

## Chapter-II

### VAT on Sales, Trade, etc. and Goods and Services Tax

#### 2.1 Tax Administration

On introduction of Goods and Services Tax (GST), the organisational set-up of the Commercial Taxes Department (CTD) continued as in the Value Added Tax (VAT) regime. The erstwhile Local VAT Offices (LVOs) were re-designated as Local GST Offices (LGSTOs), erstwhile VAT Sub-Offices (VSOs) were re-designated as Sub GST Offices (SGSTOs) and the Audit Offices continued as such. The applicable laws and Rules are administered at the Government level by the Additional Chief Secretary, Finance Department. The Commissioner of Commercial Taxes (CCT) who is the head of the Commercial Taxes Department is assisted by 14 Additional Commissioners. There are 13 Divisional Offices, 13 Appeal Offices, 13 Enforcement/Vigilance Offices and one Minor Acts Division in the State managed by 42 Joint Commissioners (JCCTs). There are 123 Deputy Commissioners (DCCTs), 321 Assistant Commissioners (ACCTs) and 526 Commercial Tax Officers (CTOs) in the State. At the field level, the tax is being administered through 118 Local GST Offices and Sub GST Offices headed by ACCTs and CTOs respectively. The DCCTs, ACCTs and CTOs head 266 Audit Offices where assessments/re-assessments are finalised by the Department.

#### 2.2 Internal Audit

As per the information furnished by the Department, the Internal Audit Wing is functioning from the year 2011-12. During the year 2020-21, 359 Offices were due for audit, of which, 53 Offices were audited. Year-wise details of the number of objections raised, settled and pending along with tax effect, as furnished by the Department, are given in **Table 2.1**.

**Table 2.1**  
Year-wise details of observations raised by IAW

(₹ in crore)

Year	Observations raised		Observations settled		Observations pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
2016-17	8,388	294.11	1,146	82.97	7,242	211.14
2017-18	7,529	139.92	301	3.73	7,228	136.19
2018-19	2,748	21.15	1,353	9.41	1,395	11.74
2019-20	5,482	71.86	373	30.50	5,109	41.36
2020-21	11,321	234.76	2,248	34.53	9,073	200.23
<b>Total</b>	<b>35,468</b>	<b>761.80</b>	<b>5,421</b>	<b>161.14</b>	<b>30,047</b>	<b>600.66</b>

Source: Information furnished by the Department

As seen from the table, 30,047 cases involving ₹ 600.66 crore were pending for settlement as on 31 March 2021. Early action may be taken to settle pending observations.

## 2.3 Goods and Services Tax

Goods and Services Tax (GST), a multistage and destination-based tax, came into effect from 1 July 2017 after enactment of the Karnataka Goods and Services Tax Act, 2017 on 27 June 2017. A few relevant aspects relating to GST registrations and the filing pattern of monthly GSTR 1 and GSTR 3B returns have been given below:

### 2.3.1 GST Registrations

The category-wise registrations under GST have been given in **Table 2.2** below.

**Table 2.2**  
**GST Registrations**

Category of Registrant	Number of Registrants	Percentage of total
Normal taxpayers	9,02,022	86.80
Composition taxpayers	1,18,378	11.39
Tax Deductors at Source	16,760	1.61
Tax Collectors at Source	1,135	0.11
Input Service Distributors	536	0.05
Others (Casual, NRTP, OIDAR)	398	0.04
<b>Total Registrants</b>	<b>10,39,229</b>	

Source: Figures furnished by the Department

The total registrations under GST as on 31 March 2021 were ₹ 10.39 lakh, of which normal taxpayers accounted for 86.80 *per cent* and composition taxpayers were around 11.39 *per cent*.

### 2.3.2 GST Return filing pattern

#### 2.3.2.1 Filing pattern of GSTR 1 and GSTR 3B

The trends of filing of GSTR-1<sup>6</sup> and GSTR-3B<sup>7</sup> for the period from April 2020 to March 2021, as per the figures furnished by the Department, have been depicted in **Table 2.3** and chart below.

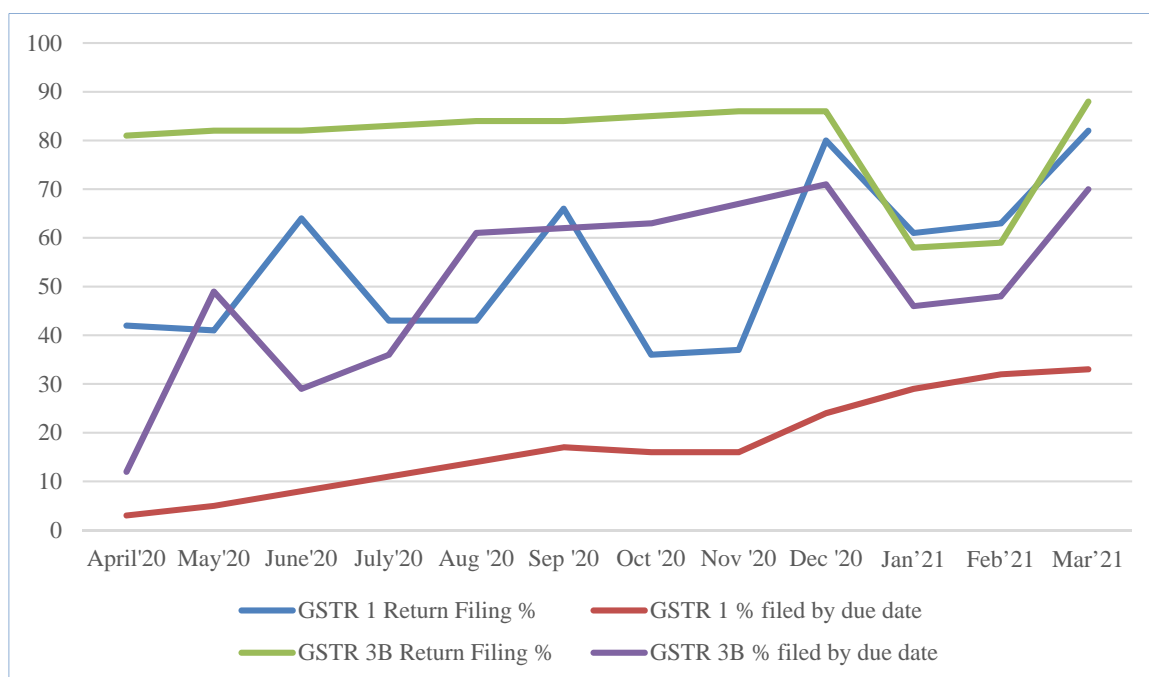
<sup>6</sup> GSTR-1 return is a monthly statement of outward supplies to be furnished by all normal and casual registered taxpayers making outward supplies of goods and services or both and contains details of outward supplies of goods and services.

<sup>7</sup> GSTR-3B return is a monthly self-declaration, to be filed by a registered GST taxpayer, consisting details regarding outward supplies, input tax credit, payment of tax etc.

**Table 2.3**  
**Filing pattern**

Return Type	GSTR-1					GSTR-3B				
Months	Due for filing	Returns filed	Return filing per cent	Returns filed by due date	Per cent filed by due date	Due for filing	Returns filed	Return filing per cent	Returns filed by due date	Per cent filed by due date
April'20	8,29,419	3,44,734	42	22,439	3	8,29,419	6,74,889	81	1,01,051	12
May'20	8,27,140	3,37,566	41	42,503	5	8,27,140	6,76,465	82	4,09,242	49
June'20	8,28,613	5,28,766	64	68,561	8	8,28,613	6,82,415	82	2,37,398	29
July'20	8,29,114	3,53,653	43	89,693	11	8,29,114	6,87,560	83	2,97,113	36
Aug'20	8,29,488	3,57,472	43	1,16,123	14	8,29,488	6,93,658	84	5,08,812	61
Sep'20	8,30,476	5,44,148	66	1,38,068	17	8,30,476	6,99,514	84	5,11,725	62
Oct'20	8,31,665	3,02,248	36	1,31,363	16	8,31,665	7,05,506	85	5,21,505	63
Nov '20	8,29,899	3,06,815	37	1,32,943	16	8,29,899	7,12,928	86	5,54,968	67
Dec'20	8,31,478	6,65,146	80	2,01,783	24	8,31,478	7,17,962	86	5,90,800	71
Jan'21	8,29,403	5,03,600	61	2,41,310	29	8,29,403	4,85,195	58	3,81,786	46
Feb'21	8,28,603	5,18,120	63	2,62,097	32	8,28,603	4,92,518	59	3,99,886	48
Mar'21	8,32,695	6,80,859	82	2,73,569	33	8,32,695	7,33,166	88	5,79,104	70

**Chart No.1: Filing of GSTR 1 and GSTR 3B returns for April 2020 to March 2021**



Source: Figures furnished by the Department.

From the above table/chart it is evident that the filing of GSTR-1, on an average for the year 2020-21, was 54.83 per cent. It was noticed that for the months of April 2020, May 2020, July 2020, August 2020, October 2020 and November 2020 the returns filing percentage of GSTR-1 was very low

(ranging from 36 per cent to 43 per cent). Further, it was observed that the GSTR-1 returns were filed within due date on an average for only 17 per cent of the assesseees for the year 2020-21.

The filing of GSTR-3B on an average for the year 2020-21 was 79.83 per cent. It was observed that for the months of January 2021 and February 2021, the returns filing percentage of GSTR-3B was only 58 per cent and 59 per cent, respectively. Further, it was noticed that for the month of April 2020, the GSTR-3B returns filed by the assesseees within due date was only 12 per cent. The Department attributed the low percentage of filing to the outbreak of COVID-19 during the last week of March 2020 and its after effects thereon.

## 2.4 Results of Audit

There are 458 auditable units in the Commercial Taxes Department. Out of these, audit selected 62 units for test-check wherein 1.50 lakh assessments were finalised. Out of these, Audit test-checked 0.75 lakh dealers (50 per cent) during the year 2020-21 and noticed 4,439 cases of underassessment of taxes and non-observance of provisions of Acts/Rules, etc., involving an amount of ₹ 136.83 crore. These cases are illustrative only as these are based on test-check of records. The observations broadly fell under the following categories as given in **Table 2.4**.

