

CHAPTER-II: TAXES ON SALES, TRADE, ETC.

2.1 Results of audit

Test check of records of the sales tax offices, conducted in audit during the year 2004-05, disclosed underassessments of tax, non levy of penalty, etc., amounting to Rs.60.72 crore in 993 cases, under the following broad categories:

(Rupees in crore)

Sl. No.	Category	Number of cases	Amount
1	Non/short levy of tax	455	18.83
2	Non/short levy of tax due to incorrect grant of exemption	105	23.37
3	Non/short levy of turnover tax/resale tax	170	6.61
4	Non levy of penalty	168	5.58
5	Non forfeiture of excess tax collected	58	3.89
6	Other irregularities	37	2.44
	Total	993	60.72

During the course of the year 2004-05, the Department accepted underassessments of tax amounting to Rs.22.07 crore in 1,094 cases that had been pointed out in audit in earlier years and recovered Rs.13.31 crore in 835 cases.

A few illustrative cases including some cases noticed in earlier years that could not be included in previous Reports involving Rs.33.53 crore are given in the following paragraphs. Of this, Rs.2.59 crore had been recovered.

2.2 Excess grant of tax incentives to industries

2.2.1 Exemption from payment of tax

In accordance with the notifications issued from time to time under the Karnataka Sales Tax Act (KST Act), 1957, and the Central Sales Tax Act (CST Act), 1956, exemption from payment of tax is allowed to tiny/small scale industries (SSI) based on the fixed assets valuation certificate (FAVC) issued by the Department of Industries and Commerce. However, the exemption is not allowed on turnover where no manufacturing activity is involved, or in respect of sales effected beyond the eligibility period or eligibility limit, or in respect of sales effected prior to the date of expansion. Further, in cases of units undertaking expansion schemes, tax exemption is to be limited to the difference between the total tax liability and the average tax liability of three years immediately preceding the year in which investment for expansion took place.

It was, noticed between August 2004 and January 2005, that in three^φ districts while finalising six assessments of three tiny/SSI units between July 1999 and January 2004, for the years 1997-98 to 1999-2000, 2001-02 and 2002-03 sales tax exemption of Rs.21.67 lakh was incorrectly granted on turnover where no manufacturing activity was involved, in respect of sales effected beyond eligibility limits and in case of one industrial unit exemption benefit under expansion scheme was incorrectly determined. These resulted in short levy of tax of Rs.21.67 lakh.

After these cases were pointed out between August 2004 and January 2005, Government reported in December 2005, initiation of proceedings for revision of assessments in five cases involving tax effect of Rs. 19.97 lakh. In respect of one case final reply has not been received (January 2006).

2.2.2 Deferment of tax

In accordance with notification issued in November 1996 under the KST Act and the CST Act, in cases of industrial units undertaking expansion schemes who have opted for deferment of sales tax payable by them, the tax liability eligible for deferment shall be the difference between the total tax liability and the average total tax liability of the three years immediately preceding the year in which investment for such expansion has taken place.

In Bangalore (Urban) district, an industrial unit was eligible for tax deferment under expansion scheme from the year 1997-98. The average tax liability of the unit for the years 1994-95 to 1996-97 was Rs.19.39 lakh. It was, noticed in May 2004, that while finalising three assessments between August 2001 and

^φ Bangalore (Rural), Dakshina Kannada, Gulbarga.

August 2003 of the unit for the years 1998-99 to 2000-01, deferment benefit was incorrectly determined. Out of the total tax of Rs.92.90 lakh levied on manufactured goods, the assessee was entitled for deferment of tax of Rs.34.74 lakh against which tax deferment of Rs.45.70 lakh was allowed. This resulted in excess sales tax deferment of Rs.10.96 lakh.

This was pointed out to the concerned assessing authority in May 2004 and reported to the Department in June 2004; replies have not been received (January 2006).

The cases were referred to Government in May 2005; replies have not been received (January 2006).

2.2.3 In accordance with notification issued in August 1997, sugar factories undertaking expansion/modernisation would be eligible for deferment of purchase tax payable on the additional quantity of sugarcane crushed as a result of expansion/modernisation for five years. This would be computed based on the average annual cane crushed over a period of three years prior to commissioning of expansion/modernisation schemes.

