

CHAPTER II: TAXES ON SALES, TRADE, ETC.

2.1 Results of audit

Test check of the records of the sales tax offices, conducted during the year 2006-07, disclosed under assessments of tax, non/short levy of interest/penalty, etc., amounting to Rs.109.30 crore in 979 cases, under the following broad categories:

(Rupees in crore)

Sl. No.	Category	Number of cases	Amount
1	Non/short levy of tax	428	25.23
2	Non/short levy of tax due to incorrect grant of exemption	117	57.62
3	Non/short levy of turnover tax/resale tax	100	2.00
4	Non/short levy of additional tax	113	1.70
5	Non-levy of interest/penalty	116	20.41
6	Non-forfeiture of excess tax collected	52	0.69
7	Non/short levy of cess	32	0.44
8	Other irregularities	21	1.21
	Total	979	109.30

During the course of the year 2006-07, the department accepted under assessments of tax amounting to Rs.11.57 crore in 823 cases pointed out in audit in earlier years and, of that, recovered Rs.7.98 crore in 624 cases.

A few illustrative cases involving Rs.23.47 crore are mentioned in the following paragraphs. Of this, Rs.1.28 crore was recovered.

2.2 Incorrect grant of tax incentives to industries

2.2.1 The Government of India amended the Central Sales Tax Act, 1956 (CST Act) from 11 May 2002, vide which production of declaration in form C or certificate in form D was essential to grant exemption from levy of tax under the Act. By a notification dated 31 May 2002 issued under the CST Act, the Government of Karnataka in partial modification of all the notifications issued on the subject, directed that tax exemption granted to industrial units under various notifications shall be subject to the condition of furnishing of declaration in form C or certificate in form D issued by the buyer.

In 12⁷ districts, it was noticed that 27 industrial units covered by various exemption notifications, made inter state sales of Rs.23.82 crore. These sales were not supported by the prescribed declarations. However, while finalising assessments for the years 2002-03 to 2004-05 of these units between February 2003 and March 2006, the assessing authorities (AAs) incorrectly allowed exemption of Rs.2.05 crore.

After the cases were pointed out between January and December 2006, the AAs concerned accepted the audit observations in seven cases involving Rs.18.89 lakh. Of these, in three cases additional demand of Rs.2.08 lakh was raised and in four cases notices for revision of assessments were issued. In respect of one case involving tax effect of Rs.1.37 lakh, the AA stated that the exemption was allowed in terms of notification dated 15 November 1996 and it was in order as the said notification was neither withdrawn nor altered. The reply is not tenable in view of the notification of May 2002 which made furnishing of declaration in form C or certificate in form D mandatory. In respect of the remaining cases, final replies are yet to be received (October 2007).

The cases were reported to the Commissioner of Commercial Taxes (CCT) in March 2006 and March 2007 and referred to the Government between March and May 2007; their replies are awaited (October 2007).

2.2.2 New Industrial Policy 2001 of the Government of Karnataka exempted 100 *per cent* export oriented units (EOUs) located in the State from payment of sales tax on purchase of raw material, components, packing material, consumable, capital goods, spares and sub-assemblies from a registered dealer. By a notification dated 14 September 2001 issued under the Karnataka Sales Tax Act, 1957 (KST Act), the Government of Karnataka exempted tax payable on sale of raw material, component parts and packing material by a registered dealer to EOUs located in the State.

⁷Bangalore (Rural), Bangalore (Urban), Bagalkot, Belgaum, Bellary, Chitradurga, Dakshina Kannada, Gulbarga, Haveri, Shimoga, Udupi, Uttara Kannada

In Bangalore (Rural) and Bangalore (Urban) districts, seven assessments of seven dealers for the years 2001-02 to 2003-04 were finalised by four AAs between April 2005 and March 2006. In these cases, turnover of Rs.2.87 crore was exempted treating these as sale to 100 *per cent* EOUs. It was noticed between April and October 2006 that in these cases the dealers were not eligible for exemption under the said notification as the sales effected were prior to 14 September 2001 or the goods sold were capital goods like machineries and furniture and consumables like lubricants. Incorrect grant of exemption resulted in non-levy of tax of Rs.39.20 lakh.

After the cases were pointed out, the department accepted the audit observation in six cases. Of these, in five cases, the assessments were revised raising additional demands totalling Rs.17.23 lakh. Rs.13.98 lakh was recovered in three of the cases. In one case notice for revision of assessment was issued. In respect of one case involving tax effect of Rs.20.03 lakh, the AA stated that consumables were also eligible for exemption under the policy. The reply is not tenable as consumables are not covered under the notification which granted exemption to EOUs.

