

CHAPTER II

SALES TAX

2.1. Results of Audit

Test check of sales tax assessments and refund cases and connected documents of sales tax offices conducted in audit during the year 2004-05 revealed non levy of interest, grant of irregular exemption, application of incorrect rate of tax, turnover escaping assessment etc., amounting to Rs 69.59 crore in 1,177 cases which may broadly be categorised as under:

(In crore of rupees)

Sl. No.	Category	Number of cases	Amount
1.	Turnover escaping assessment	125	4.51
2.	Grant of irregular exemption	116	10.05
3.	Application of incorrect rate of tax	207	8.62
4.	Interest	368	25.81
5.	Other lapses	360	18.76
6.	Review on “Working of sales tax check posts in Kerala”	1	1.84
	Total	1,177	69.59

During 2004-05, the Department accepted underassessments, etc., of Rs 3.81 crore involved in 269 cases of which 144 cases involving Rs 1.85 crore were pointed out during 2004-05 and the rest in earlier years. At the instance of audit, the Department recovered an amount of Rs 0.71 crore involved in 154 cases during the year.

A few illustrative cases, including a review on ‘Working of sales tax check posts in Kerala’, involving Rs 40.69 crore are given in the following paragraphs:

2.2. Review on “Working of sales tax check posts in Kerala”

HIGHLIGHTS

- **Bank guarantees of Rs 42.60 lakh were not renewed.**
(Paragraph 2.2.6)
- **Misclassification of entry tax of Rs 2.35 crore paid by Kerala Police Department.**
(Paragraph 2.2.6)
- **Non levy of tax and penalty of Rs 4.33 crore in cases where transit passes were not surrendered.**
(Paragraph 2.2.7)
- **Entry tax of Rs 1.02 crore from importers of goods was not levied.**
(Paragraph 2.2.9)
- **Entry tax of Rs 12.45 lakh on goods used as component parts was not levied.**
(Paragraph 2.2.9)

2.2.1. Introduction

The Kerala General Sales Tax Act, 1963 (KGST Act) empowers Government to establish check posts at places considered necessary to prevent and check evasion of tax. The driver or any other person incharge of the vehicle entering/leaving the State shall stop the vehicle at the check post, to enable the officer incharge to inspect the goods under transport and examine the documents relating to the goods carried. Where the goods transported exceed the quantity or value shown in documents and are not supported by proper documents, the incharge of check post shall detain such vehicle or seize and confiscate the goods. The owner of the goods or any other person incharge of the vehicle, shall be given the option to pay, in lieu of confiscation, penalty equal to double the amount of tax due on the value of goods or security deposit to the extent of penalty leviable and shall be allowed to transport the goods. Under the Kerala Tax on Entry of Goods into Local Area Act, 1994 (KTEGLA Act), the check post authority is to levy and collect entry tax on notified goods imported in the State. The incharge of check post is to send the information or document to the concerned circle offices to utilise the information at the time of assessment.

2.2.2. Organisational set up

The Department of Commercial Taxes which administers the sales tax and entry tax law of the State is under the control of the Commissioner of Commercial Taxes (CCT). The Commissioner is assisted by the Joint Commissioner (Enforcement) in the functioning of check posts with the assistance of Deputy Commissioners (DCs),

Inspecting Assistant Commissioners (IACs) and sales tax officers (STOs). There are 44 check posts in the State. The check posts at Amaravila, Bengara Manjeswar and Walayar are managed by IACs and remaining by the STOs/inspectors under the control of DCs.

2.2.3. Scope of Audit

A review on the working of sales tax check posts on collection of tax and penalty etc., under the KGST Act and entry tax under the KTEGLA Act during the period from 1999-2000 to 2003-04 was conducted between October 2004 and January 2005. Out of the 44 check posts all the 11^{*} major check posts (A class and B class) and seven[♥] out of the remaining 33 check posts were selected for review. The data collected from these check posts was verified with the records of concerned 10[♦] sales tax offices, three DCs (Palakkad, Thiruvananthapuram and Kasargod) as well as that maintained in CCT office.

