

CHAPTER II

Taxes on Sales, Trade, etc.

2.1 Results of audit

Test check of records of the Sales Tax Offices, conducted in audit during the year 2002-2003, disclosed under-assessments of tax, non-levy of penalty, etc. amounting to Rs.150.49 crore in 1,390 cases, under the following broad categories:

(Rupees in crore)			
Sl. No.	Category	Number of cases	Amount
1	Non-levy/short levy of tax	650	15.01
2	Incorrect grant of exemption/ concession	82	1.70
3	Non-levy/short levy of turnover tax	323	2.64
4	Non-levy of penalty	172	2.69
5	Non-forfeiture of excess tax collected	88	1.65
6	Other irregularities	75	126.80
	Total	1,390	150.49

During the course of the year 2002-2003, the Department accepted under-assessments of tax amounting to Rs.7.88 crore involved in 1,151 cases which had been pointed out in audit in earlier years and recovered Rs.6.70 crore involved in 1,013 cases.

A few illustrative cases involving Rs.136.48 crore are given in the following paragraphs. Of this, Rs.4.18 crore had been recovered.

2.2 Incorrect grant of exemption/concession

2.2.1 Under the Karnataka Sales Tax (KST) Act 1957, 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) in the execution of works contract at rates specified in the Act. In the case of a dealer executing works contract who has

not opted for payment of tax by way of composition, the total and taxable turnover are to be determined in accordance with the provisions of Karnataka Sales Tax Rules 1957. The items of expenditure such as inter-State purchases, tax deducted at source, labour and like charges in excess of the eligible limit are not admissible deductions for the purpose of arriving at the taxable turnover.

In three[√] districts, while finalising between March 2000 and March 2002 seven assessments for the years 1996-1997 to 1998-99 in respect of seven dealers who had not opted for payment of tax by composition and were engaged in civil works contracts and supply and installation of air-conditioners, tax was either not levied or levied short on a turnover of Rs.60.94 lakh due to inadmissible deductions on account of inter-State purchases, tax deducted at source, labour and like charges in excess of the eligible limit. The tax not levied or levied short worked out to Rs.6.34 lakh.

On this being pointed out, Government reported revision of the assessment in one case and creation of an additional demand of Rs.2.44 lakh. Report of recovery in this case and final replies in respect of the remaining cases have not been received (January 2004).

2.2.2 In accordance with notifications issued from time to time under the KST Act 1957 and the Central Sales Tax (CST) Act 1956, exemption from payment of tax by tiny/small scale (SSI)/medium and large scale industries is not allowed on turnovers where no manufacturing activity is involved, or in respect of sales effected beyond the eligibility period or eligibility limits, or in respect of sales effected prior to the date of expansion, or on turnovers on which tax has been collected by such units. Further, in cases of units undertaking expansion schemes, the tax exemption is to be limited to the difference between the total tax liability and the average tax liability of three years immediately preceding the year in which investment for expansion took place.

It was, however, noticed that in five districts while finalising, between November 1999 and March 2002, 13 assessments of 12 SSI/medium scale units for the years 1997-98 to 2000-2001, sales tax exemption of Rs.71.74 lakh was incorrectly granted resulting in short levy of tax of Rs.71.74 lakh, as detailed below:

[√] Bangalore (Urban), Hassan, Raichur

(Rupees in lakh)

Sl. No.	District (Number of cases)	Nature of irregularity	Assessment year (Date of assessment)	Tax incorrectly exempted
1	Bangalore (Rural) (2)	The dealers had collected tax of Rs.22.02 lakh during the period covered by exemption.	1998-99 and 1999-2000 (between August 2001 and March 2002)	22.02
2	Bangalore (Urban) (1) Bellary (1)	In two cases, tax exemption of Rs.16.87 lakh was allowed, even though there was no manufacturing activity involved.	2000-2001 (between December 2001 and January 2002)	16.87
3	Bangalore (Urban) (3) Chitradurga (1) Dakshina Kannada (1)	Tax exemption was allowed beyond the eligibility limit/period or prior to the date of expansion.	1997-98 to 2000-2001 (between May 2001 and March 2002)	12.07
4	Bangalore (Urban) (2) Chitradurga (1) Dakshina Kannada (1)	In respect of three units undertaking expansion, against tax exemption of Rs.7.39 lakh admissible, Rs.28.17 lakh was allowed.	1997-98 and 1999-2000 (between November 1999 and January 2002)	20.78
Total (13)				71.74

On this being pointed out, Government reported revision of assessments in nine cases creating additional demand of Rs.61.45 lakh, and recovery of Rs.44.67 lakh in three of them. In respect of the remaining cases, final replies have not been received (January 2004).