The Government endorsed the reply of the department in September 2007.

2.3 Incorrect grant of exemption under the CST Act

2.3.1 By a notification issued in May 2002 under the CST Act, the Government of Karnataka exempted tax payable on inter state sales turnover of liquor including beer, fenny, wine and liquor which has suffered additional excise duty or additional countervailing duty under the Karnataka Excise (Excise Duties and Fees) Rules, 1968. Tax payable on inter state sales of rectified spirit, denatured spirit and ethyl alcohol which has suffered revised fee under the Karnataka Excise (Excise Duties and Fees) Rules, 1968 was also exempted subject to production of declaration in form 'C' or certificate in form 'D' duly filled and signed by the registered dealer or the Government to whom the said goods are sold.

In Bangalore (Urban) district, two distilleries/breweries declared inter state sales of beer, IMFL⁸ and rectified spirit aggregating Rs.3.01 crore during 2002-03 and 2003-04. However, the distilleries/breweries failed to produce the required declarations/certificates in form C/D for the entire turnover. It was noticed that while finalising the assessments of these distilleries/breweries, the two AAs incorrectly exempted the turnover from levy of CST. This resulted in non-levy of tax of Rs.2.39 crore.

After the cases were pointed out in July/August 2006, the AA concerned in one case reported revision of assessment raising an additional demand of

⁸ IMFL: Indian made foreign liquor

Rs.48.56 lakh. In respect of the other case, reply is yet to be received (October 2007).

The cases were reported to the CCT in September/October 2006 and referred to the Government in May 2007; their replies have not been received (October 2007).

2.3.2 Under the CST Act, where any dealer claims that he is not liable to pay tax under this Act, in respect of any goods, on the ground that the movement of such goods, from one State to another was occasioned by reason of transfer of such goods by him to any other place of his business or to his agent or principal, as the case may be, and not by reason of sale, the burden of proving the same shall be on that dealer. For this purpose he may furnish to the AA, a declaration in form F, duly filled and signed by the principal officer of the other place of business, or his agent or principal, as the case may be, containing the particulars in the prescribed form obtained from the prescribed authority, along with the evidence of despatch of such goods. If the dealer fails to furnish such declaration, then the movement of such goods shall be deemed for all purposes of this Act to have been occasioned as a result of sale.

In eight⁹ districts, while finalising 37 assessments of 26 dealers for the years 2002-03 to 2004-05, between December 2003 and March 2006, 10 AAs allowed exemption on a turnover of Rs.20.23 crore as goods transferred to branches or agent or principal. However, it was noticed that the dealers have not filed declarations in form F in support of their claim. Incorrect exemption allowed resulted in non-levy of tax of Rs.2.01 crore.

After the cases were pointed out between February and December 2006, the department accepted audit observations in 28 cases and raised additional demands totalling Rs.1.54 crore by revision of assessments. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.3.3 Under the CST Act, where sale of any goods in the course of inter state trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods (sale in transit) to the Government or to a registered dealer shall be exempt from tax. However, the exemption is subject to production of a certificate in form EI or EII duly filled and signed by the registered dealer from whom the goods were purchased and declaration in form 'C' or certificate in form 'D' obtained from the buyer.

⁹ Bangalore (Urban), Bellary, Chitradurga, Dakshina Kannanda, Dharwad, Gulbarga, Mandya, Tumkur

In three¹⁰ districts, while finalising seven assessments of seven dealers for the years 2000-01, 2001-02 and 2003-04 between May 2004 and March 2006, five AAs allowed exemption on a turnover of Rs.2.80 crore as sales in transit. However, it was noticed that the dealers had not filed the required certificates/declarations. Incorrect exemption allowed resulted in non-levy of tax of Rs.33.10 lakh.

After the cases were pointed out between January and December 2006, the department accepted audit observations in three cases involving Rs.8.17 lakh. Of these, in two cases additional demands totalling Rs.3.59 lakh was raised and Rs.2.22 lakh was recovered. In one case, notice for revision of assessment was issued. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.3.4 By separate notifications issued under the CST Act during May 1976, May 2002 and July 2002, the Government of Karnataka exempted inter state sales turnover of declared goods¹¹, tamarind and dry chillies respectively which has suffered tax under the KST Act subject to production of declaration in form 'C' or certificate in form 'D' obtained from the buyers.

In three¹² districts, three assessments of three dealers for the years 2002-03 and 2003-04 were finalised between May 2004 and September 2005 by three AAs. In these cases, inter state sales turnover amounting to Rs.5.50 crore relating to tamarind, dry chillies and declared goods such as oil seeds and pulses which have suffered tax under the KST Act was exempted from levy of tax. However, it was noticed that the turnover involved was not supported by the required declarations/certificates in form 'C' or 'D' and hence the exemptions allowed were incorrect. This resulted in non-levy of tax of Rs.15.71 lakh.