2.2.4. Audit objectives

Audit conducted the review of the working of check posts to ascertain whether:

- adequate and effective internal control system existed to ensure compliance of provisions in the Act, Rules and notifications,
- infrastructure facilities in the check posts were adequate to check evasion of tax.

2.2.5. Trend of revenue

The revenue collected by the sales tax check posts in the State during the year 1999-2000 to 2003-04 is shown as under:

(in crore of rupees)

Year	Security deposit/ bank guarantee	Sales tax	Entry tax	Total
1999-2000	6.04	3.83	3.47	13.34
2000-2001	7.08	5.04	5.24	17.36
2001-2002	6.64	8.71	5.88	21.23
2002-2003	8.93	7.81	53.01	69.75
2003-2004	8.72	5.63	75.59	89.94
Total	37.41	31.02	143.19	211.62

The increase in revenue in entry tax during the years 2002-03 and 2003-04 was due to inclusion of more goods under the purview of KTEGLA Act.

^{*} Sales tax check posts at Amaravila, Aryankavu, Bengara Manjeswar, Feroke, Govindapuram, Gopalapuram, Karukutty, Kumily, Meenakshipuram, Velanthavalam and Walayar

[♥] Sales tax check posts at Amaravila Tile factory, Cumbummettu, Mandapathinkadavu, Muthanga, Naduppuni, Noolpuzha and Thaloer

[♦] Sales Tax Special Circles Ernakulam I, II, III, Palakkad, Kollam and Sales Tax Offices Kasargod, Palakkad I, II, III and First Circle, Thiruvananthapuram

2.2.6. Internal Control

Internal controls are intended to provide reasonable assurance of proper enforcement of laws, rules and departmental instructions. Internal audit is expected to bring the financial and procedural irregularities to the notice of the offices audited and the Department to ensure that the same are not repeated. The internal control is effected through internal audit, inspection, periodical returns and maintenance of registers. The deficiencies noticed are enumerated below.

- ***Internal audit***

Though there is an internal audit wing functioning under the control of DC (Audit and Inspection) in CCT office and the audit of check posts is conducted by the Department, there is no provision in the manual for the audit of check posts. Government directed all heads of departments in December 2003 to ensure that internal audit wing under their control works efficiently and that financial/procedural irregularities are not repeated.

It was noticed that in 12 check posts where internal audit was conducted, the inspection reports were not made available for review and in two check posts a review of inspection reports revealed that there was no comment on any financial irregularity. However, during review audit pointed out certain financial irregularities as mentioned in succeeding paragraphs.

Though the Department assured in July 2005 to make available the remaining inspection reports for scrutiny, the same were not produced (December 2005).

- ***Cash management***

According to the Kerala Treasury Code, Volume I, every officer authorised to receive cash on behalf of Government should issue receipts in the form prescribed and account for the cash received in the cash book immediately.

Audit noticed that in the case of check post at Karukutty, one used receipt book was not made available. Though there were entries in the cash book of that receipt book but in case of three numbers, entries of receipts were not shown in the cash book. In the absence of receipt book, it could not be ensured whether the money received had been correctly accounted for and remitted to Government account or not.

The Department admitted (May 2005) that the counterfoils could not be traced out.

- ***Non renewal of bank guarantee***

As per KGST Act, if the officer incharge of the check post has reason to suspect that the goods transported are without proper and genuine documents, he shall detain the goods and shall allow the same to be transported only after furnishing cash security for double the amount of tax likely to be evaded. He may also release the goods on

executing bond with or without sureties or bank guarantee for securing the amount due as security deposit. In case of bank guarantee, the same has to be renewed before its expiry till the offence is settled finally.

It was noticed that in 33 unsettled cases, bank guarantees of Rs 42.60 lakh which were due for renewal during the months between March 1996 and November 2004 were neither renewed nor any efforts were made to obtain security deposit in these cases.

The Department stated that action to review the cases was in progress.