2.2.3 Under the KST Act 1957, a dealer is liable to pay tax at the rates specified in the relevant Schedules of the Act on the taxable turnover determined after allowing prescribed deductions from the total turnover.

In four districts, it was noticed that while finalising, between January 1997 and March 2002, 17 assessments of 12 dealers for the years 1994-95 to 2000-2001, turnover of Rs.19.95 crore was incorrectly exempted / determined by omission of turnover resulting in short levy of tax of Rs.97.97 lakh, as detailed below:

(Rupees in lakh)

Sl. No.	District (Number of cases)	Period (Date) of assessment	Nature of irregularity	Turnover involved	Tax effect
1	Bangalore (Rural) (7)	1997-98 to 2000-2001 (between May 2001 and March 2002)	(1) Taxable turnover disclosed in the annual return of turnover was adopted incorrectly in the assessment concluded. (2) 'Fried gram' obtained out of tax suffered 'gram', though a distinct commodity, was incorrectly exempted from payment of tax.	207.61	7.99

Audit Report (Revenue Receipts) for the year ended 31 March 2003

(Rupees in lakh)

Sl. No.	District (Number of cases)	Period (Date) of assessment	Nature of irregularity	Turnover involved	Tax effect
			(3) Against the effective basic rate of 4 per cent on first sales of automobile spares made to M/s KSRTC, exemption was allowed incorrectly. (4) Against the effective rate of 4 per cent on first sales of iron and steel products, exemption was allowed incorrectly.		
The Department revised assessments in 6 cases creating additional demand of Rs.7.20 lakh and recovered of Rs.5.06 lakh in 5 of them.					
2	Bangalore (Urban) (7)	1994-95 to 1999-2000 (between January 1997 and January 2002)	(1) Even though the assessee had opted for composition of tax, sales of silk fabrics was incorrectly exempted. (2) By Notification issued in November 1996, sales made to 100% export-oriented units <u>located in the State</u> were exempted from tax payable under the Act. Exemption from payment of tax was allowed incorrectly even on sales to such units located <u>outside the State</u> . (3) Against the effective rate of 10 per cent on coolants, only 3 per cent was charged. (4) Works contract for printing and block making was incorrectly exempted. (5) As per judicial pronouncement ^φ , construction of flats by a property developer was taxable when the building was constructed after entering into agreement with prospective buyers. However, works contract for construction of flats by a property developer was incorrectly exempted though, the building was constructed after entering into agreement with the prospective buyers before commencement of the construction.	1,754.26	82.02
The Department revised assessments in 5 cases creating additional demand of Rs.76.72 lakh and recovered Rs.5.22 lakh in one of them.					
3	Dakshina Kannada (2)	2000-2001 (between November and December 2001)	Tax leviable at 60% on sales effected out of opening stock of IML held as on 01.04.2000 was incorrectly exempted .	7.90	4.98
The Department revised assessment in one case creating additional demand of Rs.1.67 lakh.					
4	Raichur (1)	2000-2001 (January 2002)	Works contract for processing and supplying of photographs, photo prints and photo negatives taxable at 10% was incorrectly exempted.	24.83	2.98
Total (17)				1,994.60	97.97

^φ M/s Mittal Investment Corporation Vs. Additional Commissioner of Commercial Taxes (2001) 121 STC 14 (HC).

On these cases being pointed out, Government reported revision of assessments in 12 cases creating additional demand of Rs.85.59 lakh and recovery of Rs.10.28 lakh in six of them. In respect of the other cases, final replies have not been received (January 2004).

