	30,27,496
June 2008	4,79,586	10,30,790	15,10,376	45,37,872
July 2008	4,89,061	10,76,424	15,65,485	**61,03,357**
August 2008	5,31,573	11,41,181	16,72,754	77,76,111
September 2008	4,96,608	10,80,546	15,77,154	93,53,265
October 2008	4,02,320	9,94,392	13,96,712	1,07,49,977
November 2008	4,87,969	11,67,888	16,55,857	1,24,05,834
December 2008	4,61,588	10,53,382	15,14,970	1,39,20,804
January 2009	3,53,454	8,07,901	11,61,355	1,50,82,159
February 2009	3,90,298	8,51,202	12,41,500	1,63,23,659

Month	Production in existing unit	Production in expansion unit	Total production	Total cumulative production
	(in kgs)			
March 2009	4,78,831	10,06,762	14,85,593	1,78,09,252
Total	**54,87,064**	**1,23,22,188**	**1,78,09,252**	
BPV was determined as having been achieved by the unit in April 2008 by the Department by considering the entire production of existing unit and then adding to it the month-wise production of expansion unit. However, the simultaneous consideration of the month wise production of both the units indicates that BPV was achieved only in July 2008				

Table 2.5: Determination of achievement of BSV

Base sales volume - ₹ 65.43 crore

(₹ in crore)

Month	Sales of existing unit	Sales of expansion unit	Total Sales	Total cumulative Sales
April 2008	3.90	9.28	13.18	13.18
May 2008	3.52	11.54	15.06	28.24
June 2008	3.71	7.54	11.25	39.49
July 2008	5.27	5.56	10.83	50.32
August 2008	3.89	7.09	10.98	61.30
September 2008	6.97	11.97	18.94	**80.24**
October 2008	4.07	9.16	13.23	93.47
November 2008	4.71	10.85	15.56	109.03
December 2008	2.47	6.43	8.90	117.93
January 2009	1.57	5.34	6.91	124.84
February 2009	3.47	5.67	9.14	133.98
March 2009	6.22	6.28	12.50	146.48
Total	**49.77**	**96.71**	**146.48**	
BSV was determined as having been achieved by the unit in May 2008 by the Department by considering the entire sales of existing unit and then adding to it the month-wise sales of expansion unit. However, the simultaneous consideration of the month wise sales of both the units indicates that BSV was achieved only in September 2008.				

The incorrect procedure adopted by the Department for determination of achievement of BPV / BSV resulted in excess refund of ₹ 170.93 crore in respect of six companies as mentioned in **Annexure 3.**

When the matter was referred to the Government in July 2016, the Additional Chief Secretary to Government, Commercial Taxes Department replied (December 2016) that the method adopted by the Department was in order as the protection of production / sales was in respect of the existing unit. It was, however, mentioned in the Government's reply that Industries Department would be addressed for clarification.

The reply was not acceptable as the method adopted by the CTD had resulted in granting of incentives to the units earlier though the actual achievement of BPV / BSV was registered later. Further report from the Industries Department was awaited.

2.5.5.2 Undue financial benefit due to early disbursement of soft loan prior to fulfillment of production in existing plant

Government, by issue of Order on 5 January 2006, had approved the proposal of Dalmia Cement (Bharat) India Ltd. for expansion of cement manufacturing facility. EC was issued by SIPCOT on 17 October 2008 for soft loan of ₹ 312 crore, calculated at 80 *per cent* of the investment made in EFA. Since it was an expansion project, the BPV of the existing unit was fixed at 12.75 lakh MT per annum; on the achievement of which alone, the incentive for the expansion unit was made applicable.

The GO prescribing the guidelines for implementation of SPA provides that the Project should pay tax as applicable to the CTD and obtain a certificate for having made such payment every month. This certificate should not simply state the tax remitted but should indicate the amount eligible as incentive after deducting the ineligible amounts.

We observed that based on 16 TCs issued by MoU Cell for the entire eligible amount of ₹ 312 crore between December 2008 and January 2013, soft loan was disbursed by SIPCOT. This included four instances in which payment of ₹ 54.74 crore was made even before achievement of BPV, though the quantum of production and the BPV was mentioned in the TCs furnished to SIPCOT by the MoU Cell. The period of non-achievement ranged from 38 to 143 days as mentioned in table below**.**

Table: 2.6

Undue financial accommodation due to early disbursement of soft loan

TC relating to the period		Amount disbursed against TC (₹ in crore)	Year to which TC related	Date of disburse-ment	Month of achieve-ment of BPV	No of days payment made in advance
01/04/2009	31/07/2009	13.30	2009-10	09/11/2009	March 2010	143
01/04/2010	31/05/2010	11.08	2010-11	18/01/2011	March 2011	73
01/06/2010	31/08/2010	15.49	2010-11	18/01/2011	March 2011	73
01/09/2010	31/10/2010	14.87	2010-11	22/02/2011	March 2011	38
Total		**54.74**				

Thus, the disbursement of soft loan prior to achievement of BPV resulted in pre-mature financial benefit to the Company, which was not due to the Company on the date of disbursement.

Government stated (December 2016) that TCs were given on the basis of tax paid by the dealers in returns without considering the achievement of BPV. The Government, however, stated that in respect of all the years for which tax TCs were issued by MoU Cell, the Company had achieved the BPV.

The reply was not acceptable as the guidelines prescribe that an expansion project would be eligible for incentive only after achieving the BPV. Thus, the failure of the MoU Cell to mention the eligible amount of incentive while issuing the TC and the failure of SIPCOT to ensure achievement of BPV before disbursement of soft loan resulted in undue financial benefit to the Company.

Recommendation 3: We recommend that instructions may be issued to the MoU Cell to clearly specify the eligible amount of incentive while issuing the TC and also to SIPCOT to ensure achievement of BPV before disbursement of financial incentive.

2.5.5.3 Incorrect issue of TC leading to excess refund

GoTN signed a MoU with R&N Consortium (comprising of the parent companies, Renault s.a.s and Nissan Motor Company Limited and their subsidiaries, affiliates and joint venture) on 22 February 2008 for establishment of an integrated vehicle manufacturing and assembly facility with installed capacity of not less than 4,00,000 vehicles per annum and with eligible investment of ₹ 4,500 crore within the investment period of seven years from the date of MoU. Accordingly, the Government issued orders in June 2008 for provision of SPA to the integrated automobile project, which *inter alia*, provided for refund of value added tax (VAT) on input purchases irrespective of whether the vehicles were sold within or outside Tamil Nadu.