In case of an industrial unit in Bangalore (Urban) district, as per the assessment records, the actual quantity of sugar cane crushed over a period of three years prior to commissioning of expansion/modernisation scheme was 13.97 lakh MT. Therefore, the average quantity of sugar cane crushed was 4.65 lakh MT. However, while finalising the assessments for the years 1998-99 to 2001-02 between May 2002 and July 2004, the average quantity of sugarcane crushed was incorrectly taken as 3.33 lakh MT. This resulted in allowance of excess deferment of Rs.2.08 crore on 5.06 lakh MT of sugarcane.

After this was pointed out in January 2005, the assessing authority stated that the average quantity of cane crushed communicated by the Department of Industries and Commerce was adopted in the assessments as such. The reply is not tenable as actual quantum of sugar cane crushed was available with the Department and should have been considered for assessment.

This was reported to Department in April 2005 and referred to Government in May 2005; replies have not been received (January 2006).

2.3 Non/short levy of tax/turnover tax

Under the KST Act, tax is leviable on the purchases/sales at the rates mentioned in the relevant Schedules to the Act. Further, every registered dealer, whose total turnover in a year exceeds the prescribed monetary limits,

was liable to pay turnover tax (TOT) at the prescribed rate(s) on his total turnover, after such deductions as are admissible under the Act upto March 2002. Concessional rate of tax is also applicable on sales made to certain local bodies/corporations/boards/authorities notified under the Act.

2.3.1 In 14[∅] districts, while finalising 135 assessments of 118 dealers between March 2002 and March 2004 for the years 1994-95 and 1998-99 to 2002-03, tax amounting to Rs.3.89 crore was levied short on turnover of Rs. 131.85 crore due to application of incorrect rates.

After these cases were pointed out between March 2004 and March 2005, Government reported in December 2005, revision of assessments in 56 cases creating additional demand of Rs.1.21 crore and recovery of Rs. 63.97 lakh in 38 of them. In respect of 20 other cases involving Rs.18.48 lakh, proceedings for revision of assessments have been initiated.

In respect of three cases involving tax effect of Rs.6.03 lakh, it was stated that sales made to Government organisations were eligible for concessional rate of tax. The reply is not tenable as the local body/Central Government undertaking/private educational institution to which sales were made, were not notified by Government for levy of concessional rate of tax.

In respect of a case relating to sale of SIM cards involving tax effect of Rs.38.23 lakh, it was stated that SIM card is an essential component of mobile phone and hence classifiable under entry sl.no.6 of part T of II Schedule to KST Act. The reply is not tenable as the said entry covers only telephones of all kinds and their parts and SIM card is not a part of mobile phone instrument.

In respect of other cases final replies have not been received (January 2006).

2.3.2. In eight[»] districts, while finalising 87 assessments of 81 dealers between July 1999 and March 2004, for the years 1993-94 to 2001-02, TOT was either not levied or levied short on turnover of Rs.138.27 crore due to incorrect allowance of exemptions and application of incorrect rate, etc. This resulted in non/short levy of TOT of Rs.2.18 crore.

After these cases were pointed out between April 2004 and April 2005, Government reported in December 2005 creation of additional demand of Rs.1.42 crore by revision of assessments in 46 cases and recovery of Rs.78.32 lakh in 34 of them. In respect of 10 other cases involving tax effect of Rs.9.61 lakh, proceedings for revision of assessments have been initiated.

[∅] Bangalore (Rural), Bangalore (Urban), Belagum, Bellary, Bidar, Bijapur, Dakshina Kannada, Davanagere, Dharwad, Gulbarga, Mysore, Shimoga, Tumkur, Udupi

[»] Bangalore (Rural), Bangalore (Urban), Belgaum, Bellary, Dakshina Kannada, Dharwad, Gulbarga, Raichur

In respect of two cases of non levy of TOT of Rs.2.40 lakh and two cases of short levy of TOT of Rs.11.61 lakh, Department contended that the transaction related to manufacture and sale of branded goods to their brand owners and such sales are not first sale of these goods in terms of Section 5(3)(a) of the KST Act and hence exemption allowed/concessional rate of TOT levied were in order. The reply is not tenable as Section 5(3)(a) is applicable only for the purpose of levy of tax while for the purpose of levy of TOT under Section 6B of the KST Act, such transaction is the first sale of these goods.

