

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 2007-08, disclosed under assessments of tax, non/short levy of interest/penalty, etc., amounting to Rs. 147.50 crore in 3,318 cases which fall under the following categories:

(Rupees in crore)

Sl. No.	Category	Number of cases	Amount
Sales Tax			
1.	Non/short levy of tax	396	74.57
2.	Non-levy of tax on non-surrendered transit pass	2,179	29.42
3.	Non/short levy of tax due to incorrect grant of exemption	89	11.85
4.	Non-levy of interest/penalty	50	7.14
5.	Non/short levy of additional tax	122	5.07
6.	Non/short levy of turnover tax/resale tax	103	3.58
7.	Non-forfeiture of excess tax collected	39	2.61
8.	Non/short levy of cess	43	1.29
9.	Other irregularities	13	2.10
Total		3,034	137.63
Value Added Tax			
1.	Excess/incorrect allowance of input tax credit	52	3.33
2.	Non/short levy of tax	72	2.90
3.	Non/short levy of interest/penalty	129	2.53
4.	Non-forfeiture of tax collected in excess	7	0.40
5.	Other irregularities	24	0.71
Total		284	9.87
Grand total		3,318	147.50

During the course of the year 2007-08, the department accepted under assessments of tax amounting to Rs. 13.41 crore in 671 cases pointed out in audit in earlier years and, of that, recovered Rs. 9.34 crore in 555 cases.

A few illustrative cases involving Rs. 77.54 crore are mentioned in the following paragraphs. Of this, Rs. 5.67 crore was recovered.

SALES TAX

2.2 Non/short levy of tax and penalty on non-surrendered transit pass

Under the Karnataka Sales Tax Act, 1957 (KST Act) and Karnataka Value Added Tax Act, 2003 (KVAT Act) and the rules made thereunder, where a vehicle carrying goods taxable under the said Acts from any place outside the State and bound for any place outside the State, passes through the State, the driver or any other person incharge of such vehicle is to furnish the necessary information and obtain a transit pass (TP) in duplicate from the officer incharge of the first check post (CP) after his entry into the State or after the movement has commenced in the State. The duplicate copy of TP shall be surrendered to the officer incharge of the last CP before his exit from the State. The surrendered TPs are sent back by the exit CPs with their seal and signature to the concerned entry CP. If the driver or any other person incharge of the vehicle does not surrender the TP at the exit CP within the stipulated time, it shall be presumed that the goods carried thereby have been sold within the State by the owner of the vehicle and shall, irrespective of whether he is taxable person, be assessed to tax by the officer empowered in this behalf in the prescribed manner. If the owner of the vehicle, having obtained the TP fails to deliver the same he shall be liable to pay by way of penalty a sum not exceeding twice the amount of tax leviable on the goods transported.

A test check of TP issue registers at 10 entry point CPs revealed that 2,179 transit passes issued during 2000-01 to 2006-07 had not been surrendered at the relevant exit point CPs. No action was taken to levy tax of Rs. 9.81 crore on the value of goods covered under these TPs treating them as local sales. Besides, maximum penalty of Rs. 19.61 crore was also leviable. The details are mentioned below:

(Rupees in lakh)

Sl. No.	Name of the CP	Year	No. of cases	Amount of tax	Amount of penalty	Total tax and penalty
1.	BRCP, Devanahalli	2000-01 to 2004-05	83	15.12	30.26	45.38
2.	Dhoolkhed	2005-06 to 2006-07	136	50.38	100.76	151.14
3.	Gundlupete	2002-03 to 2006-07	260	77.26	154.53	231.79
4.	Hosur Road (In)	2002-03 to 2006-07	514	219.09	438.16	657.25
5.	Kannur	2002-03 to 2005-06	107	44.57	89.14	133.71
6.	Mukka	2002-03	11	3.60	7.19	10.79
7.	Nippani(In)	2005-06 to 2006-07	849	507.78	1,015.55	1,523.33

(Rupees in lakh)

Sl. No.	Name of the CP	Year	No. of cases	Amount of tax	Amount of penalty	Total tax and penalty
8.	Punajanooru	2003-04 to 2006-07	13	3.65	7.30	10.95
9.	Sherdon	2006-07	3	3.88	7.76	11.64
10.	Tokkottu	2004-05 to 2006-07	203	55.27	110.55	165.82
Total			2,179	980.60	1,961.20	2,941.80

After the cases were pointed out, the Commissioner of Commercial Taxes (CCT) stated that necessary action would be taken in this regard.

The cases were reported to the Government in May 2008; their reply has not been received (November 2008).

2.3 Application of incorrect rate of tax

2.3.1 Under the Central Sales Tax Act, 1956 (CST Act), tax leviable on interstate 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 interstate 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.