After the cases were pointed out between February and December 2006, the AA concerned reported revision of assessment in one case raising an additional demand of Rs.31,000. In respect of the remaining cases, replies have not been received (October 2007).

The cases were reported to the CCT between April 2006 and February 2007 and referred to the Government in May 2007; their replies have not been received (October 2007).

¹⁰ Bangalore (Rural), Bangalore (Urban), Gulbarga

¹¹ "Declared goods" means goods declared under Section 14 of the CST Act to be of special importance in inter state trade or commerce

¹² Bangalore (Urban), Dharwad, Gulbarga

2.4 Application of incorrect rate of tax

2.4.1 Under the KST Act, tax was leviable on the purchase/sale at the rates mentioned in the relevant schedules to the Act. In addition, cess at the rate of five *per cent* of tax from 1 April 1998 to 31 March 2002 and 15 *per cent* of tax from 1 February 2004 was also leviable.

In 11¹³ districts, 117 assessments of 107 dealers for the years 1999-2000 to 2004-05 were finalised between May 2003 and March 2006 by 30 AAs. It was noticed between December 2005 and January 2007 that in these cases incorrect rates of tax were applied on taxable turnover of Rs.58.59 crore. These were due to misclassification of goods and transactions, extending the benefit of concessional rate given under certain notifications to ineligible cases, etc. This resulted in short levy of tax of Rs.2.99 crore. A few illustrative cases are mentioned below:

(Rupees in lakh)

Sl. No.	District (number of cases)	Assessment year (date of assessment)	Commodity	Turnover involved	Rate of tax (leviable/levied) in percentage	Tax levied short
1	Bangalore (Rural) (2)	2003-04 (February 2006)	Transformers	588.74	15 and 16/5	63.83
Concessional rate of tax prescribed in respect of sales to M/s Karnataka Power Transmission Corporation Ltd. in the notification dated 30 March 1996 read with the notification dated 29 October 2001 was incorrectly allowed on sales made to BESCOM ¹⁴ , MESCOM ¹⁵ and HESCOM ¹⁶ .						
2	Bangalore (Rural) (1)	2003-04 (February 2006)	Sweets sold in sealed containers and instant food	371.17	15 and 16/12 and 13	11.39
3	Bangalore (Rural) (1)	2002-03 (September 2004)	Water treatment equipment	446.73	5/4	4.47
Concessional rate of tax on sales made to Zilla Panchayats (ZPs) was increased from four to five <i>per cent</i> by a notification dated 30 March 2002. However, the AA levied tax at four <i>per cent</i> .						
4	Bangalore (Urban) (1)	2001-02 (May 2005)	Printed material	224.12	8/4	9.41
5	Bellary (1)	2001-02 (December 2004)	Castor Oil	133.86	8/4	5.62

After the cases were pointed out, the department revised assessment orders in 27 cases raising additional demands totalling Rs.44.93 lakh and recovered Rs.19.90 lakh in 10 of them. In respect of 25 other cases involving Rs.1.18 crore, notices were served for revision of assessment. In respect of five cases involving tax effect of Rs.10.45 lakh, the department stated that concessional rate of tax allowed as per the notification dated 30 March 1996 was in order. The reply is not tenable as the notification was not applicable in

¹³ Bangalore (Rural), Bangalore(Urban), Belgaum, Bellary, Dakshina Kannada, Davanagere, Gulbarga, Hassan, Raichur, Tumkur, Udupi

¹⁴ Bangalore Electricity Supply Company Limited

¹⁵ Mangalore Electricity Supply Company Limited

¹⁶ Hubli Electricity Supply Company Limited

respect of sales made to Electricity Supply Companies (ESCOMS). In respect of the remaining cases, replies are yet to be received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.4.2 Under the CST Act, tax leviable on inter State sale of goods shall be at the rate of 10 *per cent* or at the rate applicable for sale or purchase of such goods inside the State whichever is higher. In the case of declared goods, tax shall be calculated at twice the rate applicable to the sale of such goods inside the State. However, in case of inter state sale supported by declaration in form C or certificate in form D, tax leviable shall be at the rate of four *per cent* or the rate applicable to the sale or purchase of such goods inside the State whichever is lower.