Nissan Motors India Private Limited, a member of the Consortium, stopped its manufacturing activities and transferred its assets to Renault Nissan Automotive India Private Limited, the manufacturing entity created (with effect from 1 April 2012) under the new business model by the R&N Consortium on 10 April 2012 on an outright sales basis. Government ordered in March 2015 that Renault Nissan Automotive India Private Limited shall receive the fiscal incentive sanctioned in June 2008, with Nissan Motors India Private Limited and Renault India Private Limited becoming the marketing entities of R&N consortium.

We observed that TC for ₹ 117.47 crore for claiming refund of input VAT paid by Nissan Motors India Private Limited on the purchase of parts, raw materials, consumables, etc effected by them during the year 2011-12 for use in the manufacture of vehicles and parts was issued (June 2015) by MoU Cell of CTD. We noticed from the Audited Accounts and Balance Sheet as on 31 March 2012 of Nissan Motors India Private Limited that the closing balance of inventories comprised of raw materials and components valued at ₹ 505.10 crore and work in progress of ₹ 9.17 crore. Thus, the sale by Nissan Motors India Private Limited to Renault Nissan Automotive India Private Limited on 10 April 2012 comprised of raw materials and component parts. The sale of raw materials and component parts (inputs) without use in manufacture of motor vehicles disentitles Nissan Motors India Private Limited to avail input

tax refund on purchase of inputs. However, tax payment certificate for refund for the entire input purchase of Nissan Motors India Private Limited during 2011-12 was issued by the MoU Cell of CTD.

After we pointed this out (April 2016), the Department, accepting (June 2016) the audit observation, determined the ineligible input VAT refund amount as ₹ 25.04 crore and issued notice to Nissan Motors India Private Limited in June 2016. While accepting the audit observation (December 2016), Government stated that amendment to the TC would be made. Further report was awaited (February 2017).

2.5.5.4 Absence of mechanism to verify purchases from vendors availing incentives

Orders were issued by the Industries Department in January 2009 prescribing the guidelines for implementation of SPA as per NIP 2007. The guidelines relating to issue of soft loan/investment promotion subsidy provide that the incentive of input VAT refund would be available to a Company, only if the commodity purchased is not a subject matter of output VAT based incentive for its suppliers or manufacturers, in the previous VAT chain and the payment of input VAT by the Company has to be verified by CTD.

There, however, exists no mechanism to ensure that input VAT refund is not claimed on purchase of materials, which is the subject of output tax incentive at the hands of the suppliers. We noticed that no verification was being undertaken before issue of TC as illustrated in the following cases.

Incorrect issue of TC

We scrutinised the TCs issued by MoU Cell to Hyundai Motor India Limited and noticed that it included the claim for refund of input VAT of ₹ 1.98 crore in respect of purchases made between February 2009 and March 2010 from Saint Gobain Glass India Limited, a dealer, who avails output VAT based incentives under SPA. Based on the TCs issued by MoU Cell, SIPCOT refunded the amount to Hyundai Motor India Limited. This resulted in refund of ineligible input VAT of ₹ 1.98 crore.

After we pointed this out in March 2016, the Department stated (June 2016) that notice was issued (June 2016) to the dealer requiring payment of the ineligible input refund amount of ₹ 1.98 crore and on receipt of reply from the dealer, further action would be pursued. Further report was awaited (February 2017).

We further noticed from the refund case files of two dealers that the Department failed to identify ineligible items before issue of TC for input VAT refund. These are mentioned below.

- TC for input VAT refund of ₹ 209.54 crore relating to the year 2012-13 was issued to Renault Nissan Automotive India Private Limited on 24 April 2015 based on the applications received from the company between April 2014 and March 2015. Subsequently, the company, *suo motu,* applied (June 2015) to MoU Cell for exclusion of certain claims, which *inter alia*, included the claim of ₹ 4.10 crore pertaining to purchases from Caparo Engineering India Private Limited and Delphi TVS Diesel System Limited,

the vendors, whose application for SPA was under consideration of SIPCOT. Accordingly, a revised TC for ₹ 203.62 crore was issued by MoU Cell on 26 June 2015.

- TC for input VAT refund of ₹ 55.62 crore relating to the year 2010-11 was issued to Nissan Motors India Private Limited on 5 June 2015. Subsequently, the company, *suo motu*, applied for exclusion of claim of ₹ 1.09 crore pertaining to purchases from Caparo Engineering India Private Limited and Delphi TVS Diesel System Limited, the vendors whose application for SPA was under consideration of SIPCOT. Accordingly, a revised TC for ₹ 54.53 crore was issued by the MoU Cell on 29 June 2015.

After we pointed this out (March 2016), the Joint Commissioner, Memorandum of Understanding Cell (JC, MoU Cell) replied (June 2016) that based on the declaration by the two dealers that they were not availing any output VAT related incentives, the applications were processed and TCs were issued. However, revised TCs were issued after it was learnt from SIPCOT that the cases of two dealers were under active consideration. The JC, MoU Cell further stated that in addition to declarations being filed by the MoU dealers obtained from their vendors, the list of incentive vendors was also obtained from SIPCOT and verified.

The reply was not acceptable as the revised TCs were issued by MoU Cell on the basis of details furnished by the dealers. The MoU Cell should have effectively co-ordinated with SIPCOT to periodically obtain the list of vendors availing incentives and verified the declarations submitted by the dealers before issue of TC. The failure to do so resulted in issue of TC for refund of input VAT which was inclusive of the ineligible claims preferred by the dealers.

The matter was referred to the Government in October 2016. Reply was not furnished (February 2017).

Recommendation 4: We recommend that necessary action may be taken to co-ordinate with SIPCOT to periodically obtain list of vendors availing incentives and utilise the same to verify the claim of input VAT refund of the dealers before issue of TC.

2.5.6 Deficiencies in assessment of returns

2.5.6.1 Short payment of tax due to incorrect adjustment of tax on sale of capital goods and inventories

The Industries Department, GoTN issued orders in June 2008 for provision of SPA to the integrated automobile project of R&N Consortium, which *inter alia*, provided for refund of VAT on input purchases irrespective of whether the vehicles are sold within or outside Tamil Nadu.