Test check of the records in 14¹ districts between April and December 2007 revealed that 40 assessing authorities (AA) while finalising 151 assessments of 133 dealers for the years 1999-2000 and 2001-02 to 2004-05 between July 2004 and March 2007 levied concessional rates of tax on interstate sale turnover of Rs. 234.68 crore not supported by the prescribed declarations instead of 10 *per cent* or a higher rate prescribed under the KST Act. This resulted in short levy of tax of Rs. 8.78 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 (Urban) (2)	2003-04 and 2004-05 (March 2007)	Tax on inter state sale of woven labels not supported by form C was levied at the rate of two instead of 10 <i>per cent</i> .	1,859.80 (10/2)	148.78

¹ Bangalore (Rural), Bangalore (Urban), Belgaum, Bijapur, Dakshina Kannada, Davanagere, Dharwad, Gadag, Gulbarga, Kolar, Mandya, Shimoga, Udupi, Uttara Kannada.

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
2.	Bangalore (Urban) (1)	2004-05 (March 2007)	Tax on Inter state sale of software between 1 August 2004 and 31 March 2005 not supported by form C was leviable at the rate of 13.8 instead of 10 <i>per cent.</i>	1,085.09 (13.8/10)	41.23
3.	Bangalore (Urban) (1)	2004-05 (February 2007)	Tax on inter state sale of animal feeds and feed supplements not supported by form C was levied at the rate of one instead of 10 <i>per cent.</i>	249.60 (10/1)	22.46

After the cases were pointed out between April and December 2007, the Government/department reported in June 2008 revision of assessments in 18 cases raising additional demands totalling Rs. 1.23 crore and recovery of Rs. 7 lakh in eight cases. In respect of 65 other cases involving tax effect of Rs. 3.34 crore, notices were served for revision of assessment. In respect of the remaining cases, reply has not been received (November 2008).

2.3.2 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 leviable².

Test check of the records in 15³ districts between April and December 2007 revealed that 53 AAs while finalising 192 assessments of 169 dealers for the years 2001-02 to 2004-05, between May 2005 and March 2007, applied incorrect rates of tax on taxable turnover of Rs. 83.24 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. 6.01 crore. A few illustrative cases are mentioned below:

² There was no levy of cess under the KST Act between 1 April 2002 and 31 January 2004.

³ Bangalore (Rural), Bangalore(Urban), Bagalkot, Belgaum, Bellary, Chitradurga, Dakshina Kannada, Davanagere, Dharwad, Gulbarga, Mandya, Mysore, Raichur, Tumkur, Udupi.

2.3.2.1 Sale of food items in three star, four star and five star hotels recognised by the Tourism Department, Government of India were liable to tax at 20 *per cent* and cess at 15 *per cent* of tax. However, in Bangalore (Rural) I, while finalising the assessment for the year 2004-05, in December 2006 of a five star hotel, the AA incorrectly levied tax at rate of 11.5 *per cent* instead of 23 *per cent* on sale turnover of food valued at Rs. 4.19 crore. This resulted in short levy of tax of Rs. 48.18 lakh.

After the case was pointed out, the AA concerned accepted the audit observation and stated that notice would be issued for revision of assessment.

2.3.2.2 Concessional rate of two *per cent* tax on sale of ACSR⁴ conductors to BESCOM⁵, MESCOM⁶, HESCOM⁷ etc., prescribed under the notification dated 18 November 2002 was omitted with effect from 1 August 2004. However, in Bangalore (Rural) I, while finalising assessment for the year 2004-05 in May 2006 of a dealer, the AA levied concessional rate of tax on the sale of ACSR conductors instead of 18.4 *per cent* on the turnover of Rs. 1.75 crore for the period from August 2004 to March 2005. This resulted in short levy of tax of Rs. 25.31 lakh.

After the case pointed out, the AA concerned accepted the audit observation and issued notice for revision of assessment.

2.3.2.3 Concessional rate of tax on sale of diesel to industrial unit located in the State for use in captive power generation sets prescribed under the notification dated 30 March 2002 was withdrawn with effect from 6 November 2003. However, in Bangalore (Urban) I, while finalising the assessment for the year 2004-05 in September 2006 of a dealer, the AA incorrectly levied the concessional rate of tax of four *per cent* instead of 20 *per cent* on sale turnover of diesel valued at Rs. 63.92 lakh. This resulted in short levy of tax of Rs. 10.23 lakh.

After the case was pointed out, the AA concerned accepted the audit observation and issued notice for revision of assessment.

2.3.2.4 The concessional rate of tax prescribed in respect of the 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, MESCOM and HESCOM. The sale valued at Rs. 71.01 lakh were incorrectly taxed at the rate of five *per cent* instead of 13 *per cent*. This resulted in short levy of tax of Rs. 5.68 lakh.

After the case was pointed out, the AA concerned accepted the audit observation and issued notice for revision of assessment.

After the cases were pointed out, the Government/department reported in June 2008 revision of assessments in 35 cases raising additional demand totalling

⁴ Aluminum Conductor, Steel Reinforced.

⁵ Bangalore Electricity Supply Company Limited.

⁶ Mangalore Electricity Supply Company Limited.

⁷ Hubli Electricity Supply Company Limited.

Rs. 94.07 lakh and recovery of Rs. 75.92 lakh in 27 of them. In respect of 79 cases involving Rs. 2.54 crore, notices were served for revision of assessment. In respect of the remaining cases, reply has not been received (November 2008).

2.4 Non-levy of interest

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 the 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.