In respect of two cases involving Rs. 2.28 lakh, it was stated that tax was levied at one *per cent* as lease rentals of cylinders are second sales. The reply is not tenable as turnover of lease rentals are the consideration received for transfer of right to use cylinders but not for sale of the cylinders itself. Therefore, there was no second sale of cylinders and consideration received for transfer of right to use constitutes first sale. Turnover was thus liable to turnover tax at the rates prescribed under section 6B of the KST Act.

In respect of other cases, final reply has not been received (January 2006).

2.4 Incorrect grant of exemption

2.4.1 Under the KST Act and CST Act, taxable turnover of every dealer shall be determined in accordance with relevant provisions of the Act and Rules made thereunder after allowing prescribed deductions from the total turnover. Tax is leviable on the taxable turnover determined at the rates mentioned in the relevant Schedules to the Act. In addition, cess at the rate of five *per cent* of tax and TOT at prescribed rate were also leviable upto 31 March 2002. Under the CST Act, tax at specified rates is levied on inter State sale of goods.

In five districts, it was noticed between February 2004 and January 2005 that while finalising between April 2002 and March 2004, 29 assessments of 27 dealers for the years 1999-2000 to 2002-03, turnover aggregating Rs.27.96 crore was incorrectly exempted resulting in short levy of tax of Rs.2.22 crore. A few instances are given below:

(Rupees in lakh)				
Sl. No.	District (Number of cases)	Period (date) of assessment	Turnover involved	Tax effect
1.	Bangalore (Rural) (1)	2001-02 (April 2002)	92.80	7.43
Inter State sale of MS Scrap not covered by 'C' form declarations were liable to tax at the rate of eight <i>per cent</i> . However, while finalising the assessment it was incorrectly exempted.				

(Rupees in lakh)

Sl. No.	District (Number of cases)	Period (date) of assessment	Turnover involved	Tax effect
2.	Bangalore (Urban) (2)	2000-01 and 2001-02 (May 2002 and February 2004)	150.81	11.65
Imported textiles were liable to tax at the rate of four <i>per cent</i> under entry 7-A of Part T of II Schedule to KST Act during 2000-01. In addition cess at five <i>per cent</i> of tax and TOT at 1.5 <i>per cent</i> were also leviable. During 2001-02 inter State sale of imported textiles not covered by 'C' form declarations were taxable at the rate of 12.6 <i>per cent</i> in terms of Section 8(2)(b) of the CST Act read with entry 7-B of Part T of II Schedule to KST Act. However, while concluding the assessments of an assessee, local sale turnover of imported textiles of Rs.106.51 lakh during 2000-01 and inter State sales turnover of Rs.44.30 lakh during 2001-02 were incorrectly exempted as goods falling under V Schedule to the KST Act.				
3	Bangalore (Urban) (2)	1999-2000 and 2000-01	1215.48	83.53
By virtue of their insertion in V Schedule to the KST Act all varieties of textiles described from time to time in column 2 of the First Schedule to the Additional Duties of Excise (Goods of Special Importance) Act, 1957(ADE Act) are exempt from tax. Goods falling under Chapter 39 of the Central Excise Tariff (CET) Act are not described under ADE Act. In these cases assessee classified the HDPE ^o woven fabrics manufactured by him under Chapter 39 of the CET Act. Therefore it was liable to tax under entry 7-A of part T II Schedule to KST Act. However, while finalising the assessments, the local sales and inter State sales turnover of the assessee during the year 1999-2000 and 2000-01 were incorrectly exempted as textiles falling under V Schedule to KST Act.				