We observed that Nissan Motors India Private Limited, a member of the Consortium, which claimed refund of ₹ 184.08 crore (refund of VAT paid on inputs and capital goods purchase) relating to the years 2010-11 and 2011-12 did not adjust the same from the amount of ITC claimed in the monthly returns. As of 1 April 2012, Nissan Motors India Private Limited had carried

forward ITC of ₹ 219.40 crore. Thus, after deducting the claim of refund, the available balance of ITC of Nissan Motors India Private Limited was ₹ 35.32 crore. We, however, noticed that tax amount of ₹ 56.80 crore due on the sale of inventories and capital goods effected by Nissan Motors India Private Limited to Renault Nissan Automotive India Private Limited during the month of April 2012 was shown as having been adjusted against the ITC. As the amount of ITC available for adjustment was only ₹ 35.32 crore, it resulted in short payment of tax of ₹ 21.48 crore.

After we pointed this out in March 2016, the JC, MoU Cell replied (June 2016) that since the Company had become a trading Company with effect from April 2012, the audit observation does not relate to the MoU Cell, but to the Assessment Circle concerned. The JC, MoU Cell, further, stated that taking into consideration the notice issued (June 2016) to Nissan Motors India Private Limited regarding the inadmissibility of refund claim of ₹ 25.04 crore (in respect of tax paid on purchase of inputs not involved in manufacture of vehicles), the said amount of ITC may be available for adjustment and therefore, there would be no loss to Government.

The reply of JC, MoU Cell was not acceptable as the audit observation related to the years 2010-11 and 2011-12. MoU Cell had not forwarded a copy of TC issued by it to the Assessment Circle to enable the AA to ensure the correctness of the amount of ITC shown as available by Nissan Motors India Private Limited in the monthly returns filed by it with the Assessment Circle. Further report regarding reversal of ITC and revision of assessment was awaited (February 2017).

The matter was referred to the Government in October 2016. Reply was not furnished (February 2017).

- The Industries Department, GoTN ordered in March 2015 that consequent to stoppage of manufacturing activity by Nissan Motors India Private Limited (a member of the R&N Consortium) from 31 March 2012 and transfer of its fixed assets to Renault Nissan Automotive India Private Limited on outright sale basis, Nissan Motors India Private Limited and Renault India Private Limited were eligible for input tax credit for purchases made from their manufacturing entity Renault Nissan Automotive India Private Limited. Since the products are already the subject matter of output tax related incentives for Renault Nissan Automotive India Private Limited, the GO provided that Nissan Motors India Private Limited and Renault India Private Limited shall be allowed to avail input tax credit only to the extent of aggregate of output tax payable on the sale of such goods for set-off and the excess/balance input tax credit remaining unadjusted at their credit shall lapse/be forfeited.

We noticed from Form-WW of Nissan Motors India Private Limited for the years 2012-13 to 2014-15 that the dealer had effected import and interstate purchases of goods for ₹ 584.68 crore. Similarly, scrutiny of Form-WW of Renault India Private Limited revealed imports and interstate purchase of goods for ₹ 15.94 crore during the years 2012-13 to 2014-15. The tax due on the sale of these goods, if any, does not qualify for adjustment against ITC in

view of the provisions contained in Section 19(21) of the TNVAT Act. We, however, noticed that the two dealers had not paid any tax on their sales.

After we pointed this out in April 2016, notices were issued to the dealers. Further report was awaited (February 2017).

The matter was referred to the Government in October 2016. Reply was not furnished (February 2017).

2.5.6.2 Incorrect carry forward of ITC without forfeiture

Consequent to the creation of new business model by R&N Consortium with effect from 1 April 2012, by which Renault Nissan Automotive India Private Limited became the manufacturing entity and Nissan Motors India Private Limited and Renault India Private Limited became the marketing entities of the R&N Consortium, the Industries Department issued Orders in March 2015 that since the products purchased by Nissan Motors India Private Limited and Renault India Private Limited from Renault Nissan Automotive India Private Limited are already the subject matter of output related incentives, the marketing entities shall be allowed to avail ITC only to the extent of tax payable on the sale of such goods and the excess ITC remaining unadjusted their credit shall lapse / get forfeited.

- We noticed from the monthly return in Form I for the month of March 2015 that Nissan Motors India Private Limited had a carry forward ITC of ₹ 556.25 crore. Scrutiny of Annexure V to the return in Form I indicated the closing stock of ITC availed goods as ₹ 59.88 crore. ITC relatable to the closing stock of goods available as on 31 March 2015 works out to ₹ 8.68 crore. Predominant part of purchases of Nissan Motors India Private Limited relate to purchases effected from Renault Nissan Automotive India Private Limited. This indicated that forfeiture of excess ITC of ₹ 547.57 crore (as on 31 March 2015) relating to purchases effected from an incentive dealer was not made. We further noticed from the monthly return of February 2016 that there was carry forward ITC of ₹ 530.63 crore, indicating that forfeiture of excess ITC was not made.

- We noticed from the monthly return in Form-I for the month of March 2015 that Renault India Private Limited had a carry forward ITC of ₹ 1,049.38 crore. Scrutiny of Annexure V to the return in Form-I indicated the closing stock of ITC availed goods as ₹ 36.59 crore. ITC relatable to the closing stock of goods available as on 31 March 2015 works out to ₹ 5.31 crore. Thus, the dealer had excess ITC of ₹ 1,044.07 crore relating to purchases effected from Renault Nissan Automotive India Private Limited, and forfeiture of the same was not made. We further noticed from the monthly return of February 2016 that there was carry forward ITC of ₹ 1,067.01 crore, indicating that forfeiture of excess ITC was not made.

After we pointed this out in April 2016, the Department issued notices (April 2016) to the dealers at the instance of audit. The Government stated (December 2016) that writ petition has been filed (June 2016) by Nissan Motors India Private Limited against issue of notice before the Honourable High Court of Madras. Further report regarding outcome of writ petition was awaited (February 2017).

2.5.7 Internal control and monitoring mechanism

2.5.7.1 Inadequate monitoring of non-fulfillment of investment obligation

The guidelines issued by the Industries Department prescribe that SIPCOT shall be implementing and monitoring agency for sanction of SPA. SIPCOT was required to conduct mandatory inspection within one month of the completion of the investment period to verify the fulfillment of all investor obligations under the package. Further, SIPCOT was mandated to inform Government and seek further orders if there was non-compliance of the investment obligation. SIPCOT was also required to send a detailed return of various components of assistance released to each Project within 15 days after the end of each quarter to Government along with details of actual direct and indirect employment created by the industry.

On a scrutiny of the register maintained by SIPCOT regarding applications received from the investing companies for grant of SPA, we observed that 21 Companies had not applied for SPA even after the expiry of the investment obligation period. Out of these 21 Companies, SIPCOT had allotted land to 13 Companies with exemption from payment of stamp duty. We, however, observed that a report regarding the non-preference of claim for grant of SPA by the companies after the expiry of investment obligation period was not sent to Government.