Test check of the records in eight⁸ districts, revealed that though 48 dealers delayed payment of monthly/annual taxes amounting to Rs. 15.51 crore by 1 to 50 months relating to the years 2001-02 to 2004-05, interest of Rs. 7.36 crore was not levied by 18 AAs.

After the cases were pointed out between April and December 2007, the Government/department reported in June 2008 acceptance of audit observations in 12 cases raising demands totalling Rs. 3.22 crore and recovery of Rs. 84.88 lakh in seven of them. In other six cases involving Rs. 4.59 lakh, notices for levy of interest were issued. In respect of the remaining cases, reply has not been received (November 2008).

2.5 Non-levy of tax on HDPE⁹ woven 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). 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.

Test check of the records between April and September 2007 in Bangalore (Rural) and Bellary districts, revealed that while finalising seven assessments of four assesseees, for the years 2002-03 to 2004-05 between February 2005 and November 2006, three AAs allowed exemption from payment of tax on a turnover of Rs. 50.13 crore. The goods dealt by the assesseees were HDPE woven fabrics, which was not eligible for exemption under the notification mentioned above as it was not described in column 2 of the first schedule to the ADE Act. Incorrect exemption of the turnover resulted in non-levy of tax of Rs. 5.02 crore.

⁸ Bangalore (Urban), Belgaum, Bellary, Bijapur, Chickmagalur, Dakshina Kannada, Dharwad, Tumkur.

⁹ High density poly ethylene.

After the cases were pointed out between April and September 2007, the Government/department stated that HDPE woven fabrics fall under heading “54.06 – Man-made filament yarn (other than sewing thread), put up for retail sale”, of the CET Act which is described in ADE Act and hence eligible for exemption under the notification. The reply is not tenable as HDPE related items fall under Chapter 39 of the CET Act, which are not described in column 2 of the first schedule of the ADE Act and even the dealers concerned, in their invoices and monthly return to the Central Excise Department, classified the goods accordingly and which was accepted by that department.

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, was 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) was leviable at the rate of 1.5 *per cent* on such portion of the total turnover which was not liable to tax under other provisions of the Act. Additional tax (AT) at the rate of one *per cent* on taxable turnover was leviable with effect from 1 June 2003.

Further, in accordance with a clarification issued by the “Authority for Clarification and Advance Rulings¹⁰” where tax under Section 5, 5-B, 5-C or 6 of the KST Act was leviable on any turnover but was exempted by any notification issued under the Act, AT was leviable on such turnover.

2.6.1 Test check of the records in 12¹¹ districts between March and October 2007 revealed that while finalising 183 assessments of 173 assesseees for the years 2003-04 and 2004-05 between September 2005 and March 2007, AT of Rs. 3.82 crore was not levied on the turnover of Rs. 381.94 crore by 40 AAs due to incorrect exemption, incorrect determination of turnover, etc.

After the cases were pointed out, the Government/department reported revision of assessments in 76 cases raising additional demand totalling Rs. 2.39 crore and recovery of Rs. 2.25 crore in 60 of them. In respect of 54 cases involving Rs. 76.77 lakh, notices were served for revision of assessment. In respect of two cases involving tax effect of Rs. 8.78 lakh, the AA stated that sale turnover was exempted from levy of tax under Section 5 and hence AT under Section 6-C of the Act was also not leviable. The reply is not tenable in view of the Clarification and Advance Ruling. In respect of the remaining cases, reply has not been received (November 2008).

2.6.2 Test check of the records in eight¹² districts revealed that while finalising 71 assessments of 62 dealers for the years 2002-2003 to 2004-05, between April 2006 and March 2007, RST was either not levied or levied short on the turnover of Rs. 90.69 crore by 26 AAs due to incorrect grant of

¹⁰ The Authority was constituted by the CCT under the KST Act, for issue of clarifications and advance rulings.

¹¹ Bangalore (Rural), Bangalore (Urban), Bagalkot, Belgaum, Bellary, Bijapur, Dakshina Kannada, Dharwad, Gulbarga, Mysore, Raichur, Tumkur.

¹² Bangalore (Rural), Bangalore (Urban), Belgaum, Bellary, Bijapur, Dakshina Kannada, Dharwad, Gulbarga.

exemption, levy at incorrect rate, etc. This resulted in non-levy of RST of Rs. 1.21 crore.

After the cases were pointed out between April and December 2007, the Government/department reported in June 2008 revision of assessments in 24 cases raising additional demand totalling Rs. 33.04 lakh and recovery of Rs. 32.18 lakh in 22 of them. Notices for revision of the assessments were issued in nine other cases involving Rs. 11.52 lakh. In respect of the remaining cases, reply has not been received (November 2008).

2.6.3 Test check of the records in Bangalore (Rural) and Bangalore (Urban) districts between April and October 2007 revealed that while finalising six assessments of five dealers for the years 2000-01 and 2001-02 between May 2005 and March 2007, TOT of Rs. 15.91 lakh was either omitted to be levied or levied short by applying incorrect rates on the turnover of Rs. 10.20 crore by three AAs.

After the cases were pointed out between April and October 2007, the Government/department reported revision of assessment in one case and raising additional demand of Rs. 33,522 and issue of notice for revision of assessment in one case involving Rs. 13.25 lakh. In respect of the remaining cases, replies have not been received (November 2008).