In 14¹⁷ districts, 82 assessments of 79 dealers for the years 2000-01 to 2004-05 were finalised between March 2003 and March 2006 by 28 AAs. It was noticed between January 2006 and January 2007 that in these cases incorrect rates of tax were applied on inter state sale turnover of Rs.51.20 crore. These were due to levy of concessional rate of tax on turnover not covered by prescribed declarations, levy of tax at the rate of 10 *per cent* on turnover not covered by declarations in respect of goods which were taxed at a rate higher than 10 *per cent* under the KST Act and misclassification of goods. This resulted in short levy of tax of Rs.2.58 crore. A few illustrative cases are mentioned below:

(Rupees in lakh)					
Sl. No .	District (number of cases)	Assessment year (date of assessment)	Nature of observation	Turnover involved/ (rate of tax leviable/ levied in percentage)	Tax levied short
1	Bangalore (Rural) (1)	2004-05 (February 2006)	Tax on inter state sale of animal feeds and feed supplements not supported by form C declaration was levied at the rate of one <i>per cent</i> and two <i>per cent</i> instead of 10 <i>per cent</i> .	618.72 (10/ 1 and 2)	54.04
2	Bangalore (Urban) (1)	2003-04 (May 2005)	Under the CST Act Government departments only are entitled to issue form 'D' certificates. However, the AA levied concessional rate of tax at four <i>per cent</i> against form 'D' issued by colleges and universities on purchase of chemicals and laboratory equipments instead of levying at 10 <i>per cent</i> .	153.47 (10/4)	9.21
3	Chitradurga (3)	2002-03 and 2003-04 (between May 2004 and June 2005)	Inter state sale of deoiled cake covered by form 'C' declarations was liable to tax at the rate of four <i>per cent</i> . However, the AA levied tax at two <i>per cent</i> .	1,471.10 (4/2)	29.42

¹⁷ Bangalore (Rural), Bangalore (Urban), Belgaum, Chikmagalur, Chitradurga, Dakshina Kannada, Dharwad, Gulbarga, Kolar, Mandya, Mysore, Raichur, Udupi, Uttara Kannada

After the cases were pointed out, the department reported revision of assessment orders in 40 cases raising additional demands totalling Rs.1.35 crore and recovery of Rs.17.32 lakh in 15 cases. In respect of 18 other cases involving tax effect of Rs.61.58 lakh, notices were served for revision of assessment. In respect of the remaining cases, replies are yet to be received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.5 Non-levy of interest

2.5.1 Under the KST Act, every dealer is required to pay full amount of tax payable on the basis of the turnover computed by him for the preceding month within 30 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, the assessee is liable to pay interest at the rate of two *per cent* per month.

In 13 districts, though 184 dealers delayed payment of monthly/annual taxes amounting to Rs.7.89 crore by 3 to 47 months relating to the years 2000-01 to 2004-05, interest of Rs.3.89 crore was not levied by 29 AAs, 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) (40)	2000-01 to 2004-05 (between May 2004 and March 2006)	109.59	3 to 44	51.79
2	Bangalore (Urban) (88)	2000-01 to 2004-05 (between May 2004 and March 2006)	293.55	10 to 47	148.86
3	Belgaum (16)	2001-02 to 2003-04 (between April 2005 and March 2006)	56.37	12 to 37	27.84
4	Bellary (12)	2002-03 to 2004-05 (between November 2004 and March 2006)	74.73	9 to 34	28.95
5	Bijapur (3)	2002-03 to 2004-05 (between April 2005 and March 2006)	17.40	8 to 13	3.99
6	Dakshina Kannada (4)	2002-03 and 2003-04 (between July 2004 and January 2006)	39.38	15 to 27	13.86
7	Davanagere (1)	2004-05 (NA)	6.00	19	2.19
8	Dharwad (1)	2001-02 (February 2006)	4.12	46	3.79
9	Gulbarga (13)	2001-02 to 2003-04 (between April 2005 and March 2006)	158.06	11 to 39	94.93

(Rupees in lakh)					
Sl. No.	District (number of assesseees)	Period of assessment/ Date of assessment	Amount of tax involved	Delay in payment of tax (months)	Interest due
10	Kodagu (1)	2002-03 (May 2004)	4.48	15	1.32
11	Mysore (3)	2000-01 to 2003-04 (between November 2004 and January 2006)	10.70	6 to 30	3.30
12	Raichur (1)	2001-02 (March 2005)	9.99	34	6.93
13	Tumkur (1)	2003-04 (October 2005)	4.20	17	1.48
	Total (184)		788.57		389.23

NA-Not available

After the cases were pointed out between January and December 2006, the department accepted audit observations in 105 cases involving Rs.1.27 crore. Of these, in 74 cases demand was raised for interest of Rs.76.12 lakh and Rs.14.93 lakh recovered in 16 cases. In 31 other cases involving Rs.50.72 lakh, notices were served on the assesseees concerned. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.5.2 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 payment, the assessee is liable to pay interest at the rate of two *per cent* per month.