We pointed this out to SIPCOT in March 2016. Reply from SIPCOT was awaited (February 2017). In response to an audit query (May 2016) as to whether periodical reports were received from SIPCOT regarding the Companies, which had not fulfilled the obligations under SPA, the Secretary to Industries Department replied (August 2016) that details were sought from SIPCOT.

This indicates that SIPCOT failed to monitor the fulfillment of obligations by the companies which applied for grant of SPA, though land had been allotted by SIPCOT to the companies with exemption from payment of stamp duty.

Recommendation 5: We recommend that an appropriate system may be instituted to monitor the fulfillment of investment obligation by the companies which had applied for grant of SPA.

2.5.7.2 Meeting of the High Level Official Committee

Government constituted a High Level Official Committee (HLOC) in August 2008 under the Chairmanship of Principal Secretary to Government, Industries Department and consisting of five other members. The Chairman and Managing Director of SIPCOT, being one of the members, was also given the responsibility of convening the meeting of HLOC once in two months.

Scrutiny of the Minutes of the meetings of HLOC held during the period from 2012-13 to 2015-16 revealed that as against 24 meetings, which were required to be held, only five meetings were held. We further observed that no meeting had taken place during the year 2013-14.

Scrutiny of the Agenda and Minutes of the meetings revealed that out of the 13 Companies, which were provided with land, two were not included in any of the Agenda. Further, the details of the amount of investment and generation of employment, which were obtained from the Companies were adopted as such in the meeting of HLOC without independent verification of the correctness of the same. Thus, monitoring of the investment and employment generation in MoU Projects was done on the basis of the details furnished by the Companies rather than by ensuring independent assessment of the same.

During Exit Conference, SIPCOT stated that henceforth meetings of HLOC would be convened at prescribed time intervals. SIPCOT further agreed that independent assessment of the quantum of investment made by the company and employment generation would be undertaken.

Recommendation 6: We recommend that monitoring the details of investment and the employment generated by the companies which apply for SPA may be undertaken by SIPCOT by convening meetings of HLOC at the prescribed time intervals.

2.5.7.3 Absence of mechanism to accurately determine eligible purchases and sales

The SPA in respect of expansion is available only in respect of sale of products manufactured out of such expansion. The format of the monthly returns relating to VAT and CST does not enable the AA and the MoU Cell to accurately determine the purchases / sales, which are eligible for SPA.

We noticed that tax paid details for refund of output tax of ₹ 68.71 crore and for issue of soft loan of ₹ 96.95 crore in respect of interstate sale relating to the year 2014-15 was issued to HMIL on 8 July 2015 by AA based on the request of the dealer along with details of payment of tax though the certificate of the statutory auditor (17 August 2015) was submitted by the dealer along with application requesting refund of input tax of ₹ 447.18 crore on 17 November 2016.

The input tax refund with regard to HMIL (Phase-II) was only for purchases that were utilised for the purpose of manufacture of goods by Phase-II and not for purpose of trading. Similarly, the output VAT refund is allowed only for sale of manufactured goods by Phase-II and not for sale of traded goods. However, in the absence of provisions in the Annexure-I and Annexure-II as described above, the Department would not be able to verify the claims of input and output VAT refund, but completely rely on the self-declaration of the dealer. Further, the Department would also not be able to quantify the purchases and sales that are exclusively related to Phase-II of the project.

Government stated (December 2016) that determination of purchases and sales eligible for SPA was possible since Annexure-I contains purchases with commodity code and Annexure-II contains sales with commodity code. The Government further stated that the dealers, who were granted refund / soft loan would be subjected to detailed VAT audit or surprise inspection. The AA, however, replied (June 2016) that the declaration furnished by the dealer regarding trading and manufactured goods cannot be verified at the assessment circle.

The reply was not acceptable as the format of the monthly return does not facilitate the AA to distinguish purchases and sales pertaining to each unit separately and therefore, the correctness of the claim of input and output VAT refund could not be ensured. Thus, refund was made based on the details furnished by the dealer and certified by statutory auditor without ensuring independent check of accounts.

Recommendation 7: We recommend that the dealer may be asked to furnish separately the list of purchases and sales for each phase separately along with the monthly return containing the prescribed documentary evidences so that the correctness of claim of input and output VAT refund could be ensured by the AA before issue of TC.

2.5.7.4 System of disbursement of Investment promotion subsidy and soft loan

The allocation of funds to SIPCOT for disbursement of the investment promotion subsidy is made by the Industries Department. Budget allocation for the same is based on the requirements of SIPCOT, which in turn relies on the value of TCs issued by the MoU Cell. The soft loan shall be charged with a nominal interest of 0.1 *per cen*t per annum.

Information regarding the allotment of funds and the value of TC issued by MoU Cell during the years 2013-14 to 2015-16 revealed that funds of ₹ 3,385 crore alone was allocated as against TC of ₹ 4,296.50 crore issued by MoU Cell. We further noticed from the details furnished by SIPCOT that ₹ 2,226.47 crore relating to the years 2008-09 to 2015-16 was not disbursed in respect of nine companies. The above included a sum of ₹ 1,832.25 crore relating to three automobile companies. Though the GOs stated that disbursement of investment promotion subsidy and soft loan would be made within 45 and 30 days respectively, disbursement was yet to be made. In eight cases, there was delay ranging from 12 to 43 months for disbursement of investment promotion subsidy / soft loan.

After we pointed this out in May 2016, SIPCOT replied that amount would be disbursed based on the funds made available by Government.

The matter was referred to the Government in October 2016. Reply was not furnished (February 2017).

2.5.8 Conclusion

The audit of 'Tax Exemption to Industries' revealed deficiency in issue of Eligibility Certificate by SIPCOT in not fixing the BPV / BSV in terms of quantity. There was lack of coordination between CTD and SIPCOT which led to disbursement of soft loan prior to achievement of BPV. The failure of MoU Cell to forward to the Assessment Circles, the details of TCs issued to industries for refund of tax paid on purchases resulted in the AAs of the Assessment Circles not being able to ensure the correctness of the amount of ITC, which were carried forward by the industries in the monthly returns. The assessees, who were granted incentives should be considered as high risk and selected either for detailed scrutiny or for VAT audit / surprise inspection.

2.6 Other Audit Observations

Value Added Tax

2.6.1 Application of Incorrect rate of tax

As per Section 3(2) of the TNVAT Act, in the case of goods specified in Part B or Part C of the First Schedule, the tax shall be payable by a dealer on every sale made by him within the State at the rate specified therein. As per Section 2(9) of the TNVAT Act, 'branded' means any goods sold under a name or a trade mark registered or pending registration under the Trade Marks Act, 1999.