**Table 2.4**  
**Results of Audit**

(₹ in crore)				
Sl. No.	Category	No. of Paragraphs	No. of cases	Amount
<b>I</b>	<b>Value Added Tax</b>			
1	Non/short declaration of output tax (e-UPaSS)	15	285	7.43
2	Non/ short payment of tax as per VAT-240	10	26	1.33
3	Non/ short levy of tax	54	71	10.41
4	Non levy of tax on sale of liquor	6	19	1.56
5	Non/short levy of penalties/interest (Under Sections 36, 72(1), 72(2) & 74(4) of KVAT Act)	70	2776	20.25
6	Not-Acknowledged Returns	08	79	0.86
7	Incorrect/ excess allowance of Input Tax Credit (ITC)	38	83	8.99
8	Excess carry forward of credit	29	34	6.47
9	Non/short-levy of tax on works contract receipts, incorrect allowance of sub-contractor payments etc.	27	34	16.82
10	Incorrect/excess refund	10	12	0.93
11	Non-levy/payment of tax on URD purchases	05	10	0.25
12	Incorrect credit taken as Transitional Credit to GST	03	13	0.39
13	Other irregularities	12	30	4.92
	<b>Total</b>	<b>287</b>	<b>3,472</b>	<b>80.61</b>
<b>II</b>	<b>Entry Tax (KTEG)</b>			
1	Non/short levy of Entry Tax/interest	3	3	0.02
	Total	3	3	0.02
<b>III</b>	<b>Goods and Services Tax (GST)</b>			
1	Non/short levy of interest	19	121	6.24
2	Incorrect/excess refund	19	32	3.20

3	Non levy of late fee for delay in filing Annual Return	14	425	2.38
4	Non levy of tax for difference between GSTR1 and GSTR 3B	07	12	14.13
5	Non levy of penalty for not furnishing final Return on cancellation of GST registration	06	30	1.32
6	Non/short payment of tax	12	19	7.17
7	Non payment of tax as per GSTR 9C	04	06	0.38
8	SSCA on Transitional credit	14	263	15.75
9	SSCA on GST Refunds	09	56	5.63
	Total	<b>104</b>	<b>964</b>	<b>56.20</b>
	<b>Grand total</b>	<b>394</b>	<b>4,439</b>	<b>136.83</b>

During the course of the year, the Department reported recovery of ₹ 3.36 crore in 89 paragraphs that were pointed out in the earlier years.

A few illustrative cases of non/short-realisation of VAT, penalty and interest involving ₹ 14.70 crore and two Subject Specific Compliance Audits on 'Transitional credits' and 'GST-Refunds' involving ₹ 21.38 crore are discussed in the following paragraphs.

## 2.5 Subject Specific Compliance Audit on Transitional Credits

### 2.5.1 Introduction

Introduction of the Goods and Services Tax (GST) is a significant reform in the field of indirect taxes in our country, which replaced multiple taxes levied and collected by the Centre and States. GST is a destination based tax on supply of goods or services or both, which is levied at multi-stages wherein the taxes will move along with supply. The tax will accrue to the taxing authority which has the jurisdiction over the place of supply. Tax is levied simultaneously by the Centre and States on a common tax base. Central GST (CGST) and State GST (SGST) / Union Territory GST (UTGST) is levied on intra state supplies and Integrated GST (IGST) is levied on inter-state supplies. Availability of input tax credit i.e. taxes paid on inputs, input services and capital goods for set off against the output tax liability is one of the key features of GST. This avoids cascading effect of taxes and ensures uninterrupted flow of credit from the seller to buyer. To ensure the seamless flow of input tax from the existing laws to GST regime, 'Transitional arrangements for input tax' was included in the GST Acts to provide for the entitlement and manner of claiming input tax in respect of appropriate taxes or duties paid under existing laws.

### 2.5.2 Transitional arrangements for input tax

Section 140 of the Karnataka GST Act, 2017 (KGST Act) enables the taxpayers to carry forward the input tax credit (ITC) earned under the existing laws to the GST regime. The Section read with Rule 117 of Karnataka GST Rules, 2017 (KGST Rules) prescribes elaborate procedures in this regard. Under transitional arrangements for ITC, the ITC of various taxes paid under the existing laws such as Central Value Added Tax (CENVAT), State Value Added Tax (VAT) etc. are eligible to be carried forward to GST regime as under:

**(a) Closing balance of credit in legacy return:** The closing balance of VAT credit /CENVAT credit available in the returns filed under the existing law for the month immediately preceding the appointed day can be taken as credit in the electronic credit ledger (ECL).

**(b) Un-availed credit on capital goods:** The balance instalment of un-availed credit on capital goods can be taken by filing the requisite declaration in Form GST Tran-1.

**(c) Credit on duty paid stock:** A registered taxable person, who was not liable to be registered under the existing law or who was engaged in the sale of exempted goods, may take the credit of the duty/ tax paid on goods held in stock based on the invoices.

**(d) Credit on duty paid stock when registered person does not possess the document evidencing payment of excise duty/VAT:** A registered taxable person, other than the manufacturer or service provider, who does not have excise or VAT invoice, is eligible to take credit on the duty paid stock.

**(e) Inputs in transit:** The inputs received on or after the appointed day but where the duty or tax on the same was paid by the supplier under the existing law are also eligible for transitional credit.

**(f) Tax paid under the existing law under composition scheme:** The taxpayers who had paid tax at fixed rate or fixed amount in lieu of the tax payable under existing law, now working under normal scheme under GST can claim credit of duty on their input stock, semi-finished and finished stock on the appointed date.

All registered taxpayers, except those who were opting for payment of tax under the composition scheme (under Section 10 of the Act), were eligible to claim transitional credit by filing Tran-1 declaration within 90 days from the appointed day. The time limit for filing Tran-1 declaration was extended initially till 27 December 2017. However, many taxpayers could not file the declaration within the due date due to technical difficulties. The due date for filing Tran-1 declaration was further extended to 31 March 2020 for those taxpayers who could not file Tran-1 declaration due to technical difficulties and those cases recommended by the GST Council.

The taxpayer can file form GST Tran-2 in case of inputs held in stock on appointed day in respect of which he is not in possession of any invoice evidencing payment of tax.

### 2.5.3 Audit Objectives

Transitional credit claims directly impact GST revenues as the credit is eligible for set off against the output tax liability of taxpayers. Thus, the audit of transitional credit was taken up with the following objectives seeking assurance on:

- i. Whether the mechanism envisaged by the Department for selection and verification of transitional credit claims was adequate and effective; and
- ii. Whether the transitional credits carried over by the assessee into GST regime were valid and admissible.

#### 2.5.4 Audit Scope and sample

The audit scope comprised review of Tran-1 and Tran-2 returns filed by the taxpayers under Section 140 of the KGST Act, 2017 from the appointed date<sup>8</sup> to the end of March 2020. This involved examination of adequacy of Rules specified for transitional credit under the Act, effectiveness of departmental verification process, follow up action taken on the deviations detected, process adopted for implementation of cross-jurisdictional functions regarding transitional credit and independent examination of selected transitional credit claims for compliance assurance. Audit findings on Transitional Provisions under the GST Act were included in the Report of the Comptroller and Auditor General of India on Economic and Revenue Sectors for the year ended March 2019 covering six Divisions.

In this audit, a sample of 5,298 cases with transitional credit claims amounting to ₹ 363.90 crore, across 56 Local GST Offices (LGSTO)/ Sub GST Offices (SGSTO) in seven<sup>9</sup> Divisions (not covered in previous audit) selected on risk analysis were verified during the period from April 2021 to July 2021.

#### 2.5.5 Audit Criteria

The audit objectives were benchmarked against the criteria drawn from the following sources:

- Karnataka GST Act, 2017
- Karnataka GST Rules, 2017
- Erstwhile Acts like the Karnataka Value Added Tax Act, 2003 and Rules thereunder and Central Sales Tax Act, 1956
- Notifications/Circulars and relevant instructions issued by CBIC

#### 2.5.6 Audit Methodology

The amount of credit available in the Value Added Tax (VAT-100) return at the end of June 2017 as per VAT Electronic Filing System (e-FS) was compared with the claims of transitional credit with reference to the Tran-1 filed by the taxpayers and also the amount credited in the Input Tax Credit Ledger in GST Prime (equivalent of the Electronic Credit Ledger in the common portal). The information available in the audited statement of accounts (Form VAT-240), purchase details uploaded in Electronic Uploading of Purchase and Sales Statement (e-UPaSS), re-assessment orders issued under VAT, filing of statutory Forms under Central Sales Tax (CST) and TDS Forms were also verified as available in the e-FS which have a bearing on the closing credit available under VAT regime and consequently on the claims of transitional credit.

An Exit conference was held with the Commissioner of Commercial Taxes (CCT) in April 2022 wherein the audit observations were discussed.

<sup>8</sup> The date on which the provisions of the KGST Act came in to force i.e. 1 July 2017.

<sup>9</sup> DGSTO 2,3,6 Bengaluru, Kalaburagi, Mangaluru, Mysuru and Shivamogga Divisions



### 2.5.7 Audit Findings

The audit findings are categorized into two broad areas as systemic and compliance issues based on the objectives of audit. While systemic issues focus on the adequacy and effectiveness of the envisaged verification mechanism, the compliance issues focus on the deviations from the provisions of the Act/Rules in individual cases.

### 2.5.8 Systemic issues

#### 2.5.8.1 Verification mechanism envisaged by the Department

Audit had pointed out the absence of action plan for verification of transitional credit and ineffective risk assessment to verify the transitional credit availed, in the Audit Report for the year ended March 2019 vide para no. 2.4.10.1 and the deficiencies on account of this, were brought out in paragraph nos. 2.4.10.2 to 2.4.13.2. The current position with respect to the transitional credit and the claims verified, as furnished by the Department (December 2022) is given in **Table 2.5** below.

**Table 2.5**

**Transitional credit claimed by the Dealers**

(₹ in Crore)

Carry forward credit available as per June 2017 Return		SGST transitional credit carried forward by the dealers		SGST transitional credit admitted/ accepted by the department after verification	
Number of Dealers	Amount	Number of Dealers	Amount	Number of Dealers	Amount
42612	1499.06	19721	1277.00	17213	314.61

As seen from the table above, the Department has verified the claims in 87 per cent of the cases. The correctness of the transitional credit claimed by the dealers in the remaining 13 *per cent* of the cases may be ensured by the Department at the earliest.

Audit noticed 263 cases of ineligible or excess or incorrect transitional credit claims out of the sample of 5,298 cases. Out of this, VAT reassessment for the period 2017-18 (April 2017 to June 2017) was completed in 32 cases. In all these cases, Audit scrutiny revealed excess/incorrect transitional credit of ₹ 5.33 crore and it was also observed that there was no mention of cross verification of the credit carried forward to the GST regime (Tran-1) in the re-assessment orders.

This was brought to the notice of the department in March 2022. Replies of the department in the above 32 cases are awaited (September 2022).

Audit recommends that the department may mandatorily verify the credit available in legacy regime with the credit carried forward to the GST regime in all cases of re-assessment orders.



### 2.5.8.2 Absence of Tran-1 forms or blank Tran-1 forms

Rule 117(1) of KGST Rules prescribes submission of a declaration electronically in Form GST Tran-1 in the common portal by a registered person claiming the transitional credit.