- ***Non reporting of robbery to the Accountant General***

As per Kerala Financial Code Vol. I, when any loss has occurred, the head of office is required to send a preliminary report immediately to the Accountant General.

It was noticed that at Naduppuni check post, a robbery of cash of Rs 3.58 lakh took place on 17 May 2002. The FIR lodged with police authority in May 2002 was reported as undetectable in October 2003. The case was not reported to the Accountant General. No action was also taken to write off the case as required under the Code.

- ***Reconciliation of remittances***

The Kerala Financial Code, Vol. I, requires every head of office to consolidate revenue collection and remittances in a register and arrange to reconcile the same with treasury figures. The CCT in circular dated 27 July 2000 instructed that the reconciliation of receipts for the previous month should be done in the succeeding month.

It was noticed in audit that no reconciliation was conducted by the incharges of check posts during the period from 1999-2000 to 2003-04. Test check of records of Amaravila check post and Sales Tax Office, First Circle, Thiruvananthapuram revealed that the Police Department remitted Rs 2.35 crore towards entry tax in March 2004. The verification of the remittance by audit with the records of Sub Treasury, Vellayambalam, Thiruvananthapuram revealed that the amount was credited under head of account '0021' relating to Income Tax Department instead of head of account '0040' Entry Tax. Had the Department conducted reconciliation, the misclassification could have been set right.

The amount has not been credited to the accounts of the Department so far. The Department stated that the matter was pending with the treasury and Police Department (December 2005).

- ***Maintenance of registers***

As per Agricultural Income Tax and Sales Tax Manual Volume III (Manual), the following registers shall be maintained by the incharge of the check post.

1. Register No. I – Register of vehicles checked
2. Register No.II - Register of particulars of cases detected (offence register)
3. Register No.III- Register of goods seized and confiscated
4. Register No.IV – General Diary
5. Register of despatch of declaration in form 27B.
6. Register of commodities sent out of state
7. Register of commodities brought into the state
8. Bank guarantee register

- ***Offence register – Register No. II***

The incharge of the check post is required to maintain an offence register containing the number of goods vehicle, name and address of owner of goods, nature of irregularity, quantity/value of goods, sales tax due, number and date of challan and amount/security/bank guarantee etc. The incharge is empowered to release goods on receipt of penalty/security deposit or bank guarantee and enter the same in the register.

Test check of seven* check posts revealed that in 39 cases the goods were released during the period from 1999-2000 to 2003-04 without recording the details of security deposit or advance tax collected, if any, or reasons for release. The security deposit due in these cases amounted to Rs 55.81 lakh as shown in Annexure II.

The Department stated in May 2005 that instructions were issued for proper maintenance of registers.

- ***Entry tax register***

The KTEGLA Act and rules made thereunder states that the entry tax other than from registered dealers, is to be collected at check posts. But the Act and rules do not contemplate maintenance of registers of entry tax at check posts.

Test check of records of check posts at Walayar and Amaravila revealed that though entry tax registers were maintained but entries therein were incomplete. In 49 cases having tax effect of Rs 97.71 lakh as shown in Annexure III it was noticed that the name of importers and nature of goods were not noted therein. In a number of cases though the entry tax due was recorded, the fact whether tax had been collected or not,

* Amaravila, Cumbammettu, Karukutty, Meenakshipuram, Naduppunni, Velanthavalam and Walayar

was not recorded. In the absence of such entries, it was not possible to verify whether goods liable to tax had paid tax or not.

The Department stated in May 2005 that instructions have been issued for proper maintenance of registers.

- ***Non utilisation of check post declaration***

As per the KGST Rules, no person shall transport within the state any consignment of goods, if the value is Rs 25 and above, by any vehicle without a bill or a certificate of ownership. According to instructions in the department manual, officers incharge of the check posts should collect the declarations and send them to the assessing officers concerned to make use at the time of assessment.

Cross check of details from five* check posts with assessment records of seven circle offices[®] revealed that out of 506 declarations relating to 2000-01 to 2003-04, only 16 declarations were made use of for assessment. 347 declarations, were not seen filed in the concerned assessment files.