2.6.1.1 As per Section 7(1)(b) of the TNVAT Act, every dealer shall pay tax on the sale of ready to eat unbranded foods including sweets and savouries at the rate of two *per cent* of the taxable turnover. Sale of branded sweets and savouries are taxable at the rate of four *per cent* with effect from 1 April 2010 under entry 19 of Part C of First Schedule to the TNVAT Act, read with Notification issued in March 2010.

During test check (January 2013) of records in Royapettah-I Assessment Circle, we noticed that the Assessing Authority (AA), while finalising (March 2012) the assessment of a dealer for the year 2010-11, levied tax at the rate of two *per cent* on the taxable turnover of ₹ 8.50 crore for sweets and savouries. The sweets and savouries dealt in by the assessee were registered under the Trade Marks Act and therefore, attract levy of tax at the rate of four *per cent*. Since the rate of tax under the TNVAT Act is higher for branded food, the AA, while finalising the assessment should have ensured whether the sweets and savouries sold by the assessee were branded or otherwise. The AA, however, failed to do so and adopted the rate applicable to unbranded food. The failure of the AA to apply correct rate of tax resulted in short levy of tax of ₹ 17 lakh.

After we pointed this out in February 2013, the AA revised the assessment in April 2016 and raised additional demand of ₹ 17 lakh. Collection particulars of the additional demand were awaited (February 2017).

The matter was referred to the Government in June 2016; reply was awaited (February 2017).

2.6.1.2 As per entry 13A of Part C of First Schedule to the TNVAT Act, introduced with effect from 12 July 2011, Compact Discs (CDs) / DVDs are taxable at the rate of 14.5 *per cent.* The CCT issued instructions in January 2013 that the AAs should scrutinise all the returns, which were received during a month, to ensure the correctness of the rate of tax, claim of ITC, correctness of the claim of exemption, etc.

During test check (August 2015) of records in Valluvarkottam Assessment Circle, we noticed from the monthly returns and the statement of audited accounts in Form-WW that a dealer had paid tax at the rate of five *per cent* on the turnover of ₹ 2.87 crore pertaining to sale of CDs / DVDs instead of the correct rate of 14.5 *percent* during the assessment year 2013-14. The AA

failed to ensure collection of tax at correct rate, indicating non-adherence to the instructions of CCT regarding scrutiny of returns filed by the dealer. This resulted in short realisation of tax of ₹ 27.30 lakh.

After we pointed this out (August 2015), the AA revised the assessment in July 2016 and raised additional demand of ₹ 27.30 lakh, the collection particulars of which were awaited (February 2017).

Government accepted the audit observation and stated (December 2016) that the appeal filed by the dealer before Appellate Deputy Commissioner (CT) (Central) after paying 25 *per cent* of the disputed tax was pending.

2.6.2 Incorrect computation of taxable turnover

As per Section 5 of the TNVAT Act, every dealer shall pay a tax on taxable turnover relating to his business of transfer of property in goods involved in execution of works contract, either in the same form or some other form, which may be arrived at in such manner as may be prescribed, at such rate as specified in the First Schedule.

Rule 8(5)(d) of the TNVAT Rules provides for deduction from the total turnover of a dealer, of all amount towards labour charges and other charges not involving any transfer of property in goods, actually incurred in connection with the execution of works contract, or if they are not ascertainable from the books of accounts maintained and produced by a dealer before the AA, 50 *per cent* of the value of the works contract, in the case of dyeing contracts.

During test check (March 2015) of records in Bhavani Assessment Circle, we noticed that the assessment of six dealers engaged in dyeing business was deemed to have been assessed under the TNVAT Act on the basis of monthly returns filed by them during the year 2012-13. Scrutiny of the report in Form WW relating to the audited accounts of the dealers, however, revealed that the dealers had paid tax on the turnover of ₹ 14.58 crore after deducting 50 *per cent* from the total contract receipts of ₹ 29.15 crore, though the actual expenditure towards labour and other charges was available in the Profit and Loss Account. The AA also failed to determine the taxable turnover of the dealers in accordance with the instructions laid down in Rule 8(5) of the TNVAT Rules.

After we pointed this out (March 2015), the AA determined the taxable turnover of the dealers for the year 2012-13 as ₹ 20.58 crore in April 2016 and raised additional demand of ₹ 30 lakh by revision of assessment. Further report regarding collection of the additional demand was awaited (February 2017).

Government accepted (December 2016) the audit observation and stated that in respect of four cases, action had been initiated under the Revenue Recovery Act for enforcing recovery and that the appeal filed by two dealers against revision of assessment before the Appellate Deputy Commissioner (CT), Erode was pending.

2.6.3 Underassessment of turnover

As per Section 27 (1)(a) of the TNVAT Act, where, for any reason, the whole or any part of the turnover of business of a dealer has escaped assessment to tax, the AA may, at any time within a period of six years from the date of assessment, determine to the best of its judgment the turnover, which has escaped assessment and assess the tax payable on such turnover after making such enquiry as it may consider necessary.

As per Section 27 (3) of the TNVAT Act, the AA may, if it was satisfied that the escapement from the assessment was due to willful non-disclosure of assessable turnover by the dealer, direct the dealer, to pay, in addition to tax, penalty at 150 *per cent* of the tax due on the assessable turnover that was willfully not disclosed, if the tax due on such turnover was more than fifty *per cent* of the tax paid as per the return.

During test check (May 2015) of records in Palayamkottai Assessment Circle, we noticed that the assessment of a dealer in auto parts for the year 2013-14 was deemed to have been assessed under the TNVAT Act on the basis of returns furnished by the dealer. The taxable turnover reported by the dealer in the monthly returns was ₹ 1.76 crore.

Scrutiny of the Profit and Loss Account enclosed with the statement of audited accounts in Form-WW filed by the dealer, however, indicated the revenue from operations to be ₹ 2.66 crore. After we pointed this out (June 2015) the discrepancy in turnover between the Profit and Loss Account and that disclosed by the dealer in the monthly returns, the AA revised the assessment (January 2016) and raised additional demand of tax and penalty amounting to ₹ 13.09 lakh and ₹ 19.64 lakh respectively.

The matter was referred to the Government in June 2016. Government accepted the audit observation (March 2017) and stated that the writ petition filed by the assessee against revision of assessment was pending before the Madurai Bench of the Madras High Court.