Karnataka being a 'Model 1 State' has its own backend system (GST Prime) which draws data from the common portal for tax administration. Audit noticed that out of the sample of 5,298 cases, the form Tran-1 was either not available in GST Prime or was blank in respect of 32 dealers. These 32 dealers had transitional credit of ₹ 2.65 crore as verified from the Input Tax Credit Ledger. Audit verification revealed that these 32 dealers had availed credit of only ₹ 2.04 crore in their KVAT return for the month of June 2017. In the absence of the Tran-1 Form and the break-up of the transitional credit claim the Department could not ensure under which provision, the transitional credit was availed by them. This points to a lacuna in the process of retrieval of data in GST Prime.

On this being pointed out (March 2022), the department stated (June 2022) that one case has been referred to Principal Commissioner of Central Taxes since it comes under Central jurisdiction. Reply of the department is awaited in the remaining 31 cases (September 2022).

### 2.5.8.3 Excess credit of transitional credit

Based on the Form Tran-1 filed by a taxpayer, the transitional credit is credited to the dealer's Electronic Credit Ledger (ECL) in GST portal. As per data available in the ITC Ledger in GST Prime, Audit noticed that in four cases, as against transitional credit claim of ₹ 16.32 lakh, the ITC Ledgers of the dealers showed transitional credit of ₹ 51.20 lakh. This was either due to transitional credit being credited twice or excess credit than in Tran-1.

On this being pointed out (March 2022), the department stated (June 2022) that one case has been referred to the concerned office under the Central jurisdiction and another case has been assigned for audit. Reply of the department is awaited in the remaining two cases (September 2022).

#### Illustration:

In respect of a dealer, M/s. Navyug Energy Solutions Private Limited (GSTIN:29AADCN6371P1ZP/ TIN: 29620618628) under jurisdiction of LGSTO-090, Bengaluru, the ECL was credited with ₹ 39,86,187 that is, three times the amount of the credit of ₹ 13,28,729 claimed in Tran-1. The dealer had reversed one credit of ₹ 13,28,729 leaving an excess credit of ₹ 13,28,729 in his ITC ledger as compared to the Tran-1 form. The dealer in his annual return GSTR 9 had showed transitional credit of ₹ 13,28,729 only. Hence, the excess credit remained undetected.

### 2.5.9 Compliance issues

The table below brings out the extent of deficiencies noticed during the audit of transitional credit cases, selected for detailed audit:

**Table 2.6**  
Summary of nature of observations and deviation rates

(₹ in crore)

Nature of observations	Sample Audited		Deficiencies noticed		Deficiencies as percentage of Audited sample	
	Number	Amount	Number	Amount	Number	Amount
Claim of transitional credit without filing returns under the erstwhile KVAT Act	5,298	363.90	23	2.83	0.43	0.78
Incorrect claim of transitional credit	5,103	335.54	30	0.93	0.59	0.28
Excess Claim of transitional credit	5,103	335.54	49	2.08	0.96	0.62
Excess claim of transitional credit due to non-consideration of figures in Form VAT-240	5,103	335.54	58	0.96	1.14	0.29
Reduction of credit due to Re-assessment orders issued under KVAT Act	5,103	335.54	32	5.49	0.63	1.64
Others	5,298	363.90	71	3.46	1.34	0.95
<b>Total</b>			<b>263</b>	<b>15.75</b>		

As evident from the above table, significant deviations from rules and Act were noticed with respect to reduction of credit due to Re-assessment orders issued under KVAT Act, claim of transitional credit without filing returns under the erstwhile KVAT Act, excess claim of transitional credit etc.

Audit findings noticed, and the lapses identified in the above cases are included in the subsequent paragraphs.

#### 2.5.9.1 Ineligible claim of transitional credit

##### (a) Claim of transitional credit without filing returns under the erstwhile KVAT Act

As per Section 140(1), a registered person is entitled to take the amount of credit available under VAT in the Return for the period ending June 2017 as transitional credit. Proviso to the Section 140(1) of the KGST Act, states that the registered person shall not be allowed to take credit in his electronic credit ledger, the amount of the VAT credit carried forward, if the person has not furnished all the returns required under the existing law for the period of six months immediately preceding the Appointed date, that is, 1 July 2017. Hence, if the registered person claiming the credit of VAT as on 30 June 2017 has not furnished all the returns for the period from January 2017 to June 2017, he is ineligible to claim transitional credit.

Audit noticed that in 23 cases (out of 5,298 cases) involving transitional credit claim of ₹ 2.83 crore, the dealers had not filed all the returns for tax periods

between January 2017 to June 2017 and hence correctness of the transitional credit claimed could not be verified.

A few cases are illustrated below:

**Table 2.7**  
**Non-filing of VAT return**

Sl. No.	GSTIN / TIN / LGSTO	Trade Name (M/s.)	Ineligible transitional credit claimed (in ₹)	Remarks
1	29ABIP17472B1ZL / 29250611120 / LGSTO-065A, Bengaluru	A.R.S.Enterprises	2,27,55,453	The dealer was deregistered under VAT w.e.f. 21/03/2017 and had not filed return for the period March 2017.
2	29AAICM5191R1ZH/ 29771302541 / LGSTO-215, Mandya	M K Infra Holdings Private Limited	11,14,413	The assessee had not filed VAT returns for the period from April 2017 to June 2017.
3	29BVQPA5829M1ZV/ 29201341800 / LGSTO-110A, Bengaluru	Ajay Automobiles	1,63,833	The dealer has not filed VAT return for the period June 2017.

On this being pointed out (March 2022), department stated (June 2022) that in respect of two cases, notices have been issued. Reply of the department is awaited in the remaining 21 cases (September 2022).

**(b) Ineligible Claim of transitional credit by dealers under Composition Levy Scheme (CLS)**

A registered person under GST who had opted for payment of tax under Composition Scheme as per the provisions of Section 10 of Karnataka Goods and Services Tax Act, 2017, was not eligible for claim of transitional credit.

Audit noticed that out of 5,298 cases, in 6 cases, the dealers were under CLS in GST regime. However, they had claimed transitional credit of ₹ 13.60 lakh, which resulted in ineligible claim of transitional credit. This ineligible transitional credit was available in their Electronic Credit Ledger and the dealers could use it in the future if they migrate to regular tax scheme. The risk of availing the transitional credit in future in these cases cannot be ruled out and hence the Department needs to verify and disallow the ineligible transitional credit.

On this being pointed out (March 2022), the department stated (June 2022) that one case has been referred to audit. In one case, the ITC of ₹ 2.40 lakh was recovered and in another case, reassessment order has been passed where tax of ₹ 1.61 lakh has been levied. Reply of the department is awaited in the remaining three cases (September 2022).

### 2.5.9.2 Excess/incorrect transitional credit claimed through Table 5C of Form Tran-1

As per Section 140(1) of the KGST Act, a registered person is entitled to take, the amount of VAT credit carried forward in VAT return for the period ending June 2017 as transitional credit. Out of the sample of 5,298 cases checked, 5,103 dealers had carried forward credit available in June 2017 VAT return. Audit verification of the credit carried forward from June 2017 VAT return revealed excess/incorrect transitional credit claims in 234 cases amounting to ₹ 12.78 crore.

#### (a) Incorrect claim of transitional credit

Audit noticed 30 cases involving transitional credit claim of ₹ 0.93 crore, where the dealers had availed transitional credit under Table 5(C), which was meant to fill transitional credit carried forward from June 2017 return. However, the credit available in the VAT returns filed for June 2017 in these cases were zero. This resulted in incorrect claim of transitional credit of ₹ 0.93 crore.

A few illustrative cases are given below:

**Table 2.8**  
**Incorrect claim**

Sl. No.	GSTIN / TIN / LGSTO	Trade Name	Transitional credit claimed (in ₹)
1.	29AABFY7390N1Z9/29981347676/ LGSTO-260, Mangaluru	M/s. Yamuna Kamaldeep Developers	8,19,254
2.	29AAECB6805H1ZM/29640641800/ LGSTO-155, Ramanagaram	M/s. Minda Kyoraku Ltd.	7,87,609
3.	29AASFR2808K1ZK/29291367504/ LGSTO-120, Bengaluru	M/s. Right Properties INC	7,84,881
4.	29APGPS7738Q1ZO/ 29980814564/ LGSTO-110A, Bengaluru	M/s. Madhukar INC	5,75,845

Audit further noticed that out of the 30 cases, re-assessment orders under section 39 of KVAT Act were passed in eight cases involving an amount of ₹ 19.87 lakh for the period 2017-18. Of these however, the transitional credit availed was not discussed in four cases. Out of four cases where the transitional credit was discussed in re-assessment order, in one case, the incorrect transitional credit of ₹ 2.50 lakh was paid back by the dealer as per re-assessment order passed under the GST Act and in the remaining three cases, demand for incorrect transitional credit of ₹ 7.28 lakh was raised in the re-assessment orders based on audit observations.

On this being pointed out (March 2022), the department stated (June 2022) that four cases had been assigned to audit. In one case, tax (₹ 3.21 lakh) has been recovered. One case has been referred to Central jurisdiction. Reply in the remaining 24 cases are awaited (September 2022).

#### (b) Excess Claim of transitional credit

Audit noticed that in 49 cases, the dealers had claimed transitional credit of ₹ 4.33 crore against the credit of ₹ 2.25 crore available for carry forward as per VAT Return filed for June 2017 and VAT 240 wherever filed. This resulted in excess claim of transitional credit of ₹ 2.08 crore.

A few cases are illustrated below:

**Table 2.9**  
**Excess claim**

Sl. No.	GSTIN / TIN / LGSTO	Trade Name (M/s.)	Transitional credit claimed (in ₹)	Credit available in June 2017 VAT return/VAT 240 (in ₹)	Excess claim of transitional credit (in ₹)
1.	29ACHPK6284H1Z6/ 29740260729 LGSTO-250, Chickmagaluru	Vijayaraj Dilip Kumar	58,41,329	8,46,993	49,94,336
2.	29ABSPA7708E1ZI/ 29350070872/ LGSTO-75, Bengaluru	Ananda Metal corporation	43,27,850	4,32,785	38,95,065
3	29AABCD2432K1ZP/ 29750136030/ LGSTO-120, Bengaluru	Deepti Electronic and Electro Opticals Limited	19,52,610	4,46,042	15,06,568
4.	29AAUFS1292G1ZM/ 29430055308/ LGSTO-540, Bidar	Swamy Electricals	45,47,327	30,86,357	14,60,970

Audit further noticed that out of the 49 cases, re-assessment orders/proceedings were passed for the period 2017-18 in 7 cases. Of these 7 cases, transitional credit availed in 6 cases amounting to ₹ 28.84 lakh was not discussed in re-assessment order. In one case, the excess transitional credit of ₹ 0.93 lakh was recovered based on audit observation.

On this being pointed out (March 2022), the department stated (June 2022) that rectification orders were passed in two cases and an amount of ₹ 6.21 lakh was collected, four cases have been referred to Central jurisdiction and 2 cases have been assigned to audit. Reply in the remaining 41 cases are awaited (September 2022).