2.7 Incorrect grant of exemption under the CST Act

2.7.1 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 the 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 it 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.

Test check of the records in three¹³ districts between April and December 2007 revealed that while finalising seven assessments of seven dealers for the years 2002-03 to 2004-05 between May 2006 and March 2007, exemption was allowed on a turnover of Rs. 17.95 crore not supported by F forms as goods transferred to branches or agent or principal by five AAs. Incorrect exemption allowed resulted in non-levy of tax of Rs. 1.86 crore.

After the cases were pointed out between April and December 2007, the Government/department reported in June 2008 issue of notices for revision of assessments in three cases involving Rs. 1.73 crore. In respect of the remaining cases, reply has not been received (November 2008).

¹³ Bangalore (Rural), Bangalore (Urban), Dharwad.

2.7.2 The Government of Karnataka exempted tax on inter state sales turnover of declared goods¹⁴, areca nut¹⁵, dry chillies¹⁶ and raw coffee seeds¹⁵ which has suffered tax under the KST Act subject to production of declaration in form 'C' obtained from the buyers. Also, under the CST Act where tax is levied on inter state sale of any declared goods which had suffered tax under the KST Act, the tax levied under the KST Act shall be reimbursed to the person making such inter state sale.

Test check of the records in four¹⁷ districts between April and December 2007 revealed that while finalising 11 assessments of eight dealers for the years 2002-03 to 2004-05 between May and December 2006 inter state sales turnover amounting to Rs. 19.35 crore not supported by C form relating to areca nut, dry chillies and other declared goods such as oil seeds and iron and steel which had suffered tax under the KST Act, was exempted from levy of tax by four AAs. Incorrect grant of exemption resulted in non-realisation of revenue of Rs. 1.86 crore.

After the cases were pointed out between April and December 2007, the AA concerned reported revision of assessment in one case raising additional demand of Rs. 1.85 lakh. In two other cases involving tax effect of Rs. 6.97 lakh, notices were served for revision of assessment. In respect of the remaining cases, reply has not been received (November 2008).

The cases were reported to the CCT between July 2007 and February 2008 and the Government in May 2008; their reply has not been received (November 2008).

2.7.3 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 duly filled and signed by the registered dealer from whom the goods were purchased and declaration in form 'C' obtained from the buyer.

Test check of the records in three¹⁸ districts between April and November 2007 revealed that while finalising nine assessments of eight dealers for the years 2002-03 and 2003-04 between May 2006 and March 2007, five AAs allowed exemption of tax on a turnover of Rs. 2.17 crore not supported by required certificates/declarations as sales in transit. Incorrect exemption allowed resulted in non-levy of tax of Rs. 21.50 lakh.

After the cases were pointed out between April and November 2007, the AAs concerned accepted the audit observations in four cases involving

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

¹⁵ Notification No.FD 119 CSL 2002(3), dated 31 May 2002.

¹⁶ Notification No.FD 119 CSL 2002, dated 25 July 2002.

¹⁷ Bangalore (Urban), Davangere, Dharwad, Gadag.

¹⁸ Bangalore (Urban), Dharwad, Shimoga.

Rs. 6.70 lakh and issued notice for revision of assessments. In respect of the remaining cases, reply has not been received (November 2008).

The cases were reported to the CCT between July 2007 and February 2008 and the Government in May 2008; their reply has not been received (November 2008).

2.8 Sales turnover escaping assessment

Under the KST Act and CST Act the total turnover means the aggregate turnover in all goods of a dealer at all places of business in the State, whether or not the whole or any portion of such turnover is liable to tax and the taxable turnover means the turnover on which a dealer shall be liable to pay tax as determined after making prescribed deductions from his total turnover. Further, every registered dealer shall submit monthly/annual returns relating to his turnover within the prescribed period to the concerned AA.

2.8.1 Test check of the records in five¹⁹ districts revealed that 25 assessments of 22 dealers for the years 2001-02 to 2004-05 were finalised between May 2004 and March 2007 by 15 AAs. Taxable turnover of Rs. 16.41 crore under the KST Act had escaped assessment, due to concluding of assessments by AAs based on the original annual return filed by the dealers instead of revised annual returns reporting higher taxable turnover, omission to assess taxable turnover reported in the returns, incorrect adoption of turnover, allowing deduction twice in respect of exempted turnover and incorrect deduction allowed towards central excise duty paid, etc. This resulted in non-levy of tax of Rs. 1.79 crore.

After the cases were pointed out between September 2006 and October 2007, the Government/department reported in June 2008 revision of assessment in seven cases raising additional demand totalling Rs. 1.46 crore and recovery of Rs. 10.70 lakh in three of them. In two other cases involving tax effect of Rs. 4.30 lakh, notices for revision of assessments were issued. In respect of the remaining cases, reply has not been received (November 2008).

2.8.2 Test check of the records in Bangalore (Urban) and Dharwad districts, revealed that seven assessments of seven dealers for the years 2001-02, 2002-03 and 2004-05 were finalised between June 2006 and March 2007 by five AAs. In these cases the interstate sales turnover was omitted to be assessed, turnover was determined at a lesser extent than that reported by the dealers and incorrect deductions allowed towards central excise duty paid on goods from the sales turnover. This resulted in escapement of taxable turnover amounting to Rs. 77.87 lakh and consequent non-levy of tax of Rs. 8.74 lakh.