2.3 Non-levy/short levy of turnover tax

Under the KST Act 1957, every registered dealer, whose total turnover in a year exceeds the prescribed monetary limits, is liable to pay turnover tax (TOT) at the prescribed rate(s) on his total turnover, after such deductions as are admissible under the Act.

In 11[†] districts while finalising, between February 1999 and March 2002, 151 assessments of 136 dealers for the years 1993-94 to 2000-2001, TOT was either not levied or levied short on the turnover of Rs.229.61 crore. This resulted in non-levy/short levy of TOT of Rs.2 crore.

On these cases being pointed out, Government reported revision of assessments in 130 cases creating additional demand of Rs.1.76 crore and recovery of Rs.1.19 crore in 87 of them.

In respect of one case involving tax effect of Rs.0.79 lakh, Government stated that 'tailoring materials' were specifically exempted from levy of TOT. The reply is not tenable as the assessee had paid tax at concessional rate as applicable to industrial inputs; as such, he was liable to pay TOT at one per cent in accordance with notification No. FD 115 CSL 2000(19) dated 31.03.2000. He was not entitled to exemption under Notification No. FD 115 CSL 2000(11) dated 31.03.2000 which does not apply to industrial inputs.

In respect of the other cases, final replies have not been received (January 2004).

[†] Bangalore (Rural), Bangalore (Urban), Belgaum, Bellary, Chitradurga, Dakshina Kannada, Dharwad, Gulbarga, Hassan, Mysore, Raichur

2.4 Application of incorrect rate of tax

Under the KST Act 1957, tax is leviable on the purchases/sales at the rates mentioned in the relevant Schedules to the Act. In the case of goods not specified in any of the Schedules, tax is leviable as unspecified goods. Under the CST Act 1956, tax at specified rates is levied on inter-State sale of goods.

In 12^o districts while finalising, between September 1998 and March 2002, 82 assessments of 67 dealers for the years 1995-96 to 2001-2002, tax amounting to Rs.1.85 crore was levied short on the turnover of Rs.80.72 crore due to application of incorrect rates.

On these cases being pointed out, Government reported revision of assessments in 57 cases creating additional demand of Rs.1.18 crore and recovery of Rs.62.15 lakh in 34 of them.

In respect of one case involving tax effect of Rs.0.79 lakh, Government contended that the agreement entered into with M/s KSRTC by the assessee was only for sale of bus bodies as such for which the rate of tax was 4 per cent in accordance with the notification dated 30.03.1996. The reply of Government is not tenable since as per the work order issued by KSRTC to the assessee, bus bodies are required to be built on the chassis. Thus, it was a works contract and taxable at 8 per cent. Notification dated 30.03.1996 was not applicable.

In respect of the other cases, final replies have not been received (January 2004).

2.5 Non-levy of surcharge and cess

2.5.1 Under the KST Act 1957, a surcharge at the rate of 15 per cent of the tax payable on goods (other than declared goods) was leviable during April 1994 to March 1997.

In Bijapur district, while finalising May 2000/ June 2002 the assessment of a dealer engaged in the execution of civil works contracts for the year 1996-97,

^o Bangalore (Rural), Bangalore (Urban), Bellary, Dakshina Kannada, Dharwad, Gulbarga, Hassan, Kolar, Mysore, Raichur, Tumkur, Udupi

surcharge of Rs.5.05 lakh due on the tax of Rs.33.65 lakh was omitted to be levied by the Assessing Authority.

On this being pointed out, Government reported revision of the assessment creating additional demand of Rs.5.05 lakh. Report of recovery has not been received (January 2004).

2.5.2 Under the KST Act 1957, a cess at the rate of 5 per cent of the tax due on sales or purchases was leviable within the limits of Bangalore City Planning Area from April 1995 to March 1998. From April 1998, this cess was made applicable throughout the State.

In Bangalore (Rural) and Dakshina Kannada districts, while finalising between April and November 2001, four assessments of four dealers for the years 1995-96, 1997-98 and 1998-99, three Assessing Authorities did not levy cess amounting to Rs.8.68 lakh on aggregate tax of Rs.1.74 crore.

On these cases being pointed out, Government reported revision of assessments in all the four cases creating additional demand of Rs.8.68 lakh and recovered Rs.4.88 lakh in two cases. Reports of recovery in respect of the remaining cases have not been received (January 2004).