In Bangalore (Urban), Kolar and Tumkur districts demand notices were issued between May 2000 and July 2005 to 11 dealers in respect of the assessment years 1992-93 to 1994-95, 1998-99 and 2000-01 to 2003-04. It was noticed between April and September 2006 that the dealers paid the sums specified in the demand notices between March 2004 and June 2006. In these cases, the delay ranged between 5 to 61 months and interest of Rs.17.20 lakh was leviable. However, the concerned AAs did not levy interest.

After this was pointed out between April and September 2006, the AAs concerned raised demand for Rs.8.63 lakh on seven dealers and recovered Rs.1.74 lakh. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.6 Non/short levy of turnover tax, additional tax and resale tax

Under the KST Act, every registered dealer whose total turnover in a year exceeds the prescribed monetary limit, is liable to pay turnover tax (TOT) upto March 2002 at the prescribed rate(s) on his total turnover, after such

deductions as are admissible under the Act. With effect from 1 April 2002 resale tax (RST) is leviable at the rate of 1.5 *per cent* on such portion of the total turnover which is not liable to tax under other provisions of the Act. Additional tax at the rate of one *per cent* on taxable turnover is leviable with effect from 1 June 2003

2.6.1 In seven¹⁸ districts, it was noticed between April and December 2006 that while finalising 61 assessments of 55 assesseees for the years 2003-04 and 2004-05 between November 2004 and March 2006, additional tax of Rs.87.25 lakh was either not levied or levied short on the turnover of Rs.90.48 crore by 21 AAs due to incorrect exemption, incorrect determination of turnover, etc.

After the cases were pointed out, the department accepted audit observations in 41 cases. Of these, in 22 cases additional demand of Rs.21.49 lakh was raised by revision of assessments and Rs.13.28 lakh recovered in 15 cases. Notices for revision of assessments were issued in 19 cases. In respect of three cases involving tax effect of Rs.1.87 lakh relating to sale of machinery, cutting tools and electrical transformers, it was stated that sales were made against form-37 and hence did not attract additional tax as all the provisions relating to Section 5A of KST Act applied to the notification dated 30 March 2002 granting the concessional rate of tax. The reply is not tenable as the concessional rate of tax provided in the said notification is under Section 5 and not under Section 5A. Hence, additional tax is leviable in these cases. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.6.2 In eight¹⁹ districts, it was noticed between January and December 2006 that while finalising 16 assessments of 16 dealers for the years 1999-2000 to 2001-02, between March 2003 and January 2006, TOT of Rs.74.43 lakh was either omitted to be levied or levied short by applying incorrect rate of tax on turnover of Rs.56.42 crore by 11 AAs.

After the cases were pointed out, the department accepted the audit observation in 10 cases involving Rs.61.86 lakh. Of these, assessments were revised in four cases raising additional demands totalling Rs.5.80 lakh and recovered Rs.4.79 lakh. Notices for revision of assessment were issued in six other cases involving tax effect of Rs.56.06 lakh. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

¹⁸ Bangalore (Rural), Bangalore (Urban), Belgaum, Bellary, Chitradurga, Dakshina Kannada, Mysore

¹⁹ Bangalore (Rural), Bangalore (Urban), Bellary, Chitradurga, Dharwad, Gulbarga, Mysore, Udupi

2.6.3 In five²⁰ districts, while finalising 17 assessments of 14 assesses for the years 2002-03 to 2004-05, between January 2004 and February 2006, RST was either not levied or levied short on the turnover of Rs.22.92 crore by 10 AAs due to incorrect grant of exemption, levy at incorrect rate, etc. This resulted in non-levy of RST of Rs.30.48 lakh.

After the cases were pointed out between February 2006 and January 2007, the department accepted the audit observations in seven cases. Of these, revised orders were passed in four cases raising additional demands totalling Rs.3.29 lakh. The entire amount was recovered. Notices for revision of assessments were issued in three other cases. In respect of the remaining cases, replies are yet to be received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.7 Non-levy of tax on textiles and silk fabrics

By a notification dated 30 March 2002 issued under the KST Act, the Government of Karnataka exempted tax on sale of all varieties of textiles produced or manufactured in India which are 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). Also, silk fabrics produced or manufactured in India was exempted by a notification dated 7 October 1999.

Further, under the ADE Act, goods classified under certain specified chapter heading and sub-heading of the Central Excise Tariff Act, 1985 (CET Act) were described. Goods falling under Chapter 39 of the CET Act are not described under the ADE Act.