**(c) Claim of same amount under different provisions of transitional credit in Tran-1 resulting in enhanced credit in Electronic Credit Ledger (ECL)**

As per Section 140(1) of the KGST Act, a registered person is entitled to take, the amount of credit available for carry forward in VAT return for the period ending June 2017 as transitional credit. As per Section 140(5) of the KGST Act, a dealer can avail transitional credit on inputs/input services for which invoice has been raised in the erstwhile VAT regime and goods are received after 1 July 2017 provided the same are accounted in the books of accounts on or before 31 July 2017. Further, as per Section 140(6) of the KGST Act, a dealer can avail transitional credit on the stock held by him on which he had not availed input tax credit in the earlier regime based on availability of tax invoices, that is transitional credit on inputs/semi-finished goods in stock. The form Tran-1 provided for specific entries for claim of transitional credit under various provisions such as Table 5C for carry forward from June 2017 return, Table 7B for inputs in transit, Table 7C for inputs/semi-finished goods in stock and Table 7D for goods for which no tax invoice was available as proof of having paid tax. In respect of credit under Section 140(7) in Table 7D of Tran-1, the dealers were required to file Tran-2 on disposal of the goods whereby the transitional credit would be credited to the ITC Ledger.

Audit verification revealed that in 17 cases the dealers had entered the same amount of transitional credit under various tables in the Tran-1 form, that is under Table 5C, Table 7B, Table 7C and Table 7D and had consequently got the consolidated credit of ₹ 1.59 crore in their ECL. Audit scrutiny revealed that these dealers had a credit of ₹ 0.76 crore in their June 2017 KVAT Return. This resulted in excess credit of transitional credit of ₹ 0.83 crore.

A few cases are illustrated below:

Table 2.10

## Enhanced credit in Electronic Credit Ledger

(in ₹)

Sl. No.	GSTIN / TIN / LGSTO	Trade Name	Transitional credit claimed	Credit available in June 2017 VAT return	Excess claim of transitional credit	Remarks
1	29ASAPK9010E1Z0/ 29710676827/ LGSTO-90, Bengaluru	M/s. I Monetary Advisory	1,07,26,080	53,63,040	53,63,040	Same amount claimed under Table 5C and Table 7C
2.	29ACBPR9470L1ZU/ 29530386314/ SGSTO-265, Puttur	K.V.G Electricals & Contractors	3,72,390	0	3,72,390	The dealer had claimed ₹ 1,24,130 in tables 5C, 7B, 7C and 7D. Of these, credit claimed under tables 5C, 7B and 7C amounting to ₹ 3,72,390 was credited to the ledger.
3.	29ABMPR1417M1Z4/ 29230741402/ LGSTO-200, Mysuru	M/s. RTC Agri Services	5,44,370	1,81,457	3,62,913	Same amount of ₹ 1,81,457 claimed under 5C, 7B, 7C and 7D. Credit of amount under 7D not in ECL as Tran- 2 was not filed.
4.	29AAUFM4446Q1Z5/ 29620652578/ LGSTO-80, Bengaluru	M/s Maruthi Plywoods	6,97,468	3,48,734	3,48,734	Same amount claimed under both 5C and 7C.

Audit further noticed that, of these 17 cases, 11 dealers had filed GSTR 9, of which nine dealers had claimed the same amount of transitional credit as in Tran-1 and two had shown reduced transitional credit of ₹ 2.47 lakh in GSTR 9. However, these two dealers had not reversed the excess transitional credit or paid back through DRC 3.

On this being pointed out (March 2022), department stated two cases were assigned to audit, one case has been referred to Central jurisdiction. Reply in the remaining 14 cases are awaited (September 2022).

**(d) Non-restriction of transitional credit to the extent of tax liability on non-filing of statutory Forms**

As per proviso to Section 140(1), so much of the said credit as is attributable to any claim related to Section 3, sub-section (3) of Section 5, Section 6, Section 6A or sub-section (8) of Section 8 of the Central Sales Tax Act, 1956 (Central Act 74 of 1956) which is not substantiated in the manner, and within the period, prescribed in Rule 12 of the Central Sales Tax (Registration and Turnover) Rules, 1957 shall not be eligible to be credited to the electronic credit ledger, Form Tran-1 provided for the dealers to enter the details of turnover and tax liability for which statutory forms such as C, H, I and F were not filed for the concessional rate of tax and to reverse the same from the



credit carried forward from June 2017 return to arrive at the transitional credit to be availed.

Audit noticed that seven out of 5,298 dealers with transitional credit of ₹ 1.32 crore had shown additional tax liability of ₹ 5.28 crore towards non furnishing of statutory Forms (Form-C, F, H & I) in the Tran-1 Forms. However, the dealers had not restricted the transitional credit of ₹ 1.32 crore availed wherein the statutory Forms not filed by them. Further, after considering the statutory Forms filed post filing of Tran-1, an amount of ₹ 0.20 crore was still due (after re-assessment order issued by the department under CST Act) for non-filing of statutory Forms. Non-restriction of the tax due, while filing Tran-1 resulted in raising of demands under the legacy regime.

**Illustration:**

M/s. Weir Minerals (India) Pvt. Ltd. (GSTIN:29AAACI0519D1Z0/ TIN: 29060203873) under jurisdiction of LGSTO-075, Bengaluru, out of transitional credit of ₹ 98,68,672, dealer had reversed ₹ 1,51,706 towards H Form tax payable and availed transitional credit of ₹ 97,16,966. However, the dealer had not reversed the Form C tax due of ₹ 12,28,969 (as per re-assessment order) shown in Tran-1 Form.

On this being pointed out (March 2022), the department stated (June 2022) that four cases that pertained to Central jurisdiction have been referred to Central authority. Reply in the remaining three cases are awaited (September 2022).

**2.5.9.3 Other observations**

A registered person was entitled to carry forward the credit available in the return for the quarter or month ending June 2017, furnished by him. However, there were various factors such as reduction of credit due to filing of audited statement of accounts along with Certificate of Chartered Accountant in Form VAT 240, re-assessment orders, ineligible credit due to mismatches in e-UPaSS, non-filing of TDS certificates etc., which had an impact on the credit available at the end of June 2017. Audit noticed that the dealers had not made corresponding reductions in the credit available in June 2017 before filing Tran-1 for transitional credit and hence this had resulted in incorrect claims of transitional credit by the dealers. As the department had not initiated a mechanism for verification of transitional credit claims, these remained undetected. Such instances and the effect of the same on the transitional credit claimed are discussed below.

**(a) Excess claim of transitional credit due to non-consideration of figures in Form VAT-240**

According to Section 31(4) of KVAT Act, dealers with turnover above ₹ one crore had to file Form VAT-240 after getting their books of accounts audited by a Chartered Accountant. In respect of the financial year, 2017-18 (April 2017 to June 2017), dealers with turnover of ₹ 25 lakh and above were required to file the Form VAT-240.



Audit noticed in 58 cases (out of 5,103 cases) that a total of ₹ 8.72 crore had been availed towards transitional credit and in these cases, as per Form VAT-240 filed, either for 2017-18 or an earlier financial year, the credit available at the end of June 2017 was only ₹ 7.76 crore. This resulted in excess claim of ₹ 0.96 crore due to non-restriction of transitional credit as per VAT 240.

A few illustrative cases are given below:

**Table 2.11**

**Excess claim**

Sl. No.	GSTIN/TIN	Name	Transitional credit (in ₹)	Credit as per June 2017 VAT return (in ₹)	Credit available as on 30-06-2017 after filing VAT 240 (in ₹)	Excess transitional credit availed (in ₹)
1	29AAGFS7756M1ZA/ 29520043958 LGSTO-520, Kalaburagi	Sanjeevini Distributors	26,12,141	26,12,141	4,83,886	21,28,255
2	29AADCA2447F1ZU/ 29460129545 LGSTO-100, Bengaluru	Akshaya Agro Sales Private Limited	91,96,103	91,96,103	81,85,913	10,10,190
3	29AAACK6967D1ZA/ 29970110495 LGSTO-70A, Bengaluru	KLN Engineering Products Private Limited	39,87,968	39,87,968	34,22,389	5,65,579

Audit further noticed that out of above 58 cases, in 11 cases in efs, re-assessment orders under section 39 of KVAT Act was passed for the period 2017-18 levying tax of ₹ 25.70 lakh, out of which ₹ 0.67 lakh was collected in one case.

On this being pointed out (March 2022), the department stated (June 2022) that eight cases were assigned to audit and two cases were referred to Central jurisdiction. In two cases, the amount of ₹ 0.75 lakh was recovered. Reply in the remaining 46 cases are awaited (September 2022).

**(b) Reduction of credit due to Re-assessment orders issued under KVAT Act**

Re-assessment orders under Section 39 of the KVAT Act are passed after detailed scrutiny of the books of accounts by the Departmental Officers where the output tax and input tax may be subjected to variations due to detection of short/excess declaration of sales/purchase turnovers, non-compliance with the rules and regulations etc.

Audit noticed 32 cases of re-assessment orders out of 5,103 cases examined where transitional credit of ₹ 5.82 crore was availed. The carry forward credit available for the tax period June 2017 was ₹ 3.32 crore. However, consequent on re-assessments, the credit available as of June 2017 was reduced to ₹ 33.11 lakh. This resulted in excess claim of transitional credit of ₹ 5.49 crore due to non-consideration of the reduced credits available consequent on re-assessments. Though these re-assessments were concluded after the

implementation of GST, the department failed to assess the impact on transitional credit availed and did not take any action to reverse the additional transitional credit availed by the assesseees. A few illustrative cases are given below:

Table 2.12

## Reduction in credit after re-assessment

Sl. No.	GSTIN / TIN / LGSTO	Trade Name	Transitional credit claimed in Table 5C (in ₹)	Credit available in June 2017 after re-assessment (in ₹)	Excess transitional credit availed (in ₹)
1	29ARCPP3005F1Z2/ 29080777811/ LGSTO-90, Bengaluru	M/s. Suman Fin Stock	2,75,32,468	0	2,75,32,468
	As per re-assessment order dated: 23.3.2021 for 2017-18, there was no credit available for carry forward under GST.				
2	29AAGCA8774N1ZS/ 29800804090/ LGSTO-535, Sindhanur	M/s. Amruth Constructions Private Limited	62,51,803	0	62,51,803
	As per the rectification order dated 23.7.2021 for 2017-18, there was no credit available for carry forward under GST.				
3	29AKGPR7728A1ZY/ 29030796802/ LGSTO-195, Mysuru	M/s. Y.V.R. Constructions	58,06,001	0	58,06,001
	As per re-assessment order dated 30.10.2021 for 2017-18, there was no credit available for carry forward under GST.				
4	29AAJFS4902N1ZN/ 29531117985/ LGSTO-200, Mysuru	M/s Sripathy Associates	19,02,489	0	19,02,489
	As per re-assessment order dated 27.8.2021 for 2017-18, there was no credit to be carried forward under GST.				
5	29CBMPK9932L1ZR/ 29951352397/ LGSTO-280, Udupi	M/s. K.C.S. Timbers	17,58,398	0	17,58,398
As per the re-assessment orders dated 11.12.2020, for the years 2016-2017 and 2017-2018, there was no credit available for carry forward under GST.					