2.6 Non-levy of purchase tax

Under the KST Act 1957, a dealer, who purchases any taxable goods in circumstances in which no tax is leviable on the sale price of such goods and consumes them in the manufacture of other goods for sale or otherwise, is liable to pay tax on the purchase price of such goods at the same rate at which it would have been leviable on the sale of such goods inside the State. In the case of deemed exports penultimate purchases are not exempted from tax.

It was judicially held[⊗] in October 1997 that goods purchased from un-registered dealers and sold to exporters within the State for export outside India were liable to purchase tax.

In three districts it was noticed that while finalising, between January and December 2001, three assessments of three dealers for the years 1997-98,

[⊗] State of Karnataka Vs. B.M. Ashraf & Co. (1997) 107 STC 571 (SC)

1998-99 and 2000-2001, tax of Rs.8.39 lakh had not been levied on the aggregate purchase turnover of Rs.1.08 crore, as detailed below:

(Rupees in lakh)

Sl. No.	District (Number of cases)	Period (Date) of assessment	Goods	Purchase turnover	Tax leviable	Remarks
1	Bangalore (Rural) (1)	1997-98 (March 2001)	Herbal seeds	35.19	4.57	Herbal seeds were purchased from un-registered dealers and were sold to exporters within the State by the dealer.
2	Bangalore (Urban) (1)	2000-2001 (December 2001)	Briquette and Firewood	18.45	1.01	'Briquette' and 'Firewood' purchased from un-registered dealers were consumed in manufacture.
3	Kodagu (1)	1998-99 (January 2001)	Coffee seeds	54.07	2.81	Coffee seeds were purchased from un-registered dealers and were sold to exporters within the State by the dealer.
Total (3)				107.71	8.39	

On this being pointed out, Government reported revision of assessment in respect of sl. No. 3 creating additional demand of Rs.2.81 lakh. Report of recovery in this case and final replies in respect of the remaining cases have not been received (January 2004).

2.7 Non-forfeiture of tax collected in excess

Under the KST Act 1957, a registered dealer is prohibited from collecting any amount by way of tax in excess of that specified in the Act. Where any collection is made in contravention thereof, the Assessing Authority is required to get the tax collected in excess forfeited. The Assessing Authority is also empowered to levy penalty not exceeding one and a-half times the amount of tax so collected.

In four^Y districts while finalising, between November 1997 and May 2002, 37 assessments of 33 dealers for the years 1989-90, 1991-92 to 2000-2001, against tax of Rs.49.83 crore assessed by the concerned Assessing Authorities, the dealers had collected tax of Rs.51.15 crore. No action had been initiated to

^Y Bangalore (Rural), Bangalore (Urban), Dharwad, Tumkur

get the excess collection of tax amounting to Rs.1.32 crore forfeited. In addition, penalty amounting to Rs.1.98 crore was also leviable.

On these cases being pointed out, Government reported forfeiture of excess collection of tax of Rs.1.27 crore in 36 cases and recovery of Rs.1.10 crore in 23 of those cases. In respect of the remaining cases, final replies have not been received (January 2004).

2.8 Non-levy/short levy of penalty

Under the KST Act 1957, tax payable by a registered dealer in respect of sale of any industrial inputs or raw material to another registered dealer is at concessional rate of 3 per cent (4 per cent up to 31.03.1998) or the rate specified in the Act whichever is lower, on the turnover relating to such sale, on furnishing prescribed declarations. However, if any person sells such inputs contrary to such declaration, Assessing Authority is required to impose upon him by way of penalty, a sum not less than the tax leviable under the Act. Further, if any person uses such inputs contrary to such declaration, the Assessing Authority is required to impose upon him by way of penalty, a sum of not less than twice the amount of tax leviable under the Act.

In three[∞] districts, it was noticed that 6 dealers had purchased rough granite valued at Rs.2.07 crore on concessional rate of tax after furnishing the required declarations that it would be used as an industrial input. However, it was sold as such after cutting and polishing which does not amount to manufacturing activity. In addition to this, 2 dealers purchased batteries and electrical goods and sold them as such. However, while finalising 12 assessments between February 2000 and February 2002 pertaining to years 1998-99 to 2000-2001, six Assessing Authorities did not levy a penalty of Rs.43.35 lakh resulting in short realisation of Government revenue to that extent.