In Bangalore (Rural) and Bangalore (Urban) districts, while finalising eight assessments of six assesseees, for the years 2001-02 to 2004-05 between May 2005 and March 2006, five AAs allowed exemption on a turnover of Rs.17.59 crore. It was noticed between April and November 2006 that the goods dealt by the assesseees were HDPE²¹ woven fabrics, imported fabrics, imported silk fabrics, bed spreads, towels, bed sheets, etc. These goods were not eligible for exemption under the notifications mentioned above as these were either not described in column 2 of ADE Act or some (imported fabrics/silk fabrics) were not produced or manufactured in India. Incorrect exemption of turnover resulted in non-levy of tax of Rs.1.74 crore.

After the cases were pointed out, the department accepted the audit observations in two cases and raised additional demands totalling Rs.5.57 lakh by revising the assessment orders. In respect of four assessments of two dealers involving a tax effect of Rs.1.67 crore relating to the sale of HDPE

²⁰ Bangalore (Rural), Bangalore (Urban), Bellary, Chikmagalur, Dakshina Kannada

²¹ High density poly ethylene

woven fabrics, the concerned AAs stated that goods were eligible for exemption under the notification. The reply is not tenable as HDPE woven fabric falls under Chapter 39 of the CET Act which is not described under the ADE Act and even the dealers concerned, in their invoices, had classified the goods accordingly.

The Government endorsed the reply of the department in September 2007.

2.8 Short levy of tax due to incorrect assessment of works contract receipts

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 other than those who purchase or receive goods from outside the State for the purpose of using such goods in the execution of works contract, have the option to pay tax by way of composition, at four *per cent* on the total consideration. Where such option for payment of tax by composition is exercised, no deduction is admissible from the total consideration except for amounts paid to a 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. However, deductions towards security deposits, bonus received, etc. are not admissible.

2.8.1 In Bangalore (Urban), Chitradurga and Raichur districts, while finalising seven assessments for the years 2001-02 to 2003-04 between March and June 2005 of four dealers who were engaged in execution of works contracts and had opted for composition, deductions of Rs.16.46 crore were allowed by four AAs. It was noticed between April and October 2006 that inadmissible deductions like security deposit, bonus received for speedy completion of the project, payments to sub-contractors not supported by monthly statement of return of turnover filed by such sub-contractors, etc. were allowed by the AAs. This resulted in short levy of tax of Rs.65.85 lakh.

After this was pointed out between April and October 2006, the AAs concerned accepted audit observations in all the cases. The assessments were revised in five cases raising additional demands totalling Rs.22.86 lakh, of which Rs.13.98 lakh was recovered. In respect of the other cases, notices for revision of assessments were issued.

The cases were reported to the CCT between June / October 2006 and referred to the Government in May 2007; their replies have not been received (October 2007).

2.8.2 In Bangalore (Urban) district, while finalising the assessment of a dealer engaged in execution of electrical works contract for the year 2002-03, tax was levied at Rs.8.84 lakh on the total consideration of Rs.2.21 crore at the rate of four *per cent* allowing him the benefit of composition as opted by him. It was noticed that the dealer had brought the entire goods for use in the execution of works contract from outside the State and hence was not eligible to opt for composition. In respect of transfer of property in goods involved in the execution of works contract, after allowing deductions towards labour and like charges at 20 *per cent* of the total consideration, the dealer was liable to pay tax of Rs.21.22 lakh. Thus, incorrect grant of composition benefit resulted in short levy of tax of Rs.12.38 lakh.

After this case was pointed out in October 2006, the AA issued notice for revision of assessment.

The case was reported to the CCT in March 2007 and referred to the Government in May 2007; their reply is yet to be received (October 2007).

2.8.3 In Bangalore (Urban) district, two assessments for the year 2004-05 in respect of two dealers who were engaged in execution of works contracts were finalised by two AAs between October 2005 and February 2006. It was noticed that in one case excess deduction of Rs.47.21 lakh was allowed towards labour and like charges and in the other case involving transfer of property in goods worth Rs.32.40 lakh, the entire contract receipts were treated as labour charges and exempted. This resulted in non/short determination of taxable turnover of Rs.79.61 lakh and consequent short levy of tax of Rs.11.78 lakh.

The cases were pointed out between July 2006 and January 2007 to the AAs concerned, reported to CCT between September 2006 and February 2007 and referred to the Government in May 2007; their replies have not been received (October 2007).

2.9 Incorrect determination of taxable turnover

Under the KST Act, taxable turnover of every dealer shall be determined in accordance with the 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 sections/schedules to the Act.