On this being pointed out (March 2022), department stated (June 2022) that one case was assigned for audit. Reply in the remaining 31 cases are awaited (September 2022).

**(c) Reduction in credit due to ineligible ITC on verification from e-UPaSS**

e-UPaSS was software developed by CTD for uploading the purchase and sale invoices which served as a tool to match the purchase invoices of a purchasing dealer with the corresponding sale invoices of the selling dealer.

On cross verification of purchase details for ITC availed under KVAT in e-UPaSS with the invoice details in Tran-1 Form, it was noticed in 17 cases with transitional credit of ₹ 1.74 crore that the assesseees had claimed excess

transitional credit of ₹ 0.59 crore due to reasons such as (i) credit already availed under VAT, (ii) claim of transitional credit on inter-State purchases, etc.

Audit further noticed that out of the 17 observed cases, in 3 cases as noticed in efs, re-assessment orders/proceedings were passed for the period 2017-18. However, the excess transitional credit availed was neither detected nor any action initiated for recovery of loss of revenue.

On this being pointed out (March 2022), the department stated (June 2022) that one case was referred to the Central jurisdiction, one case was assigned to audit and in one case, an amount of ₹ 3.06 lakh was recovered. Reply in the remaining 14 cases are awaited (September 2022).

**(d) Reduction in credit due to non-filing of TDS certificates**

Section 9-A of KVAT Act provides for Tax Deduction at Source (TDS) and the person effecting TDS is required to remit the amount of tax to Government and issue a TDS Certificate in Form 156 to the person from whose payment TDS has been deducted. The TDS certificate enables the person to claim TDS credit against the tax payable while filing his return under KVAT. If a dealer claims TDS credit in his KVAT return against tax payable, but does not produce the TDS certificate, the realisation of revenue to the Government cannot be assured. Further, it also affects the carry forward credit in cases where TDS claim is more than his tax liability.

Audit noticed that in six cases, the dealers had claimed transitional credit of ₹ 0.84 crore based on credit available in VAT returns. Audit verification revealed that the carry forward credit available in June 2017 return was as a result of claim of TDS amounts of ₹ 1.46 crore. Audit noticed that TDS certificates to the extent of ₹ 0.74 crore were not filed. Out of these, it was noticed that in some cases, the disallowance of TDS claimed due to non-filing of TDS certificates was more than the transitional credit claimed. In other cases, the disallowance due to non-filing of TDS was less than the transitional credit claim. Limiting the disallowance in the former cases to the extent of transitional credit claimed and disallowing the transitional credit to the extent of non-filing of TDS certificates in the later cases, the incorrect transitional credit worked out to ₹ 0.60 crore.

These cases were brought to the notice of the Department (March 2022). Reply of the department is awaited (September 2022).

**(e) Reduction in credit due to miscellaneous reasons**

In 18 cases, out of 5,298 cases examined, with transitional credit of ₹ 2.06 crore, there were various factors impacting the credibility of transitional credit such as claims of ITC with exempted turnover, interstate purchases, incorrect and excess carry forward of ITC which had resulted in incorrect/excess transitional credit of ₹ 1.10 crore as detailed below:

**Table 2.13**  
**Reduction in credit due to other reasons**

No. of cases	Incorrect Transitional credit (₹)	Reason
09	17,40,725	Exempted turnover due to labour works
04	16,43,732	Due to interstate purchases
05	76,22,175	Other reasons like availing twice, purchases in GST period etc.

On this being pointed out (March 2022), the department stated (June 2022) that one case was referred to the Central jurisdiction, one case was assigned to audit and in one case, an amount of ₹ 0.66 lakh was recovered. Reply in the remaining 15 cases is awaited (September 2022).

#### **2.5.9.4 Conclusion and recommendations**

The transitional credit was a one-time flow of input tax credit from the legacy regime into the GST regime. Out of 5,298 cases that were examined in detail, Audit observed compliance deviations in 263 cases amounting to ₹ 15.75 crore, constituting an error rate of five *per cent*. Higher rates of irregularities were noticed in three categories namely, (i) reduction of credit due to re-assessment orders issued under KVAT Act, (ii) claim of transitional credit without filing returns under the erstwhile KVAT Act, and (iii) excess claim of transitional credit.

Though the absence of Action Plan for verification of Transitional Credits and ineffective risk assessment were pointed out in the earlier Report, the above findings reveal lack of remedial action by the department.

In view of the above compliance findings, we recommend the following:

The Department may:

- i) Prioritise verification of transitional credits based on risk parameters and analyse the impact of re-assessments vis-à-vis availment of transitional credit; and*
- ii) Initiate remedial measures for the compliance deviations pointed out during this audit before the claims become time barred.*

## **2.6 Subject Specific Compliance Audit on GST Refunds**

### **2.6.1 Introduction**

The concept of refunds under Goods and Services Tax (GST) relates to any amount that is returned to the taxpayer by the Government, that was paid by the taxpayer either in excess or which was not liable to be paid by him under the statute. The amounts that can be claimed as refund includes not merely tax but interest, penalty, fee, or any other amount paid. Refund is also permissible on the unutilised Input Tax Credit (ITC) in respect of the supplies made under zero rated or inverted duty structure categories. The provisions of refund contained in the GST law aim to streamline and standardise the refund procedures under GST regime. Further, timely refund is essential in tax administration as it facilitates trade through release of blocked funds for working capital, expansion and modernisation of existing business.

GST law envisaged an automated environment for filing and processing of refund claims through a refund module in Goods and Services Tax Network (GSTN) common portal. However, initially due to non-availability of this electronic refund module in the common portal, a temporary mechanism was devised wherein the taxpayers were required to file the claim through a manual process. Further, the input matching process was not operationalised through the envisaged forms, thus the refunds were processed based on the provisionally accepted ITC under the said manual process. Rule 97A of the Central Goods and Services Tax (CGST), Rules 2017/ Karnataka Goods and Services Tax (KGST), Rules 2017 had enabled this manual filing and processing of refund claims. However, with effect from 26 September 2019, the refund module is deployed in the common portal and the necessary capabilities of refund process are fully automated.

Accordingly, a fresh set of guidelines had been issued for electronic submission and processing of refund claims vide Circular No.125/44/2019-GST dated 18 November 2019.

### **2.6.2 Audit objectives**

Audit of Refund cases under GST regime was conducted to assess:

- i. The adequacy of Act, Rules, notifications, circulars etc. issued in relation to grant of refund;
- ii. The compliance of extant provisions by the tax authorities and the efficacy of the systems in place to ensure compliance by taxpayers; and
- iii. Whether effective internal control mechanism exists to check the performance of the departmental officials in disposing the refund applications.

### **2.6.3 Scope of Audit**

Pan-India GST refund data was obtained from GSTN and through risk-based data analysis, a sample of refund cases was extracted for detailed examination. Refund cases processed in the selected circles of State Tax Offices from July 2017 to July 2020 were scrutinised and the replies received up to June 2022 were included.

An Exit conference was held with the Commissioner of Commercial Taxes (CCT) in May 2022. The response by the CCT have been included in the relevant paragraphs.

### **2.6.4 Sample and Coverage**

GSTN provided pan-India Refund Data for the period from July 2017 to July 2020. For the period prior to 26 September 2019, i.e. pre-automation period, the refund applications under each category were sorted out in descending order of refund amount claimed by taxpayers. The sorted refund applications were divided into four quartiles for drawing the sample.

For selecting refund applications, filed after 26 September 2019, a composite risk score was devised using risk parameters such as refund amount claimed (60 *per cent* weightage), delay in sanctioning refund (15 *per cent*), Refund sanctioned/refund claimed ratio (10 *per cent*) and issue of deficiency memo.

Based on the risk score, arrived as per this process, refund applications were selected.

Based on the above procedure, a sample of 1,031 refund cases pertaining to Karnataka State covering all 13 divisions was selected for audit. Out of these, 495 claims pertain to pre-automation period and 536 claims pertain to post-automation period. The actual coverage of refund cases for audit is 1,024<sup>10</sup> claims, with 488 cases pertaining to pre-automation claims and 536 claims under post-automation, since records were not produced in seven cases out of 495 cases pertaining to pre-automation period.

### 2.6.5 Audit criteria

The audit objectives were benchmarked against the criteria drawn from the following sources:

- Karnataka Goods and Services Tax Act, 2017
- Karnataka Goods and Services Tax Rules, 2017
- Circulars and Notifications issued by the State Government
- Central Goods and Services Tax Act, 2017
- Integrated Goods and Services Tax Act, 2017

### 2.6.6 Audit findings

Audit findings are categorized into two broad perspectives viz., systemic issues and compliance issues. While the systemic issues aim to bring out the shortcomings relating to deficiency in the control mechanism in processing refund claims leading to double payments or excess payments, compliance issues highlight deviations from the provisions of Act and Rules and the resultant impact on revenue. Further, 17 instances of double/multiple payments of refunds were noticed from the test check of payments through Khajane-2<sup>11</sup> under pre-automation period. The audit findings are given in the succeeding paragraphs.

### 2.6.7 Systemic issues

Audit noticed systemic issues in processing refund claims leading to double/excess payments, non-follow-up of Central Board of Indirect Taxes and Customs (CBIC)/ Commissioner of Commercial Taxes (CCT) Circular instructions resulting in accumulation of IGST and non-adherence to the provisions of Clause (D) of Rule 89(4) of CGST Rules, 2017/ KGST Rules, 2017 for zero-rated supply of services (Exports without payment of IGST), which are detailed below.

#### 2.6.7.1 Instances of Double payment of SGST refunds in the pre-automation period

Section 6(1) of the KGST Act, 2017 specifies that the officers appointed under the Central Goods and Services Tax (CGST) Act are authorised to be the proper officers for the purpose of this Act.

<sup>10</sup> In seven cases of pre-automation period, refund files were seized by the Commissioner of Commercial Taxes and were not provided to Audit and checked by Audit.

<sup>11</sup> Khajane-2 is the Accounting & Financial Report software of the Government of Karnataka.



Based on the above provisions, the officers appointed under State Goods and Services Tax (SGST)/ Union Territory Goods and Services Tax (UTGST) Act are empowered to sanction refund of CGST or Integrated Goods and Services Tax (IGST) components of claims in respect of taxpayers coming under their respective jurisdiction. Similarly, the proper officer under CGST Act (Section 6(1) of CGST Act) is empowered to sanction refund of SGST/UTGST components of the claims pertaining to the taxpayers under their jurisdiction. During the manual processing of refund claims, the actual payment of the cross-tax components was made by the respective SGST/UTGST or CGST authorities, based on the refund orders received from the administrative authorities sanctioning refund. As against this manual payment process<sup>12</sup>, in the post-automation period, refund payments are being made through automated mode by e-PAO Chennai (PFMS).