On these cases being pointed out, Government reported creation of additional demand of Rs.27.42 lakh in 4 cases and recovery of Rs.26.42 lakh in 3 cases. Reports of action taken in respect of the remaining cases have not been received (January 2004).

[∞] Bangalore (Rural), Bangalore (Urban), Dakshina Kannada

2.9 Non-levy/short levy of interest

2.9.1 Under the KST Act 1957, the tax or any other amount due is required to be paid within the prescribed time which, in the case of final assessments, is 21 days from the date of service of demand notice. In case of default in making payments, the assessee is liable to pay interest^f at the rates prescribed from time to time.

In five districts, though 33 dealers did not pay the sums specified in the demand notices within 21 days of their service, interest of Rs.38.03 lakh as detailed below was not levied/levied short:

(Rupees in lakh)

Sl. No.	District (Number of assessees)	Period of assessment (Date of issue of demand notice)	Delay in payment of tax (Months)	Non-levy of interest
1	Bangalore (Rural) (5)	1994-95 to 1999-2000 (between January 1998 and January 2002)	1 to 43	3.01
2	Bangalore (Urban) (20)	1991-1992 to 1994-1995, 2000-2001 (between December 1996 and March 2002)	1 to 60	24.67
3	Chitradurga (1)	1998-99 (May 2000)	9	6.33
4	Gulbarga (4)	1994-95, 1995-96, 1997-98 to 1999-2000 (between January 2000 and April 2002)	1 to 16	1.57
5	Mysore (3)	1992-93 to 1994-95, 1996-97 and 1998-99 (between May 1997 and April 2000)	16 to 40	2.45
Total (33)				38.03

On these cases being pointed out, Government reported creation of additional demand of Rs.37.07 lakh in the case of 31 dealers and recovery of Rs.13.13 lakh from 10 of them. Reports of action taken in respect of the remaining cases have not been received (January 2004).

2.9.2 Under the KST Act 1957, every dealer is required to pay the full amount of tax payable on the basis of the turnover computed by him for the preceding month within twenty 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 thirty days after the close of the year to which such tax relates. In case of default beyond 10 days after that

^f prior to 01.04.2001 it was termed as 'penalty'

period, the assessee is liable to pay interest[√] at the rates prescribed from time to time.

In four districts, though 16 dealers delayed the payment of monthly/annual taxes amounting to Rs.4.72 crore by 1 to 46 months during the years 1997-98 to 2000-2001, interest of Rs.84.91 lakh was either not levied or levied short by 4 Assessing Authorities, as detailed below:

(Rupees in lakh)

Sl. No.	District (Number of assesseees)	Period of assessment	Delay in payment of tax (months)	Non- levy of interest
1.	Bangalore (Rural) (5)	1997-98 to 2000-2001	1 to 46	58.42
2.	Bangalore (Urban) (3)	1997-98 to 1999-2000	21 to 34	2.31
3.	Bellary (7)	1997-98 and 1998-99	8 to 34	19.86
4.	Udupi (1)	2000-2001	10 to 16	4.32
	Total (16)			84.91

On these cases being pointed out, Government reported creation of additional demand of Rs.19.77 lakh in the case of 10 dealers and recovery of Rs.1.29 lakh from one of them. Reports of action taken in respect of the remaining cases have not been received (January 2004).

2.10 Ineffective pursuance of arrears of tax demands

Under the KST Act 1957, the tax determined as due after final assessment is to be paid within 21 days from the date of service of demand notice. On default, the unpaid dues are recoverable as arrears of land revenue or by sale (with or without attachment) of any property of the defaulter, or on an application to a Magistrate as a fine imposed by him or by recovery from any person owing money to the defaulter. The Karnataka Commercial Taxes Manual emphasises that the effectiveness of the recovery depends on the sincerity with which it is pursued.