In Bangalore (Urban) and Bijapur districts, nine assessments of six dealers for the years 2001-02 to 2004-05 were finalised between April 2005 and March 2006 by five AAs. It was noticed that in these cases the AAs failed to levy tax on a taxable turnover of Rs.4.55 crore. This was due to incorrect determination of taxable turnover resulting from misclassification of first sale of goods in the State as resale of tax suffered goods and treating taxable

goods/transactions as exempted goods/transactions. This resulted in non-levy of tax of Rs.40.78 lakh.

After the cases were pointed out between May 2006 and January 2007, the AAs concerned in four cases of three dealers accepted the audit observations involving Rs.13.74 lakh. Of these, in two cases assessments were revised raising additional demands totalling Rs.1.09 lakh and in two other cases notices for revision of assessments were issued. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.10 Short demand of tax

After final assessment under the KST Act and the CST Act, if any amount is due from a dealer, the AA is required to serve upon him a demand notice for payment of the tax due.

It was noticed that in five²² districts, in respect of 24 assessments for the years 2000-01 to 2004-05 finalised between April 2004 and May 2006, as against the aggregate tax of Rs.6.88 crore due, only Rs.6.51 crore was demanded by the 14 AAs resulting in short demand of tax of Rs.37.15 lakh. The short demands were due to incorrect computation of tax payable (Rs.5.02 lakh), omission to raise demand for tax/penalty levied (Rs.6.22 lakh) and arithmetical error (Rs.25.91 lakh).

After the cases were pointed out between August 2005 and November 2006, the department reported raising of demands totalling Rs.13.19 lakh in 14 cases and recovery of Rs.7.34 lakh in seven of them. In five cases involving tax effect of Rs.3.57 lakh, notices were issued. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.11 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 AA is required to forfeit the tax collected in excess.

²² Bangalore (Rural), Bangalore (Urban), Belgaum, Bellary, Mysore

It was noticed that in five²³ districts while finalising, between April 2001 and March 2006, 24 assessments of 24 dealers for the years 1998-99 and 2000-01 to 2004-05, 13 AAs levied tax of Rs.31.67 crore. Against this, the dealers had collected tax of Rs.32.01 crore. No action was initiated to forfeit excess collection of tax amounting to Rs.33.82 lakh.

After the cases were pointed out between February 2006 and January 2007, the department accepted audit observations in 21 cases involving Rs.29.14 lakh. Of these, additional demands totalling Rs.14.19 lakh was raised in 13 cases and Rs.8.38 lakh recovered in nine of them. Notices for revision of assessments were issued in eight cases involving Rs.14.95 lakh. In respect of the remaining cases, replies have not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.12 Non-levy of tax on branded goods

Under the KST Act, sale of goods by the brand name or trade mark holder shall be deemed to be the sale by the first dealer liable to tax. Where for any reason, the goods sold under the brand name have been subjected to tax at the hands of the producer or the manufacturer of such goods, the tax payable by the brand name or trade mark holder, shall be reduced by the amount of tax already paid on the sale of such goods by such producer or the manufacturer and the said producer or manufacturer shall not be entitled to refund of such tax paid by him.

In Bangalore (Urban) district, three assessments of an assessee for the years 2001-02 to 2003-04 were finalised in March 2005. In these cases, the sale turnover of the assessee of 'Hello' brand packaged drinking water was treated as second or subsequent sale as the goods were purchased by them after payment of tax on sale bills raised on them by their sister concern. Accordingly, only turnover tax/resale tax was levied. It was noticed that the assessee is a franchise holder for 'Hello' brand packaged drinking water. In these circumstances, assessee was liable to pay tax as the first dealer and was eligible for reduction of the amount of tax already paid by the manufacturer. Thus, incorrect classification of first sale as second or subsequent sale resulted in short levy of tax of Rs.28.73 lakh.

After the cases were pointed out in February 2006, the AA concerned accepted the audit observation and issued notices for revision of the assessments.

The cases were reported to the CCT in May 2006 and referred to the Government in May 2007; their replies have not been received (October 2007).

²³ Bangalore(Rural), Bangalore (Urban), Bellary, Dakshina Kannada, Mysore

2.13 Non/short levy of cess

Under the KST Act, with effect from 1 February 2004, in addition to the tax payable on sale or purchase by any dealer, road cess at the rate of 10 *per cent* is to be levied and collected for the purpose of establishing a road maintenance fund. Similarly, with effect from 1 February 2004, in addition to the tax payable on sale or purchase effected by any dealer, infrastructure cess at the rate of five *per cent* is to be levied and collected for the purpose of various infrastructure projects across the State, equity investment in Bangalore Mass Rapid Transit Limited and for establishing a Mukhya Manthri Grameena Rasthe Abhivruddhi Nidhi.