After the cases were pointed out between May and September 2007, the Government/department reported in June 2008 revision of assessment in two cases raising additional demand totalling Rs. 2.03 lakh. In three other cases involving tax effect of Rs. 4.12 lakh, notices for revision of assessments were

¹⁹ Bagalkot, Bangalore (Rural), Bangalore (Urban), Bellary, Dharwad.

issued. In respect of the remaining cases, reply has not been received (November 2008).

2.9 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 the rates specified in the sixth schedule to the Act. Further, under the Act, 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, had 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 was exercised, no deduction was 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 was a registered dealer liable to tax under the Act and that the turnover of such amounts was included in the monthly returns filed by him. However, deductions towards security deposits, labour charges, transportation charges, etc., were not admissible.

2.9.1 Test check of the records in 10²⁰ districts between April and October 2007 revealed that deductions of Rs. 36.67 crore were incorrectly allowed by the 24 AAs while finalising 42 assessments for the years 2001-02 to 2004-05 between April 2005 and March 2007 of 35 works contractors who had opted for composition. The deductions related to security deposit, labour charges, transportation charges, packing charges, labour contract receipts, payments to sub-contractors not supported by monthly return of such sub-contractors, etc., This resulted in short levy of tax of Rs. 1.45 crore.

After the cases were pointed out between April and October 2007, the Government/department reported revision of assessments in 12 cases raising additional demand totalling Rs. 68.78 lakh and recovery of Rs. 54.67 lakh in four of them. In six other cases notice for revision of assessments were issued. In respect of one case involving tax effect of Rs. 8.56 lakh, it was replied that the assessee was not issued form 8-AB permitting him to pay tax under composition. The reply is not tenable as the assessment was concluded by the department under composition scheme. In respect of another case involving Rs. 2.35 lakh, the Government stated that the work carried out by the dealer was pure labour work, not involving any material. The reply is not tenable as High Court of Karnataka in its judicial pronouncement held²¹ that once dealer opted for composition, it is not open for them to bifurcate the contracts for the purpose of payment of tax. In respect of the remaining cases, reply has not been received (November 2008).

²⁰ Bangalore (Rural), Bangalore (Urban), Bagalkot, Belgaum, Bellary, Chitradurga, Hassan, Kolar, Mysore, Tumkur.

²¹ M/s. T.H. Venkate Gowda Vs CCT, Karnataka (2007) 5 VST 553 (Karn).

2.9.2 Test check of the records in Bangalore (Urban) district between August and October 2007 revealed that while finalising four assessments for the year 2003-04 and 2004-05 in respect of three dealers who were engaged in execution of works contracts between January and May 2007 deductions totalling Rs. 2.07 crore were incorrectly allowed towards royalty paid on minerals and material purchased from unregistered dealers by two AAs. This resulted in short levy of tax of Rs. 29.86 lakh.

After the cases were pointed out between August and October 2007, the AAs concerned accepted audit observations in all the cases. Assessments were revised raising additional demands totalling Rs. 2.16 lakh in two cases and in two other cases notices for revision of assessments were issued.

The cases were reported to the CCT in November/December 2007 and referred to the Government in April 2008; their replies have not been received (November 2008).

2.10 Short demand of tax due to arithmetical mistake

Test check of the records in six²² districts revealed that in respect of 11 assessments for the years 2003-04 and 2004-05 finalised between October 2004 and March 2007, as against the aggregate tax of Rs. 34.90 crore due, only Rs. 33.49 crore was demanded by the nine AAs resulting in short demand of tax of Rs. 1.41 crore. The short demands were due to arithmetical error.

After the cases were pointed out between May and December 2007, the Government/department reported raising of additional demands totalling Rs. 1.13 crore in five cases and recovery of Rs. 2.33 lakh in three of them. In four other cases notices were issued. In respect of the remaining two cases, final reply has not been received (November 2008).

2.11 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* was 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* was 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*.

Test check of the records in nine²³ districts between April and December 2007 revealed that while finalising 56 assessments of 55 assesseees for the years 2003-04 and 2004-05 between April 2006 and March 2007, on sales tax of Rs. 8.41 crore levied, cess of Rs. 2.24 lakh only was levied as against Rs. 1.26 crore by 21 AAs. This was due to arithmetical error or incorrect

²² Bangalore (Rural), Bangalore (Urban), Dakshina Kannada, Davanagere, Dharwad, Tumkur.

²³ Bangalore (Rural), Bangalore (Urban), Belagum, Bellary, Dakshina Kannada, Dharwad, Gulbarga, Mysore, Raichur.

exemption or omission. The non/short levy of cess amounted to Rs. 1.24 crore.

After the cases were pointed out between April and December 2007, the Government/department reported in June 2008 revision of assessments in 35 cases raising additional demands of Rs. 85.62 lakh and recovery of Rs. 68.57 lakh in 23 of them. In 10 other cases involving Rs. 10.07 lakh, notices for revision of assessment were issued. In respect of the remaining cases, reply has not been received (November 2008).