After these cases were pointed out between February 2004 and March 2005, Government reported in December 2005 revision of assessments in seven cases creating additional demand of Rs. 7.73 lakh and recovery of Rs.6.49 lakh in five of them. In respect of three other cases involving Rs.10.91 lakh proceedings for revision of assessments have been initiated.

In respect of the other cases, final replies have not been received (January 2006).

2.4.2 Under the KST Act, 'fresh milk' is exempted from levy of tax by virtue of its inclusion in the Fifth Schedule. For this purpose, 'fresh milk' shall not include milk powder, condensed milk and milk with additives such as flavours, colours, preservatives, cereals, spices and dry fruits.

In four^o districts, while finalising between October 1999 to September 2004, 20 assessments of six registered dealers who sold milk involving turnover of Rs.124.47 crore during the period 1997-98 to 2002-03, six assessing authorities exempted this turnover from the levy of tax treating these as fresh milk. It was noticed that these dealers had purchased skimmed milk powder

^o High density poly ethylene

^o Bangalore (Rural), Bangalore (Urban), Belgaum, Dharwad

worth Rs.10.09 crore for the purpose of adding to the fresh milk procured from farmers. The milk sold by them was, therefore, not fresh milk and was liable to tax. The incorrect exemption caused non levy of tax of Rs.15.22 crore.

After these cases were pointed out during December 2004 and January 2005, in respect of one dealer in Bangalore (Rural) involving tax effect of Rs.8 crore, the assessing authority stated in February 2005 that the milk powder was being added to fresh milk to maintain the fat content/nutrition value at required level and even after addition of milk powder, the fresh milk would remain as such. The reply is not tenable as under the Act, once any additive is introduced to milk, it ceases to be 'fresh milk'.

The cases were referred to Government in May 2005; replies have not been received (January 2006).

2.5 Incorrect determination of taxable turnover

Under the KST Act, a dealer is liable to pay tax on his taxable turnover, determined after allowing prescribed deductions from the total turnover of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contracts at rates specified in the Sixth Schedule to the Act. However, dealers executing works contract have the option to pay tax for any year at four *per cent* on the total consideration. Where such option for payment of tax by composition is exercised, there is no provision for allowing any deduction whatsoever from the total consideration except for amounts paid to sub contractor as consideration for execution of works, subject to production of proof that such sub contractor is a registered dealer liable to tax under the Act and that the turnover of such amounts is included in the monthly returns filed by him.

2.5.1 It was noticed between July and December 2004, that in Bangalore (Urban) and Dakshina Kannada districts while finalising six assessments between August 2003 and March 2004 for the years 2000-01 to 2002-03 in respect of five dealers who were engaged in execution of works contracts, taxable turnover was incorrectly determined at Rs.2.97 crore instead of Rs.4.66 crore by excess apportionment of gross profit towards exempted turnover, allowing deductions on account of various items not prescribed under the Act such as tax deduction at source (TDS), security deposit, etc. This resulted in short levy of tax of Rs.26.29 lakh.

After these cases were pointed out between July 2004 and January 2005, Government reported in December 2005 revision of assessments and recovery

of Rs.16.29 lakh in three cases. In respect of remaining three cases final replies have not been received (January 2006).

2.5.2 It was noticed between May and December 2004, that in Bangalore (Urban) and Bellary districts while finalising five assessments between May 2003 and March 2004 for the years 1998-99, 2001-02 and 2002-03 in respect of five dealers who were engaged in execution of works contracts and had opted for composition, deductions were incorrectly allowed on account of TDS, security deposit recovered, payments made to sub contractors not supported by required proof, etc., involving turnover of Rs.2.12 crore. This resulted in short levy of tax of Rs.8.50 lakh.

After these cases were pointed out between May 2004 and January 2005, Government reported in December 2005 creation of additional demand of Rs.2.32 lakh and recovery of Rs.1.51 lakh in two cases.

In respect of remaining three cases final replies have not been received (January 2006)

2.6 Short demand of tax

Under the KST/CST Act, if any amount is due from a dealer after final assessment, the assessing authority is required to serve upon him a notice demanding its payment.