The Department stated that check posts will be linked with circle offices on computerisation.

2.2.7. Absence of control over transit of goods

The KGST Act stipulates that in case where any vehicle carrying goods from outside the state and bound for outside the State enters the State, the owner or driver or any other person incharge of the vehicle shall obtain three copies of transit pass (TP) (Form 27C) from the officer incharge of the check post at the entry point and deliver it to the officer incharge of the exit check post before leaving the State. No time limit has been prescribed by the Department for surrendering of TPs at the exit check posts.

The incharge of the entry check post who issues TP shall forward one copy of the TP to the concerned STO within a month, who is required to enter the details in a register. Incharge of the exit check post of the State is also required to send the copy of TP to the same officer who shall enter the details in that register to ensure that the goods have actually crossed the State. If the owner or driver or person incharge of the vehicle fails to deliver TP to the designated exit check post, it shall be presumed that the goods were sold within the State. In such cases the driver, owner, or any other person incharge of the goods shall be assessed to tax and penalty equal to twice the amount of tax shall be levied on him.

* STCP Amaravila, Walayar, Gopalapuram, Naduppuni and Velanthavalam

[®] Sales Tax Offices: Special Circles Kollam, Ernakulam I, II, III, Palakkad and ordinary Circles Palakkad I and II

Test check of records of check posts Amaravila, Bengara Manjeswar, Velanthavalam, Gopalapuram and Walayar revealed that 29 TPs having tax effect of Rs 13.37 lakh sent by the check posts during 2001-02 and 2002-03 were not entered in the register by the circle offices, Chittur and Thiruvananthapuram. In the absence of these entries, the receipt of TPs from exit check posts and tax leviable, if any, could not be watched as shown in Annexure IV.

In sales tax offices at Kasaragod and Chittur, it was noticed that in 170 cases goods valued at Rs 10.35 crore having tax effect of Rs 4.33 crore were entered in the register on the basis of TPs sent by entry check posts, but no TPs were received from the exit check post. In absence of this, it is presumed that goods have been sold in the State. As such tax of Rs 4.33 crore including penalty was leviable.

Follow up action on TPs sent to circle offices from check posts was not monitored by the Department.

2.2.8. Infrastructure facilities in check posts

As per the instructions in the Manual, the officer incharge of check post has to examine the documents relating to the goods transported and to physically inspect the goods to ensure that the nature, description, quantity and weight of the goods shown in the document agrees with those transported.

It was noticed that no weighing machine has been provided in 16 out of 18 check posts test checked. In case of other two check posts, though weighing machines were provided, these were not functioning at check post Feroke for the last 20 years and at Walayar for the last two years.

The remarks were accepted by Government. It was further stated in July 2005 that weighing machine at Walayar has since been repaired.

2.2.9. Non/ short levy of entry tax

As per KTEGLA Act, entry tax shall be levied and collected on the entry of any goods into local areas for consumption, use or sale therein at such rate as may be fixed by the Government on the purchase value of goods but not exceeding the rates specified for the goods in the KGST Act. The KTEGLA Rules prescribe the procedure for levy and collection of entry tax. A few illustrative cases where short levy of entry tax was detected by audit are detailed below.

- ***Other than registered dealers in the goods***

Under KTEGLA Rules, every importer other than registered dealer in the goods shall file a return in duplicate before the officer incharge of the check post along with proof of payment of tax on the purchase turnover of the goods. Government exempted iron

and steel, timber and petroleum products from levy of entry tax provided these are used as raw material in the manufacture of other goods in the State for sale, and products are liable for sales tax.

Test check of records of nine[♦] check posts revealed that in 50 cases entry tax of Rs 96.49 lakh on the import of generators, air conditioners, furniture, computers, trucks, paints, electrical goods, hospital equipments and tiles was not collected during the period from 2000-01 to 2003-04 as shown in Annexure V, even though importers were not registered dealers in these goods. These goods were imported by them for their own use. It was also noticed that in 16 cases iron and steel, timber and petroleum products imported for use in manufacture of other goods were actually not used for the purpose. Entry tax of Rs 5.98 lakh was exempted in these cases as shown in Annexure VI. This resulted in a loss of revenue of Rs 1.02 crore.