2.12 Excess collection of the tax

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 excess of the tax due to the Government the same is required to be remitted to the Government account.

Test check of the records in three²⁴ districts revealed that while finalising, between June 2005 and June 2007, 56 assessments of 54 dealers for the years 2002-03 to 2004-05, 12 AAs levied tax of Rs. 30.17 crore. Against this, the dealers had collected tax of Rs. 30.84 crore. No action was taken to remit the excess collection of tax amounting to Rs. 66.69 lakh into the Government account.

After the cases were pointed out between April and October 2007, the Government/department reported in June 2008 revision of assessments raising additional demands totalling Rs. 25.76 lakh in 23 cases and recovery of Rs. 4.53 lakh in seven of them. Notices for revision of assessments were issued in 23 cases involving Rs. 18.30 lakh. In respect of the remaining cases, reply has not been received (November 2008).

2.13 Incorrect grant of tax incentives to industries

In accordance with the notifications issued in November 1996 under the KST Act, exemption from payment of tax by tiny/small scale (SSI)/medium and large scale industries is allowed upto a monetary limit fixed and for the period prescribed in the Fixed Assets Valuation Certificate (FAVC) issued in each case by the Department of Industries and Commerce. Further, as per the notification sanctioning incentives and concessions to industries, when an industrial unit which has opted for tax exemption collects any amount by way of tax or purporting to be by way of tax, it shall forthwith cease to be eligible for tax exemption. For the period during which such amounts were collected and subsequently for the remaining prescribed period, such units shall be eligible only for tax deferment.

Test check of the records in four²⁵ districts between June and December 2007 revealed that while finalising eight assessments of six SSI units between June 2006 and January 2007, for the years 2003-04 and 2004-05, sales tax exemption of Rs. 59.69 lakh was allowed under industrial incentives scheme by five AAs. Of this, in one case tax of Rs. 4.81 lakh was collected by the

²⁴ Bangalore (Rural), Bangalore (Urban), Dharwad.

²⁵ Dakshina Kannada, Davangere, Dharwad, Tumkur.

industrial unit which had opted for tax exemption, in another case exemption of Rs. 2.33 lakh was allowed in excess of the monetary limit fixed in FAVC and in the remaining six cases exemption of Rs. 46.98 lakh was allowed beyond the period of exemption prescribed in the FAVC. The excess/incorrect grant of exemption aggregated to Rs. 54.12 lakh.

After the cases were pointed out between June and December 2007, the AAs concerned accepted audit observation in three cases involving Rs. 46.65 lakh and stated that notices for revision of assessments will be issued.

The cases were reported to the CCT between August 2007 and January 2008 and the Government in May 2008; their reply has not been received (November 2008).

2.14 Non-levy of purchase tax

Under the KST Act, there shall be levied and collected a tax on last purchase of sugarcane in the State at the rates prescribed from time to time. In addition, there shall be levied and collected each year by way of cess for the purpose of improvement of roads in sugarcane growing areas reserved for any factory, a tax at the rate of Rs. 10 per metric tonne on the purchase of sugarcane by a manufacturer of sugar.

Test check of the records in Belgaum district in May 2007 revealed that while finalising in December 2006, assessment of an assessee²⁶ engaged in manufacture of sugar for the year 2004-05 purchase tax and cess were omitted to be levied on 33,334.518 metric tonne of sugarcane purchased for the manufacture of sugar. This resulted in non-levy of purchase tax of Rs. 20 lakh including cess.

The case was reported to the CCT in August 2007 and the Government in April 2008; their reply has not been received (November 2008).

2.15 Short levy of composition tax

Under the KST Act, a hotelier or a restaurateur including a dealer running a catering service had the option to pay tax for any year by way of composition at the rate of four *per cent* of his total turnover. No deduction was admissible from total turnover.

Test check of the records in Bangalore (Urban) between April and October 2007 revealed that while finalising four assessments of four dealers running hotel/restaurant/catering service who had opted for composition for the years 2002-03 to 2004-05 between May and December 2006 deductions of Rs. 1.50 crore was incorrectly allowed by three AAs from the total turnover towards cooking charges, transportation charges, taxes collected and discount allowed. The incorrect deductions allowed from the total turnover resulted in short levy of tax of Rs. 5.99 lakh.

After the cases were pointed out between April and October 2007, the Government/department reported in June 2008 revision of assessment in three

²⁶ M/s. Gokak Power Distilleries and Sugars Pvt. Ltd.

cases raising additional demand totalling Rs. 4.23 lakh and recovery of Rs. 1.47 lakh in two of them. In respect of the remaining one case, notice for revision of assessment was issued.

VALUE ADDED TAX (VAT)

2.16 Excess/incorrect allowance of input tax

Under the KVAT Act and the rules made thereunder, the tax paid on purchases (input tax) shall be deducted from the tax payable on the sales (output tax) by any dealer, in calculating the net tax payable subject to conditions prescribed.