In two^φ districts, it was noticed between May and October 2004, that in respect of six assessments for the years 1998-99 to 2001-02 concluded between May 2003 and March 2004, as against the aggregate tax of Rs.1,081.37 lakh due, only Rs.1,041.82 lakh were demanded due to arithmetical errors, incorrect implementation of assessment order, typographical errors and error in computation of tax. This resulted in short demand of Rs.39.55 lakh.

After these cases were pointed out between June 2004 and March 2005, Government reported in December 2005 revision of assessment by creating additional demand of Rs.38.04 lakh in respect of four cases and recovery of Rs.28.04 lakh in three of them. Replies in respect of the remaining two cases have not been received (January 2006).

^φ Bangalore (Urban), Bangalore (Rural)

2.7 Non forfeiture of tax collected in excess

Under the KST Act, a registered dealer is prohibited from collecting any amount by way of tax in excess of that specified in the Act. Where any collection is made in contravention thereof, the assessing authority is required to forfeit the tax collected in excess.

It was noticed in Bangalore(Urban) District that in 27 assessments of 26 dealers finalised between October 1999 and March 2004 for the years 1992-93, 1994-95, 1996-97 and 1998-99 to 2002-03, against tax of Rs.35.07 crore assessed by the concerned 10 assessing authorities, the dealers collected tax of Rs.38.38 crore. No action was initiated to forfeit the excess collection of tax amounting to Rs.3.31crore.

After these cases were pointed out between April and October 2004, Government reported in December 2005 forfeiture of Rs.33.57 lakh in 20 cases and recovery of Rs.33.03 lakh in 19 of them. In respect of four cases involving tax effect of Rs.4.30 lakh, proceedings for revision of assessments/rectification of mistakes have been initiated. In respect of one case relating to transaction for 1996-97, it was stated that taxes have been levied to the extent of tax collected by the assessee and therefore there was no excess collection to be forfeited. The reply is not tenable, as the dealer opted for composition and was not entitled to collect any tax during 1996-97. In respect of the remaining cases, final replies have not been received (January 2006).

2.8 Non/short levy of cess

Under the KST Act, cess at the rate of five *per cent* of the tax due was leviable from April 1998 to March 2002.

It was noticed between July and September 2004 that in Bangalore (Urban) district, while finalising three assessments of three dealers between March 2000 and January 2004 for the years 1998-99 and 2001-02 two assessing authorities did not levy cess amounting to Rs.48.84 lakh on aggregate tax of Rs.9.84 Crore.

After these cases were pointed out in July and September 2004, Government reported in December 2005 revision of assessments and recovery of

Rs.6.92 lakh in two cases and initiation of proceedings for revision of assessment in the other case.

2.9 Non levy of penalty

Under the provisions of the KST Act, tax payable by a registered dealer in respect of sale of any industrial inputs to another registered dealer for use as a component part, raw material, packing material or consumables in the manufacture of other goods inside the State for sale, shall be at the specified concessional rate on the turnover relating to such sale, on furnishing prescribed declarations (upto March 2001). When a registered dealer purchases industrial inputs from another registered dealer and uses them in the manufacture of other goods for sale, he is eligible for reimbursement of tax. Further vide notification dated 31 August 2001, he is also eligible to purchase industrial inputs at specified concessional rate of tax against prescribed declarations. However, if any person sells such inputs contrary to such declaration or sells after claiming reimbursement, the assessing authority shall impose upon him by way of penalty a sum not less than double the amount of tax leviable under the Act but not exceeding three times of the tax leviable on sale of such inputs.

In Bangalore (Urban) and Davangere districts, it was noticed in August 2004 that two dealers purchased aluminum ingots and weighbridge machinery at concessional rate against declaration and claimed reimbursement of tax as industrial inputs. Of these, one dealer sold aluminium ingots in the same form while other dealer was not entitled to concessional rate of tax as weighbridge machinery is not an industrial input. However, while finalising (February 2003 and March 2004) two assessments of these two dealers relating to years 1998-99 and 2001-02, two assessing authorities failed to levy penalty of Rs. 10.31 lakh.