[√] prior to 01.04.2001 it was termed as 'penalty'

During the course of audit, it was noticed that Coffee Board was assessed to tax of Rs.123.68 crore for assessment periods 1980-81 to 1989-90, 1991-92 and 1994-95 to 1996-97. The demands were raised between June 1995 to February 2000 against which the Board preferred appeals with the departmental authorities. These appeals have not been decided. This is in spite of the fact that Hon'ble High Court of Karnataka while disposing of a curative petition filed by the Board for the year 1983-84 to 1986-87 and 1994-95 had directed the department to dispose of the appeals pending before the Appellate Authority within three months from the date of submission of Court's order which was September 1999. Thus, inaction on the part of department had resulted in blocking of revenue of Rs.123.68 crore.

Thus, non-pursuance of the demands raised had resulted in non-realisation of revenue for two to ten years.

The matter was referred to Government in June 2003; their reply has not been received (January 2004).

2.11 Suppression of taxable turnover

Under the KST Act 1957, a dealer is liable to pay for each year, tax on his taxable turnover of transfer of property in goods involved in the execution of works contracts at the rates specified in the Sixth Schedule. The taxable turnover is determined after allowing the specified deductions from the total turnover. However, if a dealer so liable opts to pay tax by way of composition in any year, tax is leviable at separate rates on the 'total consideration' involved in the execution of works contracts and no deductions are allowable.

Under the KST Rules 1957, every dealer shall submit annual return of turnover to the concerned jurisdictional Assessing Authority within 60 days after the close of the year to which such return relates showing the actual total and taxable turnovers for that year and the amounts actually collected by him by way of tax or purporting to be by way of tax during that year.

In Bangalore (Urban) district, a cross verification of turnovers declared by five dealers engaged in the execution of electrical works contracts with the records of 10 contractees revealed non-inclusion of consideration of Rs.26.65 crore received by them in the returns submitted to the Commercial Taxes Department for the years 1994-95 to 2000-2001. Since the assessments were finalised between October 1999 and June 2002 on the basis of returns only,

there was non-levy of tax of Rs.99.75 lakh (including surcharge, cess and turnover tax).

On these cases being pointed out, Government reported raising of demands for Rs.54.17 lakh including penalty of Rs.2.20 lakh in 11 cases out of 12 cases. Of them an amount of Rs.26.58 lakh had been recovered in four cases. Reports of recovery in the remaining 7 cases and action taken for raising the demand in the other case have not been received (January 2004).

2.12 Unauthorised collection of turnover tax (TOT) not forfeited

Under the KST Act 1957, no dealer who is liable to pay turnover tax is authorised to collect any amount by way of such tax which is to be borne by him. Where any collection is made in contravention thereof, the turnover tax collected is required to be forfeited. The Assessing Authority is also empowered to levy penalty not exceeding one and a-half times the amount of tax so collected.

In Bangalore (Urban) district, a dealer engaged in the manufacture of pre-stressed cement concrete sleepers had included the turnover relating to supplies made by him to the Southern Railway during the years 1994-95 to 1998-99 in the returns submitted to the Commercial Taxes Department. Cross verification by Audit of the returns with the payments of the claims of the dealer by the Southern Railway revealed in January 2003 that the dealer had specifically charged turnover tax of Rs.35.43 lakh on the turnover of Rs.14.08 crore in the claims made against the contractee and the same had been duly reimbursed to him in terms of the agreement. Since collection of turnover tax from buyers is prohibited under the Act, collection of such tax of Rs.35.43 lakh by him was incorrect and was required to be forfeited to Government. However, in five assessments concluded by the Deputy Commissioner of Commercial Taxes (Assessments)-12 between May 1995 and January 2002 the unauthorised collections had not been noticed, and hence no forfeiture had been made. This resulted in non-realisation of revenue of Rs.35.43 lakh. Besides, penalty of Rs.53.15 lakh could also be levied.

On these cases being pointed out, Government stated that it was seen from the sale bill produced by the assessee that he had not collected TOT separately; in the absence of clear evidence in the bills it could not be presumed. The reply is not tenable since in the supplier's bills presented to the Southern Railway, the dealer had separately claimed TOT and had been paid up by the Southern Railway.