After this being pointed out, the Department replied in 32 cases that most of the importers were public sector undertakings which were having registration certificates. In such cases, there would be directions from the higher authorities to release goods without payment of entry tax. It was also stated that entry tax was recoverable at the time of assessment, importers being registered dealers.

The reply is not tenable, since these importers were not registered dealers in the goods which were imported. The goods were intended for their own use and not for sale. Further reply was awaited (December 2005).

- ***Goods used as component parts***

Test check of records of check posts Gopalapuram and Walayar revealed that Indian Telephone Industries, Kanjikkode which imported computers and UPS[▲] valued at Rs 3.10 crore during the period during 2000-01 to 2003-04 through these check posts without payment of entry tax on the ground that the goods were for sale. On verification of assessment records of AC (Assessment) Special Circle, Palakkad, it was noticed that the dealer sold electronic exchanges and batteries and not computers or UPS. Non levy of entry tax worked out to Rs 12.45 lakh.

After this was pointed out in November 2004, the Department stated that the imported goods were used to manufacture telephone exchanges which suffered sales tax. The reply is not tenable as Government has specifically exempted certain goods from entry tax which were used in the manufacture of other goods by the registered dealer, but computers and UPS were not included in that list. Further reply was awaited (December 2005).

[♦] Amaravila, Bengara Manjeswar, Feroke, Gopalapuram, Meenakshipuram, Aryankavu, Walayar, Velanthavalam and Muthanga

[▲] Uninterrupted power supply

- ***Entry tax on Petroleum products***

Government vide notification dated 30 March 2002 levied entry tax on petroleum products with effect from 1 April 2002 and superseded this notification on 2 September 2002 exempting the same from entry tax.

Test check of records of check posts Bengara Manjeswar and Walayar revealed that seven dealers in eight cases imported petroleum products valued at Rs 22.85 lakh between the period from 1 April 2002 to 1 September 2002, but no entry tax was levied. This resulted in loss of revenue of Rs 5.11 lakh.

- ***Entry tax on import of bitumen***

Government vide notification dated 19 June 2003 exempted bitumen imported by Kerala State Public Works Department from levy of entry tax.

Test check of records of check post Bengara Manjeswar revealed that the Executive Engineer, Roads Division Kannur and Kasargod imported bitumen valued at Rs 8.93 lakh between April 2002 and April 2003, but entry tax was not levied. This resulted in loss of revenue of Rs 2.68 lakh.

- ***Entry tax on excavators***

It has been held[♥] by the Hon'ble Supreme Court of India that excavators are motor vehicles as defined in Section 2(28) of the Motor Vehicles Taxation Act, 1988. Therefore, it is liable for entry tax.

During the course of review, it was noticed that entry tax of Rs 0.55 lakh was not levied on import of two excavators valued at Rs 13.60 lakh during the period from 1999-2000 to 2002-03.

- ***Application of incorrect rate of entry tax***

Government of Kerala vide notifications issued from time to time prescribed the rate of entry tax leviable on the goods imported.

Test check of records of check posts Amaravila, Bengara Manjeswar and Walayar revealed that generators, bitumen, petroleum products, road rollers, air conditioners etc., were imported in the State during the period between January 2002 to November 2003 but entry tax was levied at incorrect rates. This resulted in short levy of entry tax of Rs 5.10 lakh.

After this was pointed out, the Department stated that the rate of entry tax of bitumen was 24 *per cent*. The reply is not tenable as the rate of other petroleum products

[♥] Bose Abraham Vs State of Kerala and another - 9 KTR 336 (SC)

which includes bitumen is 30 *per cent* with effect from 1 April 2002. Further progress in the case and reply in other cases was awaited (December 2005).