2.6.4 Incorrect claim of input tax credit

As per Section 19 (1) of TNVAT Act, there shall be input tax credit (ITC) of the amount of tax paid or payable under this Act, by the registered dealer to the seller on his purchase of taxable goods specified in the First Schedule, provided that the registered dealer, who claims ITC shall establish that the tax due on such purchases has been paid by him in the prescribed manner.

As per Section 27(2) of the TNVAT Act, where for any reason, ITC has been availed wrongly, the AA shall reverse the ITC availed and determine the tax due. Section 27(4) of the Act, *ibid*, provides for levy of penalty, in the case of first detection, at the rate of 50 *per cent* of the ITC wrongly claimed.

The CCT issued instructions in January 2013 that the AAs should scrutinise all the returns, which were received during a month to ensure the correctness of the rate of tax, claim of ITC, correctness of the claim of exemption, etc.

Our test check of records revealed the following irregularities in claim of ITC by the dealers.

2.6.4.1 During test check of monthly returns filed by the assessees of Large Taxpayers Unit-IV (LTU-IV) and Evening Bazaar Assessment Circles (December 2014 and August 2015), we noticed that two assessees reported purchase of goods for ₹ 17.77 crore and claimed ITC of ₹ 1.61 crore during 2012-13. We cross verified the details contained in the monthly returns of the purchasing dealers with the details contained in the monthly returns filed by the selling dealers. We observed that no sale had been effected by the selling dealers to the assessees. Thus, the assessees incorrectly claimed ITC of ₹ 1.61 crore, which was required to be reversed along with levy of penalty of ₹ 81.04 lakh at 50 *per cent* of such incorrect claim of ITC. The incorrect claim of ITC preferred by the dealers in the monthly returns was, however, allowed by the AA, indicating non-adherence to the instructions of the CCT regarding scrutiny of returns issued in January 2013.

After we pointed this out (January and August 2015), the AA, LTU-IV Assessment Circle revised (December 2015) the assessment of the dealer, raising fresh demand of ₹ 6.21 lakh (including penalty of ₹ 2.07 lakh) and collected ₹ 4.14 lakh. The appeal filed by the dealer against levy of penalty was stated to be pending before the Joint Commissioner (Appeal). The AA, Evening Bazaar Assessment Circle issued notice (August 2015) to the dealer proposing reversal of ITC and levy of penalty. Further report regarding revision of assessment and outcome of appeal was awaited (February 2017).

Government, to whom the matter was referred (January / June 2016), accepted the audit observation in the case pertaining to LTU-IV Assessment Circle. Reply of the Government in respect of the remaining case was awaited (February 2017).

2.6.4.2 Under Section 2(24) of the TNVAT Act, 'input tax' means the tax paid or payable under the Act by a registered dealer to another registered dealer on the purchase of goods in the course of his business.

During test check of records (May 2015) in Tirunelveli Junction Assessment Circle, we cross verified the details contained in the monthly returns of the purchasing dealers with the details contained in the monthly returns filed by the selling dealers. We noticed that the claim of ITC of a dealer during the years 2012-13 and 2013-14, *inter alia*, included ITC of ₹ 13.07 lakh in respect of purchases effected from three dealers, whose registration certificates were cancelled prior to the transaction of sale / purchase. Thus, at the time of purchase made by the dealer, the selling dealers were not registered under the Act and the claim of ITC by the buying dealer was not in order. The incorrect claim of ITC preferred by the dealer in the monthly returns was, however, allowed by the AA indicating non-adherence to the instructions of the CCT regarding scrutiny of returns issued in January 2013.

After we pointed this out (July 2015), the AA revised the assessment (March 2016) and raised additional demand of ₹ 13.06 lakh, besides levying equal amount of penalty. The demand was adjusted against the refund amount due to the dealer.

Government to whom the matter was referred (June 2016), accepted the audit observation (February 2017).

2.6.4.3 During test check (March 2015) of records in Velachery Assessment Circle, we noticed during verification of monthly returns filed by the dealers that the claim of ITC of a dealer during the year 2012-13, *inter alia*, included claim of ITC of ₹ 18.99 lakh in respect of purchases effected from a dealer whose registration certificate (RC) was cancelled by the AA. The AA of the purchasing dealer, subsequent to such cancellation of RC of the selling dealer, should have initiated action to reverse the ITC of ₹ 18.99 lakh availed by the dealer and recover the same along with penalty of ₹ 9.49 lakh. The AA, however, failed to do so, resulting in allowance of incorrect claim of ITC and non-levy of penalty for such incorrect claim.

After we pointed this out (March 2015), the AA, Velachery Assessment Circle revised the assessment (October 2015) and raised additional demand of ₹ 28.48 lakh (inclusive of penalty). Further report regarding collection particulars was awaited (February 2017).

The matter was referred to the Government in July 2016; reply was awaited (February 2017).

2.6.4.4 As per Rule 7(7) of TNVAT Rules, every registered dealer, who is not liable to pay tax under the Act shall file return for each year in Form I-1 on or before the 20th day of May of the succeeding year showing the actual total turnover in respect of all goods dealt with by him.

During test check of records (between March and December 2015) in six[32] Assessment Circles, we noticed that 13 dealers had, *inter alia*, reported in their monthly returns for the years 2009-10, 2010-11 and 2013-14, purchase of goods from 11 selling dealers for ₹ 20.90 crore and claimed ITC of ₹ 1.21 crore. Verification of 'Dealer Profile' (available in intranet of the CTD) indicated that the selling dealers were filing annual returns with no tax liability. The incorrect claim of ITC in respect of purchases made from annual return filing dealers was, however, not known to the AAs, indicating non-adherence to the instructions of the CCT issued in January 2013 regarding scrutiny of returns. The ITC of ₹ 1.21 crore claimed by the dealers was, therefore, reversible along with levy of penalty of ₹ 60 lakh.

After we pointed this out (between March and December 2015), the AAs of Thiruvallikeni and Nanganallur Assessment Circles revised (June 2016) the assessments of two dealers and raised additional demand of tax and penalty of ₹ 26.71 lakh and ₹ 13.36 lakh respectively. Report regarding recovery of additional demand and reply in respect of the remaining cases was awaited (February 2017).

The matter was referred to the Government in July 2016; reply was awaited (February 2017).

[32] Alwarpet, Esplanade, Harbour, Nanganallur, Thiruvallikeni and Tondiarpet

2.6.5 Non / short reversal of input tax credit

2.6.5.1 As per Section 19(2)(v) of the TNVAT Act as amended in 2013, ITC shall be allowed on the tax paid or payable on the purchase of goods in excess of three *per cent* of tax relating to such purchases, if the goods purchased were sold in the course of interstate trade or commerce falling under sub-section (1) of Section 8 of the CST Act, provided, that if a dealer had already availed ITC, there shall be reversal of credit against such sale.