Refund payment data of SGST component (Head of Account-0006-SGST) from the records of Khajane-2 statements in the respective Local GST Offices (LGSTOs) was examined to assess timely disbursement of the refunds sanctioned by the cross jurisdictional authorities.

During the test check of refund payments in respect of claims made during the period from July 2017 to September 2019 (pre-automation period), Audit noticed instances of double payments of refund of SGST component in five<sup>13</sup> LGSTOs. In these cases, it was observed that the payments were initiated twice at the LGSTOs on the same base documents and reasons for double payments were not forthcoming from the refund files. This reflected a control deficiency in the manual payment process pertaining to SGST component, resulting in double/ excess payment of SGST component in 17 cases amounting to ₹ 1.96 crore.

On this being pointed out (between August and September 2021), the department intimated (between May and June 2022) that an amount of ₹ 45.26 lakh was recovered in three cases and endorsement was issued in two cases. The reply in the remaining 12 cases are awaited (September 2022).

Two illustrative cases are given below:

- i) The assessee, M/s. CSR India Private Limited/29AAACU4714E1ZH, had claimed refund on account of zero rated supply of goods and services for the relevant period July 2017 to March 2018 vide ARN: AA290318063699H dated 29-03-2019. The provisional refund amount of ₹ 66.83 lakh was sanctioned twice, once on 26-04-2019 for ₹ 66.83 lakh and another provisional refund order was issued on 30-07-2019 for ₹ 66.83 lakh, to two different bank accounts. On verification of KFC 62-B Treasury Schedule in the office of LGSTO-15, it was confirmed that the refund was made twice resulting in double payment of refund of ₹ 66.83 lakh.
- On this being pointed out (August 2021), the department stated (May 2022) that the endorsement had been issued to repay the excess payment.

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<sup>12</sup> In Karnataka, refund of SGST component was issued by State Tax Authorities.

<sup>13</sup> LGSTO-15, LGSTO-16, LGSTO-90, LGSTO-120 and LGSTO-152.



ii) The assessee, M/s. Aruba Networks India Private Limited/ 29AAFCA4556M1Z7, had claimed refund on account of zero rated supply of goods and services for the relevant period July 2017 to September 2017 vide ARN: AB290917101992Q dated 07-09-2018. In the provisional refund order dated 12-10-2018, refund of ₹ 43.55 lakh was sanctioned. On verification of KFC 62-B Treasury Schedule, it was noticed that refund was made twice i.e. refund of ₹ 43.55 lakh made vide Token No.1800297906 dated 26-10-2018 and ₹ 43.55 lakh vide Token No.1901173391 dated 06-05-2019, which resulted in double payment of refund of ₹ 43.55 lakh.

On this being pointed out (August 2021), the department intimated (May 2022) that the amount of ₹ 64.96 lakh along with interest was recovered.

Reconciliation of refund payments needs to be done by the Department to address the systemic issue of double payments of SGST component of refunds in the pre-automation cases.

#### **2.6.7.2 Non follow up of CBIC/CCT Circular instructions resulted in accumulation of IGST and consequent refund of CGST and SGST**

In the Circular No. 59/33/2018-GST dated 4 September 2018 issued by Central Board of Indirect Taxes and Customs and corresponding Circular of Commissioner of Commercial Taxes, Karnataka vide Circular No. GST-28/2018-19 dated 25 March 2019, provides for debit of the refund amount of accumulated ITC by the claimant from its electronic ledger in the following order:

- a) Integrated tax, to the extent of balance available;
- b) Central tax and State tax/Union Territory tax, equally to the extent of balance available and in the event of a shortfall in the balance available in a particular electronic credit ledger (say, Central tax), the differential amount is to be debited from the other electronic credit ledger.

During test check it was noticed in 16 refund cases (five cases under Pre-Automation and 11 cases under Post-Automation) that neither the refund claimants (assesseees) nor the Assessing Officers (LGSTOs/SGSTOs) had followed the order of debiting the refundable amount under IGST, CGST and SGST in the Electronic Credit Ledger (ECL) as clarified by the CCT Circular No. GST-28/2018-19 dated 25 March 2019. This has resulted in accumulation of IGST and consequent issue of CGST and SGST to the same extent.

On this being pointed out (between August and September 2021), the department during exit conference stated (May 2022) that it was only a technical issue and there is no loss of revenue.

Audit once again reiterates that the said circular instructions may be adhered to.

### 2.6.7.3 Grant of provisional refunds to ineligible cases

As per Section 54(6) of the CGST Act, 2017/ KGST Act, 2017, the proper officer may in the case of any claim for refund on account of zero-rated supply of goods or services or both made by the registered persons, other than such category of registered persons as may be notified by the Government on the recommendations of the Council, refund on a provisional basis 90 *per cent* of the total amount so claimed.

During test check it was noticed that in three cases out of 110 cases provisional refund was sanctioned under the category of inverted duty structure even though the rules did not permit provisional refund under the inverted duty structure. An Illustrative case is given below.

➤ M/s. Mangalore Chemicals & Fertilizers Limited/ 29AABCM3599G1Z3 had claimed refund of accumulated ITC on account of supplies made under inverted Duty Structure for the periods September 2018 to October 2018, December 2018 and July 2019. The refund claimed for these refund periods was ₹ 92.27 crore. On verification of the refund claim, it was noticed that the provisional refund of ₹ 83.05 crore, being 90 *per cent* of total amount claimed, was sanctioned for the said refund periods even though the claim was under inverted duty structure category.

On this being pointed out (September 2021), the Department during exit conference stated (May 2022) that the issue was only a procedural lapse and not a wrong refund.

Audit reiterates that such lapses may be avoided in future.

### 2.6.8 Compliance issues

Table below brings out the extent of deficiencies noticed during the detailed audit of refund cases.

**Table 2.14**  
**Summary of nature of observations and deviation rates**

Nature of Audit Findings	Audit Sample in number	Number of deficiencies noticed in number	Deficiencies as percentage of Sample
Delay in issuance of provisional refund on account of zero-rated supply	1,024	41	4.00
Delay in issue of final Refund	1,024	61	5.96
Incorrect refund due to allowing capital goods credit under net ITC	1,024	11	1.07
Excess refund due to allowing ineligible credit under net ITC and ITC on input services under Inverted duty structure	1,024	20	1.95
Excess refund due to incorrect adoption of turnover	1,024	23	2.25

As evident from the table above, Audit noticed delays in issuance of provisional refund on account of zero rated supply in four *per cent* and delay in final refund in 5.96 *per cent* cases. Audit also noticed that excess refund due to incorrect adoption of turnover in 2.25 *per cent* cases, excess refund due to

allowing ineligible credit under net ITC and ITC on input services under inverted duty structure in 1.95 *per cent* cases and incorrect refund due to allowing capital goods credit under net ITC in 1.07 *per cent* cases.

#### **2.6.8.1 Delay in issuance of provisional refund on account of zero rated supply**

Rule 91(2) of KGST Rules, 2017, envisages that the proper officer, after scrutiny of the claim and on the evidence submitted in support thereof and on being *prima-facie* satisfied that the amount claimed as refund is due to the applicant in accordance with the provisions of sub-section (6) of 54, shall make an order in Form GST-RFD-04, sanctioning the amount of refund on a provisional basis within a period not exceeding seven days from the date of acknowledgement.

Audit noticed that out of 1,024 sample cases (488 pre-automation and 536 post-automation), there was delay in issue of provisional refund orders in 41<sup>14</sup> cases (4.00 *per cent*) in fifteen<sup>15</sup> LGSTOs. The delay ranged from two to 89 days. Out of these, 39 cases were delayed up to two months and two cases were delayed by more than two months.

On this being pointed out (between February 2021 and December 2021), two<sup>16</sup> LGSTOs intimated (between August and September 2021) that no interest was paid under Section 56 of the KGST Act and the delay was due to technical glitches in transmitting the data from GSTN to the State Portal.

The reply is not tenable since the statutory provisions regarding sanction of refund on provisional basis within the statutorily specified time lines is part of Government's policy of 'ease of doing business' and to release the blocked revenue as soon as possible to the businesses concerned.

#### **2.6.8.2 Delay in issue of final Refund**

Section 54(7) of the KGST Act, 2017 stipulates that the proper officer shall issue the order under sub-section (5) within sixty days from the date of receipt of application complete in all respects.

Audit noticed that out of 1,024 sample cases (488 pre-automation and 536 post-automation), final refund orders were issued after a delay in 61<sup>17</sup> cases (5.96 *per cent*) in 13<sup>18</sup> LGSTOs. The delay ranged from two to 229 days. Out of these, 45 cases were delayed up to three months, 13 cases were delayed between three to six months and three cases were delayed by more than six months.

On this being pointed out (between July and March 2022), three LGSTOs<sup>19</sup> intimated (between July and September 2021) that no interest was paid under

<sup>14</sup> 10 in pre-automation and 31 in post-automation.

<sup>15</sup> LGSTO 15,20,26, 30,36,40,46,50,66,150 Bengaluru, LGSTO 190 Mysuru, LGSTO 310 Dharwad, LGSTO 320 Hubballi, SGSTO 261 Bantwal and SGSTO 191 Nanjangud.

<sup>16</sup> LGSTO 20 and 36, Bengaluru.

<sup>17</sup> 34 in pre-automation and 27 in post-automation.

<sup>18</sup> LGSTO 15, 20,26,35,36,46,75, 90 Bengaluru, LGSTO 190 Mysuru, LGSTO 320 Hubballi, LGSTO 360 Ranebennur, SGSTO 191 Nanjangud and SGSTO 261 Bantwal.

<sup>19</sup> LGSTO 20,36 and 75 Bengaluru.

Section 56 of the KGST Act and that the delay was due to technical glitches in transmitting the data from GSTN to the State Portal.

The reply is not tenable since the law has specified the timelines for each stage of refund.

#### **2.6.8.3 Incorrect refund in respect of export invoices pertaining to pre-GST period**

As per section 142(4) of KGST Act, 2017 every claim of refund filed after the appointed day for refund of any duty or tax paid under existing law in respect of the goods or services exported before or after the appointed day shall be disposed in accordance with the provisions of existing law.

During test check, two cases<sup>20</sup> were noticed where exports were made under the pre-GST law. However, while processing the refund, these cases were treated as a part of zero rated supply made under the GST law. This resulted in incorrect grant of refund of ₹ 1.98 crore as detailed below.

i) The assessee, M/s VM Ware Software India Private Limited/ 29AACCV4573E1Z5, had claimed refund for the period July 2017 in respect of export invoices issued during the month of June 2017 (i.e. pre-GST period) and payments in convertible foreign exchange realised (FIRCs) during the month of July 2017. Thus, the said export of services were made under the provisions of pre-GST law and hence cannot be considered as a part of zero rated supply made under GST law. This resulted in incorrect grant of refund of ₹ 42.24 lakh.