2.2.10. Recommendations

Government may consider that:

- the internal control mechanism may be toned up to ensure better financial management and adherence to prescribed rules and procedures,
- directions may be issued to the officers in charge of the check posts and circle offices to maintain the prescribed registers properly and completely,
- time limit may be prescribed for surrendering TPs at the exit check posts,
- weighing machines may be provided at check posts for effective functioning.

2.2.11. Acknowledgement

Audit findings as a result of review on the working of sales tax check posts (STCPs) in Kerala were reported to Government/ Department in June 2005 with a specific request to attend the meeting of Audit Review Committee for Comprehensive Appraisal of State Receipts (ARCCASR) so that the viewpoint of Government/Department was taken into account before finalising the review. The meeting of ARCCASR was held on 30 July 2005 and attended by the Secretary, Taxes Department, Government of Kerala and Commissioner of Commercial Taxes. The views expressed by the members have been taken into account during finalisation of review. All the recommendations were accepted by Government.

2.3. Non /short levy of interest

Under KGST Act read with Central Sales Tax Act, 1956 (CST Act), where any dealer has failed to include any turnover in the return filed by him or any turnover has escaped assessment or if the tax due is not paid by him within the time prescribed, the dealer shall pay interest at the rate of one *per cent* per month for first three months and at the rate of two *per cent* per month for subsequent months of delay.

During the course of audit of nine[♦] offices it was noticed, that while finalising the assessments between November 2002 and February 2004 the assessing officers failed to levy or levied short interest of Rs 50.61 lakh in 11 cases. A few illustrative cases are given below:

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/Month and year of assessment	Nature of irregularity	Turnover tax (Non/short levy of interest)	Remarks
1.	<u>STO, Special Circle I, Ernakulam</u> 1	<u>1998-99</u> November 2002	Turnover detected towards purchase suppression was added and subjected to levy of tax. But interest on tax due on the escaped turnover for the period from May 1999 to December 2002 was not demanded.	<u>260.76</u> 20.86 (17.73)	After this was pointed out in November 2003, the assessing authority stated that notice was issued in December 2003 to the assessee demanding Rs 17.73 lakh. Government informed in November 2005 that the assessment had been revised making good the loss pointed out by Audit.
2.	<u>STO, Special Circle, Alappuzha</u> 2	<u>1999-2000</u> January 2004	Revenue recovery certificates (RRC) were issued to the revenue authority for recovery of interest of Rs 99.94 lakh on 01.06.2004 against the correct amount of Rs 1.07 crore.	-- -- (7.54)	After this was pointed out in July 2004, Government stated in July 2005 that revised RRC was issued in July 2004 demanding Rs 7.54 lakh towards interest. Further report was not received (December 2005).
3.	<u>STO, Special Circle, Kollam</u> 2	<u>2001-02</u> January 2003	While finalising the assessment of a dealer in cashew, the turnover detected towards suppression was considered for assessment. But interest for the period from July 2001 to February 2003 on tax due on the escaped turnover was not levied.	<u>239.30</u> 21.68 (6.49)	After this was pointed out in July 2003, the assessing officer stated that the interest could not be levied if the assessee had not admitted the tax liability. The reply was not tenable in view of the extant provision of KGST Act. Further report has not been received (December 2005).
4.	<u>AIT & STO, I Circle, Thodupuzha</u> 1	<u>1998-99</u> March 2003	Interest on tax due on the escaped turnover on unaccounted interstate purchase for the period from May 1999	<u>30.70</u> 3.84	After this was pointed out in February 2004, the assessing authority stated that demand notice for payment of interest

♦ Sales Tax Office Special Circles Alappuzha, Ernakulam I, Kollam, Palakkad, Sales Tax Offices Pala, Kasargod and III Circle Kollam, Agricultural Income Tax and Sales Tax Offices Thodupuzha I and Kuthiathode

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/Month and year of assessment	Nature of irregularity	Turnover tax (Non/short levy of interest)	Remarks
			to March 2003 was not levied.	(3.49)	was issued in February 2004. The collection particulars have not been received (December 2005).