The CCT issued instructions in January 2013 that the AAs should conduct scrutiny of all returns received during a month under the TNVAT Act, and while doing so, corresponding verification of the returns filed under the CST Act should also be made.

During scrutiny (between May 2015 and February 2016) of records in eight[33] Assessment Circles, we noticed from the returns filed under the CST Act that 13 dealers had effected interstate sale of goods covered by 'C' Form declarations for ₹ 117.38 crore for the period from December 2013 to March 2014. The sale of goods against declaration forms during December 2013 to March 2014 warranted reversal of ITC of ₹ 1.65 crore. Our scrutiny of the returns filed by the dealers under the TNVAT Act, however, indicated that in one case, reversal of ITC of ₹ 6.09 lakh was made by the dealer as against the amount of ₹ 15.88 lakh, which was due to be reversed. In the remaining cases, reversal was not made by the dealers. The AAs also failed to enforce reversal of ITC, which indicated non-adherence to the instructions issued by the CCT. This resulted in non / short reversal of ITC of ₹ 1.59 crore.

After we pointed this out between May 2015 and February 2016, the AAs of four[34] Assessment Circles revised (between December 2015 and August 2016) the assessments of eight dealers and raised additional demand of ₹ 54.58 lakh of which ₹ 6.45 lakh in respect of a case pertaining to Harbour Assessment Circle was collected. In respect of the other case pertaining to Harbour Assessment Circle, the appeal filed by the dealer after paying ₹ 4.12 lakh was stated to pending before Appellate Deputy Commissioner (CT) North. The writ petition filed by a dealer of Hosur (North) Assessment Circle before the Honourable High Court of Madras against the revision of assessment was stated to be pending. Further report regarding recovery of the additional amount and reply in respect of the other cases was awaited (February 2017).

The matter was referred to the Government during May / June 2016. Government accepted the audit observation in the cases relating to LTU-IV, Harbour and Hosur (North) Assessment Circles. Reply of the Government in the remaining cases was awaited (February 2017).

2.6.5.2 As per Section 19(5)(c) of the TNVAT Act, no ITC shall be allowed on the purchase of goods sold as such or used in the manufacture of other goods and sold in the course of interstate trade or commerce without declaration forms.

---

[33] Avarampalayam, Harbour, Hosur (North), LTU-IV, Manali, Mylapore, Sholinganallur and Sriperumbudur

[34] LTU-IV, Hosur (North) and Sholinganallur

The CCT issued instructions in January 2013 that the AAs should conduct scrutiny of all returns received during a month under the TNVAT Act, and while doing so, corresponding verification of the returns filed under the CST Act should also be made.

During test check (November 2014 and June 2015) of records in Nandanam and Chidambaram I Assessment Circles, we noticed that two dealers had claimed ITC of ₹ 4.12 crore on purchase of goods during the year 2008-09 and during the years 2010-11 to 2013-14. We further observed from the orders passed (between August 2013 and October 2014) by the AAs under the CST Act that a turnover of ₹ 178.44 crore had been assessed to tax as interstate sales not covered by valid declaration forms. Though, such sale warranted reversal of ITC of ₹ 1.60 crore, reversal was neither made by the assessees nor enforced by the AAs. This indicated that the AAs failed to adhere to the instructions issued by the CCT.

After we pointed this out (January / July 2015), the AAs revised the assessments (January / March 2016) and raised additional demand of ₹ 1.60 crore; the collection particulars of which was awaited (February 2017).

The matter was referred to the Government during April / May 2016. Government accepted (January 2017) the audit observation pertaining to Nandanam Assessment Circle and stated that the writ petition filed by the dealer before the Honourable High Court of Madras after paying the amount of ₹ 19.37 lakh was pending. Further report regarding outcome of writ petition and reply in respect of the remaining case was awaited (February 2017).

2.6.5.3 As per Section 19(4) of the TNVAT Act, ITC shall be allowed on the tax paid or payable on the purchase of goods in excess of three *per cent* of tax up to 10 November 2013 and *five per cent* thereafter relating to such purchases, if the goods purchased are transferred or used in the manufacture of other goods and transferred to other States otherwise than by way of sale, provided, that if a dealer has already availed ITC, there shall be reversal of credit against such transfer.

During scrutiny (March 2014) of records in Sankari Assessment Circle, we noticed that a dealer, who claimed ITC of ₹ 39.18 crore on purchase of goods during the year 2007-08, had transferred goods valued at ₹ 12.68 crore to other States, otherwise than by way of sale. We observed that while the transfer of goods to other States, otherwise than by way of sale, warranted reversal of proportionate ITC of ₹ 9.83 lakh, reversal was not made by the dealer. The AA, while finalising (March 2012) the assessment of the dealer under the Central Sales Tax Act also failed to enforce reversal of ITC.

After we pointed this out (April 2014), the AA revised the assessment (March 2016) and raised additional demand of ₹ 9.83 lakh. Further report regarding collection particulars was awaited (February 2017).

The matter was referred to the Government in May 2016. Government accepted the audit observation and stated that the appeal preferred by the dealer against revision of assessment after paying ₹ 2.46 lakh was pending before the Appellate Deputy Commissioner (CT), Erode.

2.6.6 Non-levy of interest

As per Section 42(1) of the TNVAT Act, the tax assessed or that has become payable under this Act from a dealer shall be paid in such manner and in such instalments, if any, and within such time as may be specified in the notice of assessment, not being less than thirty days from the date of service of the notice. As per Section 42(3) of the TNVAT Act, on any amount remaining unpaid after the date specified for its payment as referred to in sub-section (1) or in the order permitting payment in instalments, the dealer or person shall pay, in addition to the amount due, interest at one and a quarter *per cent* per month upto 28 May 2013 and at two *per cent* per month thereafter of such amount for the entire period of default.

As per proviso to Rule 7(1)(b) of the TNVAT Rules, every registered dealer, whose taxable turnover in the preceding year is two hundred crore rupees or above, shall file the monthly returns on or before 12th of the succeeding month to the AA and that such return shall be accompanied by proof of payment of tax.

During test check of records (between December 2014 and August 2015) in three[35] Assessment Circles, we noticed that three dealers had paid tax of ₹ 25.26 crore belatedly; the delay ranging from 3 days to 23 months and 10 days. The belated payment of tax attracts levy of interest of ₹ 22.42 lakh. The AAs, however, failed to levy interest for such belated payment of tax.