On this being pointed out (December 2020), the LGSTO stated (August 2021) that the case would be forwarded to the Divisional Office for necessary action.

ii) The assessee, M/s Sabre Travel Technologies Pvt Ltd/ 29AAICS5777P1Z7, had claimed refund for the period July 2017 to September 2017 in respect of export invoices issued during the months of March 2017, April 2017 and May 2017 (i.e. pre-GST period) and payments in convertible foreign exchange realised (FIRCs) during the months of July 2017 and September 2017. Thus, sanctioning of refund of GST in respect of Export of Services which were made under the provisions of pre-GST law, considering as a part of zero rated supply made under the GST law was not in order. This omission resulted in irregular grant of refund of ₹ 1.56 crore.

On this being pointed out (April 2021), the LGSTO stated (August 2021) that the observation would be examined.

#### **2.6.8.4 Incorrect refund due to allowing capital goods credit under net ITC**

As per Section 54 of Karnataka Goods and Services Act, 2017, refund of unutilized input tax credit (ITC) can be claimed by a registered person at the end of any tax period. Rule 89(4) of KGST Rules, 2017, prescribes the

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<sup>20</sup> Out of 1,024 sample cases.

formula<sup>21</sup> as per which the refund in the case of zero-rated supply of goods or services shall be granted. 'Net ITC' means input tax credit availed on inputs and input services during the relevant period. Thus, ITC availed on capital goods shall not be considered.

During test check it was noticed that in 11 refund claims out of 1,024 claims (five cases in the pre-automation period and six cases in the post-automation period), the ITC on capital goods was allowed as net ITC for the purpose of calculation of refund amount, resulting in incorrect refund of ₹ 1.89 crore.

Further, it was noticed that in two out of 11 cases pointed out, the refund claimants had not followed the instructions contained in the Circular No. 125/44/2019-GST dated 18-11-2019 while submitting the Annexure-B distinguishing the ITC on capital goods and/or input/ input services. Thus, while sanctioning the refunds, the LGSTOs/ SGSTOs had to insist the assessee to furnish the ITC claim statements distinguishing the ITC on capital goods and/or input/ input services.

On this being pointed out (between December 2020 and September 2021) the LGSTO intimated (September 2021) that an amount of ₹ 30.33 lakh including interest was recovered in one case. In the remaining ten cases, replies are awaited (September 2022).

Two illustrative cases are given below.

i) Refund of unutilised ITC in respect of M/s SAP Labs India Pvt Ltd/29AAFCS3649P1ZJ on account of zero-rated supply of goods and services without payment of tax for the period October 2017 to December 2017 was sanctioned for an amount of ₹ 35.85 crore. On verification of input tax claimed by the taxpayer along with the supporting documents, it was noticed that net ITC claimed by the taxpayer included ITC on capital goods amounting to ₹ 24.05 lakh. However, the same was allowed resulting in incorrect sanctioning of refund of ₹ 23.11 lakh.

On this being pointed out (August 2021), the LGSTO intimated (September 2021) that an amount of ₹ 30.33 lakh including interest was recovered.

ii) Refund of unutilised ITC in respect of M/s Cambium Networks Private Limited/ 29AAECC7182N1Z0 on account of zero-rated supply of goods and services without payment of tax for the period October 2018 to March 2019 was sanctioned for an amount of ₹ 39.73 lakh. In the Annual Return GSTR-9 for the year 2018-19, the assessee had declared ITC of ₹ 89.86 lakh on capital goods. However, the assessee while claiming refund, ITC on capital goods was not excluded which resulted in excess refund of ₹ 39.73 lakh for the refund period October 2018 to March 2019.

On this being pointed out (July 2021), the LGSTO stated (May 2022) that the order was passed for the year 2018-19 in which ITC on capital goods was restricted.

<sup>21</sup> Refund amount=(Turnover of zero-rated supply of goods + Turnover of zero-rated supply of services) × Net ITC ÷ Adjusted Total Turnover

**2.6.8.5 Excess refund due to allowing ineligible credit under net ITC and ITC on input services under Inverted duty structure**

Section 17(5) of CGST Act, 2017/ KGST Act, 2017 stipulates that ITC is not available on supplies like food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, services of general insurances, works contract services when supplied for construction of an immovable property (other than plant and machinery) except where it is an input service for further supply of works contract service.

As per Rule 89(4)(B) of KGST Rules, 2017, Net ITC means input tax credit availed on inputs and input services during the relevant periods.

Further, the explanation under Rule 89(5) of CGST Rules/ SGST Rules, states that the 'Net ITC' shall mean input tax credit availed on inputs during the relevant period other than the input tax credit availed for which refund is claimed under sub-rules (4A) or (4B) or both. Further, Inputs as per section 2(59) of the Act means any goods other than capital goods used or intended to be used by a supplier in the course of furtherance of business. Hence, the refund under inverted duty structure is available only for ITC claimed on inputs.

In 20 refund claims out of 1,024 sample cases (eight cases in the pre-automation period and 12 cases in the post-automation period), we noticed that the taxpayers had claimed ITC on supplies which are not eligible for credit/refund as per the above rules. Allowing input tax credit on ineligible credits had resulted in excess refund of ₹ 64.59 lakh.

On this being pointed out (between April and December 2021), the LGSTOs intimated (June 2022) that in three cases ITC of ₹ 9.31 lakh (including interest in one case) was recovered and one case was assigned for audit. Reply in the remaining 16 cases was awaited (September 2022).

An illustrative case is given below:

➤ The assessee M/s Fowler Westrup India Pvt Limited/ 29AAACF5164H1ZK while claiming the refund for the period April 2019 to June 2019, declared the turnover of inverted rated supply of goods of ₹ 11.94 crore with inverted rate of tax ₹ 59.69 lakh and Adjusted Total turnover of ₹ 14.94 crore with Net ITC of ₹ 1.59 crore and refund of ₹ 67.10 lakh was claimed and same was allowed. On cross verification of Refunds claimed under category of EXPWOP (Export of Goods and Services without payment of IGST) for the Refund periods April 2019, May 2019 and June 2019, the assessee had declared Net ITC of ₹ 1.59 crore of which ITC of ₹ 22.82 lakh was on services. However, the assessee while claiming refund under the category of inverted duty structure, ITC on services was not excluded. This resulted in excess allowance of refund of ₹ 18.24 lakh.

On this being pointed out (October 2021), the LGSTO stated (October 2021) that the case would be examined.



### 2.6.8.6 Excess refund due to incorrect adoption of turnover

As per Rule 89(4) of KGST Rules 2017, the refund in case of zero-rated supply of goods and services without payment of tax under bond or letter of undertaking, is based on the Formula; Refund Amount = (Turnover of zero-rated supply of goods + Turnover of zero-rated supply of services)  $\times$  Net ITC  $\div$  Adjusted Total Turnover.

As per Rule 89(5) of KGST Rules 2017, the refund of accumulated ITC on account of inverted duty structure is based on the Formula; Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services)  $\times$  Net ITC  $\div$  Adjusted Total Turnover} – tax payable on such inverted rated supply of goods and services.

Where 'Adjusted Total Turnover' means sum total of the value of turnover in a State or a Union territory, as defined under clause 112 of section 2, excluding exempted supplies other than zero rated supplies.

During test check it was noticed in 23 cases out of 1,024 sample cases (eight cases in the pre-automation period and 15 cases in the post-automation period), that the adjusted turnover adopted was not in accordance with the rule provision. This had resulted in excess refund amounting to ₹ 1.11 crore.

On this being pointed out (between July 2021 and March 2022), the LGSTOs intimated (between September 2021 and June 2022) that in four cases the amount of ₹ 47.91 lakh was recovered and in two cases endorsements were issued. In one case the department stated (June 2022) that the turnover of services is not to be considered for 'Adjusted turnover' as per Notification No.39/2018 dated 4.9.2018 and hence refund allowed is in order.

The reply of the LGSTO is not acceptable as the definition of 'Adjusted turnover' includes the 'turnover of zero-rated supply of services determined in terms of clause (D) of Rule 89(4) of CGST/SGST Rules and non-zero rated supply of services.

The replies in the remaining 16 cases are awaited (September 2022).

One illustrative case is given below:

➤ The assessee, M/s Rashi Granite Exports India Limited/29AABCR9305B1ZK while claiming the Refund for the period January 2018, had declared the turnover of zero rated supply and Adjusted Total turnover of the same amount of ₹ 87.65 lakh with Net ITC of ₹ 2.03 crore and claimed refund of ₹ 33.87 lakh and same was allowed. However, the assessee did not consider the outward taxable supply (other than zero rated, Nil rated and exempted) of ₹ 9.94 crore for arriving at the Adjusted Total turnover, which resulted in excess refund of ₹ 17.38 lakh.

On this being pointed out (August 2021), the LGSTO stated (September 2021) that an amount of ₹ 25.04 lakh (including interest) was recovered.



### 2.6.9 Conclusion and recommendations

We conducted the Subject Specific Compliance Audit on GST Refunds with the objectives of assessing adequacy of rules and orders/notifications relating to refunds, compliance of provisions by tax authorities and internal control mechanism to check the performance of tax authorities in disposing the refund claims.

Our sample of 1,024 cases was divided into two broad categories of pre-automation (488 cases) and post-automation (536 cases). Our audit disclosed both systemic issues and compliance deviations.

As regards systemic issues, we noticed double payments of refunds in pre-automation cases due to deficiency in the control mechanism in the processing of refund claims. As for compliance issues, we noticed delays in issuance of provisional refund on account of zero-rated supply in four *per cent* and delay in final refund in 5.96 *per cent* cases. We also noticed excess refund due to incorrect adoption of turnover in 2.25 *per cent* cases and excess refund due to allowing ineligible credit of ITC in 1.95 *per cent* cases.

#### ***Recommendations:***

- i) The department may take up reconciliation of refund payments in pre-automation period;*
- ii) The department may identify risk areas on the basis of observations pointed out and institute a mechanism to strengthen verification process while sanctioning refunds.*

### 2.7 Non-forfeiture of tax collected in excess

According to section 47 of the KVAT Act, 2003, where any amount is wrongly collected by way of tax or purporting to be way of tax from any person by any dealer, whether knowingly or not, such dealer shall pay the entire amount so collected, to the prescribed authority within 20 days after the close of the month in which such amount was collected. Any such amount which is not due as tax shall be forfeited to the Government and recovered from the dealer which will discharge him of the liability to refund the amount to the person from whom it was collected.

During test-check of records of 206 assesseees out of 7135 assesseees (2.89 *per cent*) in LGSTO-25 (Additional), Bengaluru and 1981 re-assessment orders (100 *per cent*) in DCCT(Audit)-5.5, in Bengaluru District during December 2019 to September 2020, it was noticed that in respect of one assessee in LGSTO and one assessee in Audit office, the excess tax collected amounting to ₹ 4.65 crore was not forfeited to the Government under section 47 of KVAT Act, 2003. In the former case, the assessee concerned had collected tax at a higher rate (14.5 *per cent*), but while levying/payment of the tax, the tax-payable was quantified at a lower rate (4 *per cent*). In the latter case, while passing the rectification order, the tax payable by the assessee was determined lesser than the actual tax collected by the assessee, resulting in excess tax collection. In both the cases, the excess tax collected had to be forfeited to the Government. Besides, the assesseees were also liable to pay interest at the rate of one and a quarter *per cent* of the amount excess collected for each month of

default amounting to ₹ 2.00 crore. Total liability including interest worked out to ₹ 6.65 crore.