Test check of the records in three²⁷ districts between July 2007 and February 2008 revealed that 14 assesseees had claimed input tax credit of Rs. 8.02 crore in their returns for 139 assessments between April 2005 and March 2007. The input tax admissible as per provisions of the Act in these cases was Rs. 5.11 crore which resulted in allowing excess/incorrect input tax of Rs. 2.91 crore. The details are mentioned below:

(Rupees in lakh)					
Sl. No.	Nature of omission	Number of returns	Input tax claimed	Input tax allowable	Amount of excess/incorrect input tax
1.	As per section 35(4) of the Act, the assessee was required to file revised returns within six months from the end of the relevant tax period. But in the instant case, the assessee had filed in October 2006 revised returns claiming input tax for seven months between May 2005 and March 2006 after a lapse of 7 to 18 months	7	1.80	Nil	1.80
2.	As per section 14 of the Act, input tax on petroleum and furnace fuel used in the manufacture of taxable goods was admissible to the extent of the input tax paid at a rate higher than four <i>per cent</i> . However, in respect of 33 returns furnished by dealers, input tax paid at 12.5 <i>per cent</i> on petroleum products and fuel used in the manufacture of taxable goods was claimed in full by them and was allowed instead of restricting the claim to 8.5 <i>per cent</i> .	33	149.87	132.56	17.31
3.	As per the notification ²⁸ issued by	1	1.11	Nil	1.11

²⁷ Bangalore (Urban), Dharwad and Shimoga.

²⁸ Notification No. FD 316 CSL 2005 (I), Bangalore, dated 5 August 2005.

(Rupees in lakh)

Sl. No.	Nature of omission	Number of returns	Input tax claimed	Input tax allowable	Amount of excess/incorrect input tax
	the department, only electric transformers of 33 KV ²⁹ are capital goods eligible for claim of input tax. However, input tax claimed on 11 KV electric transformer as input tax paid on capital goods was allowed.				
4.	Under the KVAT Rules where any input tax relates to both the sale of taxable goods and exempted goods, input tax proportionate to the exempted goods out of the total sales shall be non-deductible input tax. In these cases, non-deductible input tax was not computed as per the formula prescribed under the Act and entire input tax claimed was allowed.	98	649.27	378.16	271.11
Total		139	802.05	510.72	291.33

After the cases were pointed out, the AAs concerned accepted audit observations in five cases involving Rs. 2.23 crore and finalised reassessment orders in four cases disallowing the excess/incorrect input tax of Rs. 18.90 lakh and issued notice in the remaining cases. Final replies in respect of the remaining cases has not been received (November 2008).

The cases were reported to the CCT between September 2007 and February 2008 and the Government in May 2008; their reply has not been received (November 2008).

2.17 Non-levy of interest on belated payment of VAT

Under the KVAT Act, every registered dealer liable to pay tax shall furnish a return as prescribed and shall pay the tax due on such return within 20 days after the end of the preceding month or any other tax period. Every dealer shall be liable to pay simple interest at the rate of 1.25 *per cent* per month on any amount of tax which should have been declared on a return, but which has been omitted from it, and such interest is payable from the date the tax should have been declared. Further, under the Act, when any prescribed authority has grounds to believe that any return furnished understates the correct tax liability, it may re-assess to the best of its judgment the additional tax payable and demand payment of any interest thereon.

Test check of the records in three districts between October 2007 and January 2008 revealed that while finalising reassessments for 78 assessment months in respect of 11 assesseees between September 2005 and March 2007,

²⁹ Kilo volt.

nine AAs created additional demand of Rs. 3.84 crore. However, interest of Rs. 56.76 lakh though leviable was not levied as mentioned below:

(Rupees in lakh)				
Sl. No.	District (number of assessees)	Period of assessment/ date of reassessment	Amount of tax involved	Non- levy of interest
1.	Bangalore (Urban) (9)	Between April 2005 and March 2006 (September 2005 and March 2007)	317.01	47.88
2.	Davanagere (1)	Between April 2005 and November 2006 (June 2007)	61.86	7.70
3.	Shimoga (1)	Between April 2005 and November 2005 (March 2007)	5.04	1.18
Total (11)			383.91	56.76

After the cases were pointed out to the AAs concerned between October 2007 and January 2008, the AAs accepted audit observations in respect of three cases involving Rs. 20.32 lakh and created demand of Rs. 12.62 lakh in two cases. Final replies in respect of the remaining cases have not been received (November 2008).

The cases were reported to the CCT between November 2007 and February 2008 and the Government in May 2008; their reply has not been received (November 2008).

2.18 Non/short levy of penalty on VAT

Under the KVAT Act, every registered dealer liable to pay tax shall furnish a return as prescribed and shall pay the tax due on such return within 20 days after the end of the preceding month or any other tax period. A dealer who for any prescribed tax period furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five *per cent* of his actual liability to tax, shall after being given the opportunity of showing cause in writing against the imposition of a penalty, be liable to a penalty equal to ten *per cent* (20 *per cent* up to 31 March 2006) of the amount of such tax under or overstated. Also, a dealer who fails to furnish a return or who fails to pay the tax due on any return furnished shall be liable to pay a penalty of a sum not less than 10 *per cent* but not exceeding 50 *per cent* of the amount of tax due together with any tax or interest due.