2.13 Excess credit afforded towards tax deducted at source (TDS)

Under the KST Act 1957, the Central Government or any State Government or an industrial/commercial/trading undertaking of Central/State Government or a local authority or a statutory body shall deduct an amount at the rate of four per cent, herein called tax deducted at source – TDS, of the total amount payable to a dealer in respect of the works contracts executed for them, if he has been permitted to pay tax by way of composition.

In Bangalore (Urban) district, while finalising between November 1999 and March 2001 two assessments of a dealer for the years 1997-98 and 1998-99, TDS credit of Rs.54.53 lakh towards execution of civil works contract on behalf of the Karnataka Housing Board, Mysore Division was allowed as against the actual TDS credit of Rs.43.15 lakh to be allowed as per certificate of tax deduction (Form 50) furnished by the Division. This resulted in excess credit of Rs.11.38 lakh.

On this being pointed out, Government stated that recovery action had been initiated. Report of recovery has not been received (January 2004).

2.14 Evaluation of internal audit system

Introduction

2.14.1 The Karnataka Commercial Taxes Manual (1995) recognises the Internal Audit Wing as an essential and indispensable part of the Commercial Taxes Department. The objectives enjoined on it are –

- To have a deterrent and reforming effect in the direction of prevention of mistakes;
- To play a corrective role by pointing out mistakes and ensuring remedies without loss of time; and
- To improve the quality of the functioning of the department so as to reduce the criticism of the department by statutory audit and the Public Accounts Committee.

The Commercial Taxes Department which, *inter alia*, is responsible for administration of the KST Act 1957 and the CST Act 1956, works under the administrative control of the Finance Department at the Government level. The Department is headed by a Commissioner of Commercial Taxes (CCT). The Internal Audit Wing in each of the 13 Divisions in the Department is in overall control of a Joint Commissioner of Commercial Taxes (Administration) at each Division. In each Division, there is an Internal Audit Wing consisting of a Deputy Commissioner of Commercial Taxes (DCCT) (Audit) and an Assistant Commissioner of Commercial Taxes (ACCT) (Audit), called Audit Officers. They are assisted by two Commercial Tax Inspectors (Audit) and a Stenographer. While the DCCT (Audit) is responsible for audit of assessments made by DCCTs, the ACCT (Audit) is responsible for audit of assessments made by ACCTs and Commercial Tax Officers.

Scope of Internal Audit

2.14.2 The scope of internal audit as envisaged in the Manual includes:

- Auditing of all the offices in the Department on annual basis
- Audit Planning, i.e., prioritising the offices for audit
- Coverage in internal audit which is to include short/excess levy due to incorrect rate of tax, incorrect computation of taxable turnover, double credits and incorrect refunds, non-recovery/short recovery of penalty, incorrect grant of composition, short levy where declarations have not been produced.
- Follow up of audit by issue of inspection reports to be complied with by the auditee office.
- Watching compliance to the inspection reports by maintenance of control registers.

A test check conducted by Audit to evaluate the working of the internal audit wing in the Department with reference to the records of three[^] out of the 13 Divisions disclosed the following points.

[^] Bangalore Division, Bangalore City Divisions II and III

Internal audit coverage

2.14.3 According to the provisional figures furnished by the Department, the number of offices due for audit during the years 1998-99 to 2002-2003 and the number actually covered by the Internal Audit Wing are given below:

Year	Total number of offices	Number of offices due for audit during the year	Number of offices audited	Shortfall (Percentage to (3))
(1)	(2)	(3)	(4)	(5)
1998-1999	296	219	142	77 (35)
1999-2000	296	296	123	173 (58)
2000-2001	296	193	128	65 (34)
2001-2002	397	326	127	199 (61)
2002-2003	379	379	102	277 (73)

Shortfall varied between 34 per cent to 73 per cent. The Department attributed the shortfall to the following:

- Several posts of DCCT/ACCT and other staff were kept vacant for long periods;
- A few of the officers of internal audit were deployed for other items of work to augment revenue collections; and
- The DCCT had been entrusted with appellate functions in addition to audit work.

This would show that adequate importance was not being accorded for internal audit and also that the independence of functioning of the internal audit wing was affected due to entrustment of regular departmental work to it.