Audit brought these cases to the notice of the Department/ Government during September 2021 and October 2021. The Government stated that reassessment orders were passed and demand notices were issued in both the cases and tax amount of ₹ 75.28 lakh was forfeited in one case (September 2022).

It is stated that the progress of recovery in the remaining case may be expedited and recovery may be intimated to audit.

***It is recommended that the Department may review all such cases of non-forfeiture of taxes collected in excess, before the cases get time-barred for assessment.***

## 2.8 Non-payment of tax on sale of liquor

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

The Government, vide Notification No. FD 21 CSL 2014 (II) dated 28 February 2014, removed exemption of tax payable on sale of liquor and introduced Value Added Tax (VAT) at the rate of five and one half *per cent* on sale of liquor by CL-9 licensees<sup>22</sup> in areas coming under Bruhat Bangalore Mahanagara Palike, City Municipal Corporation, City Municipal Council and Town Municipal Council or Town Panchayat, and CL-7 licencees<sup>23</sup> located in the entire state with effect from 1 March 2014. The aforesaid Notification was amended vide Notification No. FD 41 CSL 2014 on 21 April 2014, where tax on sale of liquor by CL-9 licencees situated in rural areas was exempted and sale of liquor by these assesseees only in urban areas were subjected to tax. However, sale of liquor by CL-7 licencees in the entire State were liable to tax.

During test-check of records of 36 CL-9 and CL-7 licensees (Audited sample-100 *per cent*) in LGSTO-430-Jamakhandi, JCCT (Admin.)-DVO-03-Bengaluru offices (one Local Goods and Service Taxes Office (LGSTO) and one Admin Office) in Bagalkote and Bengaluru Districts between February 2021 to March 2021, Audit noticed that in respect of four licensees (11.11 *per cent*) (Bar and Restaurants situated in urban areas, Hotel and Boarding houses), the turnover of sale of liquor for the period from April 2014 to March 2017 was ₹ 3.71 crore. Tax payable at the rate of five and one half *per cent* amounted to ₹ 20.42 lakh, of which, no tax was paid. Further, penalty and interest under Sections 72(2) and 36 of KVAT Act, 2003, amounted to ₹ 2.04 lakh and ₹ 15.02 lakh respectively, which too remained unpaid.

<sup>22</sup> CL-9 licence is given by the Excise Department for sale of liquor in Bar and Restaurants.

<sup>23</sup> CL-7 licence is given by the Excise Department for sale of liquor in Hotel and Boarding Houses.

Hence, total non-payment of tax, including penalty and interest, works out to ₹ 37.48 lakh. Though the tax on sale of liquor by Bars and Restaurants situated in urban areas and by Hotel and Boarding houses in the entire State was to be levied with effect from 1 March 2014, the Department did not take action to verify whether the taxes were getting paid from all the dealers concerned.

These cases were brought to the notice of the Department/Government in December 2021. In reply, the Government stated that reassessment orders were passed in all the cases and tax amount of ₹ 4.25 lakh was recovered in one case (September 2022).

It is stated that recovery proceedings may be expedited in the remaining cases and recovery intimated to audit.

*It is recommended that the Department may review all such cases in the other Districts as well and demand taxes wherever they are not paid.*

## **2.9 Short-levy of tax due to incorrect allowance of sub-contractor payments**

According to Section 4 (1) (c) of the Karnataka Value Added Tax (KVAT) Act, 2003, tax shall be levied in respect of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contracts at the rates specified in the Sixth Schedule of the Act. Section 15(1) of the KVAT Act, 2003 provides that a dealer who executes works contract may elect to pay, in lieu of the net amount of tax payable by him under this Act, by way of composition at the specified rate on the total consideration for the works contracts executed.

As per Rule 3(2) of KVAT Rules, 2005 the taxable turnover shall be determined by allowing the deductions from the total turnover as prescribed in clauses (a) to (m). Rule 3(2) (i-1) of the KVAT Rules provides for deduction of all amounts paid or payable to sub-contractors as the consideration for execution of works contract whether wholly or partly, provided that no such deduction shall be allowed unless the dealer claiming deduction produces document in proof that the sub-contractor is a registered dealer liable to pay tax under the Act and that the turnover of such amounts is included in the return filed by such sub-contractor.

During test check of 7410 out of 7474 (99.14 per cent) re-assessment orders in four Audit offices (DCCT (Audit)-1.2, Bengaluru, DCCT (Audit)-5.1, Bengaluru, DCCT (Audit)-5.7, Bengaluru and DCCT (Audit)-4, Hubballi) in Bengaluru and Dharwad districts between October 2020 and April 2021, Audit noticed 04 cases in which the civil works contractors claimed deduction of ₹ 58.09 crore in turnover towards sub-contractor payments in respect of 11 sub-contractors for the tax periods 2014-15 to 2016-17.

On cross-verification of returns filed by these works contractors with those filed by related sub-contractors, it was noticed that a turnover aggregating ₹ 26.41 crore only was declared in the returns filed by the sub-contractors as against ₹ 58.09 crore claimed as exemption by the works contractors in their returns, contrary to Rule 3(2)(i-1) of KVAT Rules. After deduction of ₹ 3.59 crore towards labour and like charges, the excess allowance of sub-contractor turnover worked out to ₹ 28.09 crore which resulted in short levy of tax of

₹ 2.07 crore. Besides, penalty of ₹ 0.20 crore and interest of ₹ 1.10 crore were also leviable. Total liability worked out to ₹ 3.37 crore.

These cases were brought to the notice of the Department/Government during December 2021 and January 2022. In reply, the Government stated that reassessment orders were passed and demand notices were issued in all the cases and a tax amount of ₹ 43.74 lakh was recovered in one case (September 2022).

The recovery proceedings may be expedited in the remaining cases and recovery intimated to audit.

*It is recommended that the Department may fix responsibility for these lapses and also ensure the application of due vigour to verify the claims of the works contractors vis-à-vis the sub-contractors, to avoid such incorrect allowances in future.*

## 2.10 Incorrect/Excess adjustment of credit amount

According to Section 10 of the KVAT Act, 2003, the tax payable by a dealer under the Act on sale is called 'Output Tax' while the tax paid by the dealer on purchases is called 'Input Tax'. A dealer is liable to pay the net tax after setting off input tax paid against output tax payable.

The said provision of the KVAT Act, 2003, also stipulates that "where the input tax deductible by a dealer exceeds the output tax payable by him, the excess amount shall be adjusted or refunded together with interest, as may be prescribed". As per Rule 127 of the Karnataka Value Added Tax Rules, 2005, any dealer, whose input tax deductible exceeds the output tax payable by him, as specified under sub-section (5) of Section 10 or sub-section (4) of Section 27, may, adjust such amount towards the tax payable by him under this Act or the Central Sales Tax Act, 1956.

Test check of records of 5028 out of 7924 (63.45 per cent) in three<sup>24</sup> Offices (two Audit Offices and one LGSTO) in two<sup>25</sup> districts were conducted between October 2020 to March 2021. Audit cross-verified the credit amounts brought forward and adjusted against the output tax liability by the dealers in their returns with respect to returns filed by them for previous tax periods and re-assessments/rectification orders concluded by the prescribed authorities.

The cross-verification revealed that three dealers for the tax periods from 2013-14 to 2016-17 were eligible for input tax credit amounting to ₹ 6.76 crore. However, these dealers had adjusted input tax credit of ₹ 7.08 crore, resulting in excess adjustment of credit amount of ₹ 0.31 crore. Further, penalty (at 10 per cent) and interest (at 1.5 per cent) wherever applicable amounted to ₹ 0.03 crore and ₹ 0.20 crore respectively. Total liability amounted to ₹ 0.54 crore.

These cases were brought to the notice of the Department/Government during January 2022 and February 2022. In reply, the Government stated that notices

<sup>24</sup> DCCT(A)-2.5, Bengaluru, DCCT(A)-4.2, Bengaluru and LGSTO-180, Kolar.

<sup>25</sup> Bengaluru and Kolar.

were issued to all the dealers concerned and tax of ₹ 11.20 lakh was recovered in two cases (September 2022).

The recovery proceedings may be expedited in the remaining cases and recovery intimated to audit.

*It is recommended that the correctness of carry forward credit available in monthly returns, revised returns, audited statement and re-assessment orders with respect to credit brought forward in subsequent monthly returns may be ensured by the Department through timely reconciliation.*

### **2.11 Short-levy of tax due to excess deduction of labour and like charges**

Rule 3(2)(h) of KVAT Rules, 2005 provides that the taxable turnover shall be determined after allowing for deduction of all amounts collected by way of tax under the KVAT Act. Rule 3(2)(m) of KVAT Rules provides for deduction towards labour and like charges 'as a percentage of the value of the contract' in the execution of a works contract, when such charges are not ascertainable from the books of accounts maintained by the dealer. The table included under the Rule *ibid* prescribes different percentages ranging from 10 to 40 *per cent*, for labour and other like charges for different types of contracts.

Audit test-checked 7486 re-assessment orders out of 7521 re-assessments orders (99.53 *per cent*) in three<sup>26</sup> Audit Offices in Bengaluru district between October 2020 and February 2021. In five cases, it was noticed that for the period from 2014-15 to 2016-17, Assessing Officer had allowed deduction of labour and like charges of ₹ 139.19 crore as against the eligible deduction of ₹ 124.05 crore. The excess deduction of ₹ 15.14 crore was due to the fact that the Assessing Officers had not deducted amounts relating to Value Added Tax, Service Tax and sub-contractor payments from the turnover before calculating the allowable labour and like charges at 30 *per cent*. The short-levy of tax worked out to ₹ 2.20 crore. Besides, penalty of ₹ 0.22 crore and interest of ₹ 1.35 crore was leviable. Total liability worked out to ₹ 3.77 crore.

These cases were brought to the notice of the Department and the Government during January 2022 and February 2022. In reply, the Government stated that demand notices have been issued in all the cases and in one case an amount of ₹ 1.76 lakh was collected, whereas interest and penalty of ₹ 2.99 lakh was waived under Karasamadhana Scheme (September 2022).

It is stated that recovery proceedings may be expedited in the remaining cases and recovery intimated to audit.

*It is recommended that the correctness of the deduction allowed towards labour and like charges may be ensured by the Department.*

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<sup>26</sup> DCCT (Audit)-4.6, Bengaluru, DCCT (Audit)-4.8, Bengaluru and DCCT (Audit)-5.1, Bengaluru.