2.18.1 Test check of the records in Bangalore (Urban) and Shimoga districts, between August 2007 and January 2008 revealed that 21 assessees understated the tax liability/overstated the input tax credit in their monthly returns for 123 assessment months during the year 2005-06. 12 AAs finalised reassessment orders in respect of 121 of these assessment months between April 2006 and March 2007 and raised an additional demand of Rs. 2.31 crore. Penalty of Rs. 31.32 lakh was either not levied or levied short in these cases as mentioned below:

(Rupees in lakh)

Sl. No.	District (number of assesseees)	Period of assessment/ date of reassessment	Amount of tax involved	Penalty due/ levied	Non/short levy of penalty
1.	Bangalore (Urban) (20)	April 2005 to March 2006 and September 2006 (April 2006 and March 2007)	231.05	46.21/ 15.39	30.82
2.	Shimoga (1)	April 2005 to November 2005 (October 2006)	5.04	1/ 0.50	0.50
Total (21)			236.09		31.32

After the cases were pointed out to the AAs concerned between August 2007 and January 2008, the AAs contended that as per provisions, power to levy penalty vested in the authority to whom returns were required to be furnished. The reply is not tenable since as per amendment of April 2006³⁰ deemed to have effect from 1 April 2005, to the penal provisions, the reassessing authorities had powers to levy penalty and the cases were reassessed between April 2006 and March 2007.

The cases were reported to the CCT between September 2007 and February 2008 and Government in May 2008; their reply has not been received (November 2008).

2.18.2 Test check of the records of Bangalore (Urban) district in November and December 2007 revealed that two dealers furnished returns for eight³¹ assessment months with an output tax effect of Rs. 22.21 lakh after a delay ranging from 2 to 61 days and two other dealers did not remit the output tax of Rs. 1.08 crore along with the returns filed for six assessment months within the prescribed period. In the reassessment orders finalised by three AAs between May 2006 and March 2007, penalty was either not levied or levied short. The non/short levy of minimum penalty worked out to Rs. 13.38 lakh as mentioned below:

(Rupees in lakh)

Sl. No.	Nature of omission (number of assesseees)	Period of assessment/ date of reassessment	Amount of tax involved	Penalty due/ levied	Non/short levy of penalty
1.	Belated filing of returns (2)	Between June 2005 and January 2006 (December 2006 and March 2007)	22.21	2.59/ nil	2.59
2.	Non-payment of output tax due along with the returns (2)	Between April 2005 and February 2006 (May 2006)	108.45	10.84/ 0.05	10.79

³⁰ Karnataka Act No.4 of 2006.

³¹ June 2005 (2), July 2005 (1), August 2005(2), September 2005(1), October 2005 (1), January 2006 (1).

(Rupees in lakh)

Sl. No.	Nature of omission (number of assessees)	Period of assessment/ date of reassessment	Amount of tax involved	Penalty due/ levied	Non/short levy of penalty
Total (4)			130.66		13.38

The cases were pointed out to the AAs concerned in November and December 2007, reported to the CCT between December 2007 and February 2008 and referred to the Government in May 2008; their reply has not been received (November 2008).

2.19 Non/short levy of output tax

Under the KVAT Act, 2003 every registered dealer shall be liable to pay tax on his taxable turnover at the rates specified in the relevant schedules to the Act. In respect of goods not specified in any of the schedules, tax is payable at the rate of 12.5 *per cent*.

Test check of the records in Bangalore (Urban) between August 2007 and January 2008 revealed that while finalising reassessment orders of four dealers for the year 2005-06 in December 2006 tax of Rs. 6.05 lakh was omitted to be levied on the sale turnover of motor vehicles of Rs. 48.38 lakh by two AAs and while finalising reassessment order for the month of June 2005 of a dealer engaged in fabrication and supply of boiler units in February 2007 tax was levied at the rate of four instead of 12.5 *per cent* on the turnover of Rs. 33.09 lakh by one AA resulting in short levy of tax of Rs. 2.81 lakh. Thus, there was non/short levy of tax of Rs. 8.86 lakh.

After the cases were pointed out between August 2007 and January 2008, the AA concerned issued notice for revision of assessment in one case involving tax of Rs. 97,779. Reply in the remaining cases has not been received (November 2008).

The cases were reported to the CCT between September 2007 and February 2008 and the Government in May 2008; their reply has not been received (November 2008).

2.20 Non-forfeiture of VAT collected in excess

Under the KVAT Act, when any amount is wrongly collected by way of tax or purporting to be by 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, notwithstanding that the dealer is not liable to pay such amount as tax or that only a part of it is due from him as tax under the Act. Such amount paid by the dealer to the extent it is not due as tax shall be forfeited to the Government and recovered from him.

Test check of the records in Bangalore (Urban) district revealed that an assessee engaged in the construction of apartments for sale had collected tax of Rs. 16.14 lakh for the months of June 2005 and February 2006. It was noticed from the two revisional orders passed by the Joint Commissioner of Commercial Taxes in July 2007 for these two months, that the output tax

payable by the assessee was determined at Rs. 9.18 lakh. No action was initiated to forfeit the excess tax of Rs. 6.96 lakh collected by the assessee.

The cases were reported to the CCT in February 2008 and referred to the Government in May 2008; their reply has not been received (November 2008).