In four²⁴ districts, while finalising 13 assessments of 12 assesseees for the years 2003-04 and 2004-05 between July 2004 and March 2006, sales tax of Rs.2.48 crore was levied. On this “road and infrastructure” cess leviable at 15 *per cent* amounted to Rs.37.15 lakh. However, it was noticed that cess of Rs.11.18 lakh only was levied for reasons like arithmetical error or levy of cess at five *per cent* instead of 15 *per cent*, or omission to levy cess on sales made against form-37 declarations after 1 August 2004, etc. The non/short levy of cess amounted to Rs.25.97 lakh.

After the cases were pointed out between November 2005 and August 2006, the department revised assessments in six cases raising additional demands totalling Rs.11.91 lakh of which Rs.3 lakh was recovered. In respect of the remaining cases, replies are yet to be received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.14 Sale turnover of import or export licenses escaping assessment

By notifications dated 31 March 2001 and 31 March 2002 issued under the KST Act, the Government of Karnataka reduced the tax payable on the sales of special import licenses, DEPB²⁵ licenses, and the like to four *per cent*. Besides, cess and turnover tax at prescribed rates during 2001-02 and additional tax during 2003-04 was also leviable.

In Bangalore (Rural) and Bangalore (Urban) districts, 10 assessments of six assesseees for the years 2001-02 to 2003-04 were finalised between February 2005 and March 2006 by five AAs. It was noticed, from the audited annual accounts filed by the assesseees that they had accounted for receipts of Rs.3.81 crore by sale of DEPB licenses and import licenses. However, the AAs failed to consider the turnover in the assessments and levy tax accordingly. This resulted in non-levy of tax of Rs.20.10 lakh.

²⁴ Bangalore (Rural), Bangalore (Urban), Bellary, Dakshina Kannada

²⁵ DEPB - Duty entitlement passbook scheme is an entitlement given to the exporters for importing duty free goods in proportion to their export earnings

After the cases were pointed out between April 2006 and January 2007, the department accepted audit observations in nine cases involving tax effect of Rs.16.87 lakh and raised additional demands totalling Rs.7.86 lakh by revision of five cases and recovered Rs.1.63 lakh in two cases. Notices for revision of assessment were issued in four cases involving tax effect of Rs.9.01 lakh. In respect of the remaining case, reply has not been received (October 2007).

The Government endorsed the reply of the department in September 2007.

2.15 Incorrect grant of composition benefit

Under the KST Act, dealers whose total turnover in a year does not exceed Rs.10 lakh, may opt for, in lieu of tax payable under the Act, by way of composition, on the total turnover, an amount at the rates prescribed from time to time. A hotelier or a restaurateur may also opt for, in lieu of tax payable under the Act, by way of composition, tax at the rate of four *per cent* on total turnover. However, the benefit of opting for composition is not available to dealers/hoteliers/restaurateurs engaged in vending of liquor and/or beer, in reselling of goods purchased in the course of inter state trade or commerce against declarations in form 'C' or obtaining goods from outside the State against declarations in form 'F'. Further, under the KST Rules, the dealers have to, for grant/renewal of permission for composition benefit for any year, file application in the prescribed form before the jurisdictional AA within 30 days of the commencement of such year. The AA, on sufficient cause being shown and for reasons to be recorded in writing condone delay in respect of an application made after the expiry of 30 days but within a period of 90 days from the date of commencement of the year.

In five²⁶ districts, 12 assessments of 10 assesseees for the years 1999-2000, 2000-01, 2002-03 and 2003-04 were finalised between March 2002 and February 2006 under the composition scheme by levying tax of Rs.2.83 lakh on a turnover of Rs.91.21 lakh. It was noticed that the assesseees were not eligible to opt for composition of tax, as either the dealers had not filed any application for composition or it was filed belatedly beyond the condonation power of the AA or had effected inter state purchases against form 'C' declarations or were such hoteliers who had dealt with liquor. Thus, they were liable to pay tax of Rs.11.28 lakh. Thus, incorrect grant of composition benefit resulted in short levy of tax of Rs.8.45 lakh after deducting the tax levied under the composition scheme.

After the cases were pointed out in June 2004 and January 2007, the AAs concerned revised the assessments in five cases involving tax of Rs.3.44 lakh and recovered Rs.2.13 lakh in four of them and issued notices for revision of assessments in four cases involving Rs.2.43 lakh. In respect of the remaining cases, replies have not been received (October 2007).

²⁶ Bangalore (Rural), Bangalore (Urban), Bijapur, Dharwad, Koppal

The cases were reported to the CCT between July 2004 and February 2007 and referred to the Government in May 2007; their replies have not been received (October 2007).