After these cases were pointed out between August 2004 and January 2005, the Government stated in December 2005 that additional demand of Rs.3.34 lakh has been created, of which Rs.3 lakh had been recovered in one case.

In respect of the other case final reply has not been received (January 2006).

2.10 Non levy of interest

2.10.1 Under the KST Act, tax or any other amount due is required to be paid within the prescribed time which, in the case of final assessments, is 21 days from the date of service of demand notice. In case of default in making payments, the assessee would be liable to pay interest at the rates prescribed from time to time.

In six districts, though 40 dealers in 61 cases did not pay the sums specified in the demand notices within 21 days of their service, interest of Rs.45.08 lakh was not levied by the concerned assessing authorities as detailed below:

(Rupees in lakh)

Sl. No.	District (Number of assessees)	Period of assessment (Date of issue of demand notice)	Tax due paid belatedly	Date of payment of tax /Delay in payment of tax (Months)	Interest due
1	Bangalore (Urban) (11)	1995-96 to 2001-02 (between July 1999 and January 2004)	108.52	between October 2001 and April 2004/ 1 to 45	8.58
2	Bangalore (Rural) (9)	1993-94, 1995-96, 1997-98 to 2000-01 (between July 1997 and March 2003)	33.48	between January 2003 and March 2004/ 4 to 68	9.14
3	Bidar (1)	1994-95 (February 1997)	1.89	between March 2004 and June 2004/ 87	3.53
4	Bijapur (4)	1996-97, 1998-99, 2000-01 to 2001-02	10.01	between August 2001 and March 2004/ 10 to 16	1.91
5	Dharwad (12)	1992-93 to 1999-2000 and 2001-02 (between October 1996 and August 2003)	40.48	between July 2001 and March 2004/ 4 to 86	20.82
6	Tumkur (3)	1999-2000 and 2000-01 (between September 2001 and July 2003)	4.74	between January 2003 and March 2004/ 10 to 16	1.10
	Total (40)		199.12	1 to 87	45.08

After these cases were pointed out between June 2004 and February 2005, Government reported in December 2005 raising of additional demand of Rs.10.15 lakh in 19 cases and recovery of Rs.4.22 lakh in 10 of them. Reports of action taken in respect of the remaining cases have not been received (January 2006).

2.10.2 Under the KST Act, every dealer is required to pay the full amount of tax payable on the basis of the turnover computed by him for the preceding month within 20 days of close of that month. Further, the full amount of tax payable by a dealer in advance for the year as reduced by the amount of tax already paid is to be paid within 30 days after the close of the year to which such tax relates. In case of default beyond 10 days after that period, the assessee is liable to pay interest at the rates prescribed from time to time.

In six districts, though 46 dealers delayed the payment of monthly/annual taxes amounting to Rs.7.13 crore by one to 47 months during the years 1997-98 to 2002-03, interest of Rs.2.51 crore was not levied or levied short by 16 assessing authorities, as detailed below:

(Rupees in lakh)

Sl. No.	District (Number of assessees)	Period of assessment/ Date of assessment	Amount of tax involved	Delay in payment of tax (months)	Interest due
1	Bangalore (Rural) (7)	1998-99 to 2001-02 (between May 2002 and March 2004)	22.46	17 to 36	12.48
2	Bangalore (Urban) (16)	1999-2000 to 2002-03 (between June 2001 and March 2004)	580.34	1 to 47	193.28
3	Belgaum (1)	2000-01 and 2001-02 (September 2003 and November 2003)	5.52	19 to 30	2.73
4	Bellary (14)	1997-98, 1999-2000 to 2002-03 (between September 2000 and November 2003)	55.05	8 to 35	25.91
5	Davangere (2)	1999-2000 (between March 2001 and September 2003)	21.44	11 to 40	8.05
6	Gulbarga (6)	1999-2000 and 2002-03 (between July 2003 and February 2004)	28.11	1 to 41	8.26
	Total (46)		712.92	1 to 47	250.71

After these cases were pointed out between August 2004 and March 2005, Government reported in December 2005 recovery of Rs.16.86 lakh in four cases. In respect of the remaining case final reply has not been received (January 2006).