After we pointed this out (between December 2014 and August 2015), the AA, Madurantakam Assessment Circle levied (December 2015) interest of ₹ 5.68 lakh. The AA, Large Taxpayers Unit-IV Assessment Circle, Chennai issued notice (July 2015) to the dealer proposing levy of interest amounting to ₹ 4.78 lakh. Further report regarding collection particulars, levy of interest and reply in respect of the remaining case was awaited (February 2017).

The matter was referred to the Government in July 2016; reply was awaited (February 2017).

Sales Tax

2.6.7 Application of incorrect rate of tax

Section 8(2)(b) of the CST Act, as it existed prior to 1 April 2007, provided that interstate sale of goods, other than declared goods, shall be assessed to tax at the rate of ten *per cent* or at the rate applicable to the sale or purchase of such goods inside the appropriate State, whichever was higher.

Section 2(1)(aa) of the Tamil Nadu Additional Sales Tax Act, 1970 provided for levy of Additional Sales Tax (AST) at the rate of 1.5 *per cent* on the taxable turnover, where the taxable turnover of a dealer was in excess of ₹ 25 crore but less than ₹ 50 crore with effect from 1 April 1998.

[35] Lalgudi, LTU-IV, Chennai and Madurantakam

The Madras High Court has held[36] that the taxable turnover under the Tamil Nadu General Sales Tax Act, 1959 (TNGST Act) has to be considered for reckoning the AST liability under the CST Act.

During test check of records (July 2015) in LTU-I Assessment Circle, Chennai, we noticed that the AA, while finalising the assessment of a dealer for the year 2000-01 under the CST Act (May 2014) did not consider the element of AST for computing the rate of tax applicable on interstate sales of electric storage batteries not covered by valid declaration forms though the taxable turnover of the dealer under the TNGST for the year was ₹ 49.91 crore. The applicable rate of tax on the turnover of ₹ 22.10 crore not covered by valid declaration forms was 21.5 *per cent* taking into consideration the element of AST. The AA, however, levied tax at the rate of 20 *per cent*. This resulted in short levy of tax of ₹ 33.15 lakh.

Government accepted (December 2016) the audit observation and stated that the AA, taking into consideration the subsequent filing of C Form declarations, had revised the assessment (October 2015) and collected the additional demand of ₹ 22.27 lakh.

2.6.8 Escapement of taxable turnover

As per Section 27 (1)(a) of the TNVAT Act, where, for any reason, the whole or any part of the turnover of business of a dealer has escaped assessment to tax, the AA may, at any time within a period of six years from the date of assessment, determine to the best of its judgment the turnover, which has escaped assessment and assess the tax payable on such turnover after making such enquiry as it may consider necessary. As per Section 27 (3) of the TNVAT Act, the AA may, if it is satisfied that the escape from the assessment is due to willful non-disclosure of assessable turnover by the dealer, direct the dealer, to pay, in addition to tax, penalty at 150 *per cent* of the tax due on the assessable turnover that was willfully not disclosed, if the tax due on such turnover is more than fifty *per cent* of the tax paid as per the return.

As per Section 6-A of the CST Act, where any dealer claims that he is not liable to pay tax under this Act, in respect of any goods, on the ground that the movement of such goods from one State to another was occasioned by transfer of such goods to other place otherwise than by way of sale, the burden of proving so shall be on the dealer and for this purpose, he shall furnish to the AA, the declaration in Form-F. As per Rule 5(1) of the Central Sales Tax (Tamil Nadu) Rules, 1957, the provisions of the TNVAT Act shall apply, *mutatis mutandis*, for the purpose of making provisional assessment, best of judgment assessment, final assessment, re-assessment and payment of tax under the CST Act.

During test check (January 2013) of records in Royapettah Assessment Circle, we noticed that the AA, while finalising (February 2012) the assessment of a dealer for the year 2008-09 under the CST Act, allowed exemption as stock transfer of furniture for ₹ 7.37 crore on the basis of declarations in Form-F filed by the dealer. Scrutiny of the 'check post module' in intranet of the

[36] Sri Kaliswari Fireworks Vs. Commercial Tax Officer-I, Sivakasi – (2009) 25 VST 384(Mad)

Department, however, revealed that the dealer had moved goods to other States by way of stock transfer for ₹ 9.32 crore. Thus, the movement of furniture to other States for ₹ 1.95 crore had escaped assessment though the same was not covered by valid declaration in Form-F. This resulted in non-levy of tax of ₹ 24.32 lakh and penalty of ₹ 36.48 lakh.

After we pointed this out (February 2013), the AA revised (June 2016) the assessment of the dealer under the CST Act and raised additional demand of tax and penalty of ₹ 24.32 lakh and ₹ 36.48 lakh respectively. Further report regarding collection was awaited (February 2017).

The matter was referred to the Government in July 2016; reply was awaited (February 2017).

2.6.9 Non-levy of tax

As per Section 3-B of the erstwhile Tamil Nadu General Sales Tax Act, 1959 (TNGST Act), the turnover representing value of goods involved in the execution of works contract and which had not suffered tax earlier inside the State was assessable to tax, at the rates specified for such goods in the Schedules to the Act. As per Section 3-I of the TNGST Act, surcharge at the rate of five *per cent* was leviable on the tax levied under Section 3-B. Dyes were taxable at the rate of 10 *per cent* under entry 12 of Part C of the First Schedule to the TNGST Act. Chemicals were taxable at the rate of 12 *per cent* under entry 7 of Part D of the First Schedule to the TNGST Act.

During test check (March 2015) of records in Bhavani Assessment Circle, we noticed that four dealers had purchased dyes and chemicals amounting to ₹ 4.85 crore from interstate during the year 2006-07 (upto 31 December 2006) and utilised the same in dyeing contracts. The AA, while finalising the assessment (November / December 2011) of the dealers for the year 2006-07 under the TNGST Act, however, omitted to levy tax on the deemed sale value of dyes and chemicals, which were utilised in the execution of the process of dyeing under Section 3-B of the TNGST Act.

After we pointed this out (April 2015), the AA revised the assessment of the dealers in March 2016 and raised additional demand of ₹ 81.29 lakh by levying tax and surcharge at the rate of 10.5 *per cent* and 12.6 *per cent* on the deemed sale value of dyes (₹ 1.84 crore) and chemicals (₹ 4.91 crore) respectively. Recovery of the additional demand of ₹ 81.29 lakh was awaited (February 2017).

Government accepted (December 2016) the audit observation and stated that action had been initiated for recovery of the additional demand under the Revenue Recovery Act. Further report regarding recovery was awaited (February 2017).