Audit Planning

2.14.4 The Manual lays down the criteria for prioritisation of audit and its duration. Accordingly, top priority was to be given to audit of assessments made by DCCT followed by those of ACCT. The audit of assessments made by DCCT was to be conducted in two spells, the first to be done in October covering the cases finalised during April-September and the other in April

covering the cases finalised during October-March. The whole process was to be concluded before the audit by the statutory audit.

However, this was not followed in any of the Divisions test-checked. On the other hand, wherever statutory audit was concluded by the Accountant General before internal audit was taken up, those offices were excluded by internal audit coverage. Thus, in drawing the Audit Plan, the programme of the Accountant General was not being taken into account.

2.14.5 Audit of assessments concluded by CTOs was not to be programmed till all the offices of DCCT and ACCT were covered. However, 36 out of 153 CTOs' offices were covered during 2002-2003, though 160 offices of DCCT/ACCT were left unaudited.

2.14.6 Though the Manual laid down the number of files to be reviewed in a day, the duration of audit to be planned according to the volume of work involved in terms of number of assessments concluded, period elapsing from the last audit, etc., these criteria were not followed in allowing the duration of audit.

2.14.7 Priority was not being given for high revenue earning offices like Fast Track Divisions. As a result, Fast Track Divisions were not at all audited or were given the same number of days as other offices of DCCT/ACCT. Thus, the selection of offices and the time allowed were not based on any risk parameters.

Delay in issue of internal audit reports (IARs)

2.14.8 The maximum time limit allowed for issue of internal audit reports (IARs) to the concerned office is one month from the last day of audit.

Test check revealed that there was delay in issue of 19 IARs ranging from 2 to 13 months. Belated issue of IARs defeated the objective of internal audit, i.e., to ensure remedies without loss of time.

Non-coverage of certain areas in internal audit

2.14.9 Verification of remittances made into treasuries and their postings in the 'D' Register to the account of the concerned dealers are some of the important aspects to be covered by the Internal Audit. However, these were not being covered.

Non-maintenance of control registers/records

2.14.10 The Manual prescribes maintenance of a number of control registers and records for proper monitoring of the results of audit. The position obtaining in respect of a few of them is detailed below:

➤ Internal Audit Report

This Report is to be prepared in respect of each office audited showing in three parts the important observations, the minor irregularities and outstanding items of previous reports. The reports were not being prepared as envisaged affecting proper monitoring of the action taken.

➤ Internal Audit Note Book

This is to be maintained by the office inspected showing an abstract of monthly review by the head of the office, index for various category of objections, details as to date of commencement, completion and period of audit, etc. This Register was not being maintained in any of the circle offices test checked.

➤ Register of discrepancies and defects, etc.

This Register showing nature of discrepancies, omissions and defects noticed during internal audit was not being maintained in the Divisions test checked except Bangalore Division.

➤ Preparation of annual review

The Manual envisages preparation of an annual review of working of internal audit by the Divisional Heads on the basis of information furnished in four formats and also lays down the procedure for filling in details therein. However, these guidelines were not being followed and the Review was not being conducted by the Division Head.

Outstanding Internal Audit Reports and Paragraphs

2.14.11 The position of number of internal audit reports and paragraphs issued and disposed of during the years 2000-2001 to 2002-2003 is given below:

Year	Opening balance Paragraphs (IAR)	Additions Paragraphs (IAR)	Total Paragraphs (IAR)	Clearance Paragraphs (IAR)	Balance Paragraphs (IAR)	Percentage of disposal/ Total Paragraphs (IAR)
2000-2001	2,784 (301)	1,322 (124)	4,106 (425)	522 (33)	3,584 (392)	13 (8)
2001-2002	3,584 (392)	1,189 (83)	4,773 (475)	44 (5)	4,729 (470)	1 (1)
2002-2003	4,729 (470)	1,278 (102)	6,007 (572)	131 (3)	5,876 (569)	2 (1)

It can be seen from the above that disposal was tardy as its percentage varied between 1 per cent and 13 per cent during these years.

The matter was reported to the Commissioner of Commercial Taxes and to Government in October 2003; their replies have not been received (January 2004).