The above cases were reported to Government between June 2004 and April 2005; Government informed that the assessment had been revised in eight cases.

2.4. Application of incorrect rate of tax

Under the KGST Act, rate of tax depends on the nature of sale, point of sale and also on the kind of commodity. Under the Kerala Surcharge on Taxes Act, 1957, surcharge at the rate prescribed is also leviable on sale and purchase tax.

In 11 offices, it was observed that while finalising assessment between November 2000 and March 2004 the assessing officers levied tax and surcharge of Rs 31.12 lakh short in 12 cases due to application of incorrect rate as shown in Annexure VII.

The cases were reported to Department/Government between May 2004 and April 2005. Assessments were revised in six cases raising demand of Rs 19.94 lakh and notice to revise the assessment was issued in two cases and final report and reply was awaited in other cases (December 2005).

2.5. Underassessment of turnover

2.5.1 Under the KGST Act, every dealer whose total turnover for a year exceeds Rs 2 lakh shall pay tax at the rate of six *per cent* in the case of transfer of right to use any goods for any purpose. It has been judicially* held that rentals collected by Department of Telecom from subscribers is exigible to tax. On the analogy of the said decision, rental collected for the use of pager is also taxable.

In sales tax office, Special Circle I, Ernakulam, while finalising the assessment in March 2003 of a dealer in pagers for the year 1998-99, rent received for pagers amounting to Rs 3.90 crore was not assessed to tax. This resulted in short levy of tax and surcharge of Rs 25.72 lakh.

* State of Uttar Pradesh Vs Union of India (2003) 11 KTR 79(SC)

After this was pointed out in December 2003, the assessing authority revised the demand in February 2004. Further progress in the case was awaited (December 2005).

The case was reported to Government in June 2004; their reply had not been received (December 2005).

2.5.2. Under the KGST Act, any dealer in gold or silver ornaments or wares, may at his option, instead of paying tax, opt to pay tax at the compounded rate at 120 per cent of the tax payable for the previous year.

In sales tax office, Special Circle II, Ernakulam, it was noticed in December 2004 that the assessing authority completed the assessment under compounding scheme of a dealer in jewellery of gold, standard gold and precious stones for 2000-01 in March 2003, leaving the turnover of standard gold and precious stones which should have been assessed separately. This resulted in escapement of turnover of Rs 24.50 crore and consequent short levy of tax of Rs 24.50 lakh. Besides, interest of Rs 20.82 lakh was also leviable.

After this was pointed out in December 2004, Government informed in December 2005 that notice had been issued to revise the assessment. Further report was not received (December 2005).

2.5.3. Under the KGST Act, taxable turnover means the turnover on which a dealer shall be liable to pay tax, after making the prescribed deductions from the gross turnover.

In two offices, turnover of Rs 1.49 crore in three cases was incorrectly excluded from levy of tax resulting in short levy of tax of Rs 15.03 lakh including surcharge as shown below.

(In lakh of rupees)

Sl. No.	Name of office/ No. of cases	Assessment year/ Month of assessment	Name of commodity/ Rate of tax	Nature of irregularity	Short levy of tax including surcharge	Remarks
1.	STO, Special Circle, Palakkad 2	1998-99 November 2002	DEPB ^a licence 10	While finalising the assessment of a manufacturer and exporter of electronic goods, the assessing authority did not levy tax on Rs 79.96 lakh received towards sale of import entitlement.	8.80	After this was pointed out in September 2003, the Department intimated in June 2004 that the assessment was revised in January 2004 and demand raised. Government informed in November 2005 that the amount was still pending collection. Further report was not received (December 2005).

^a Duty Entitlement Pass Book

(In lakh of rupees)

Sl. No.	Name of office/ No. of cases	Assessment year/ Month of assessment	Name of commodity/ Rate of tax	Nature of irregularity	Short levy of tax including surcharge	Remarks
		<u>2000-01</u> August 2002	<u>Raw cashew nut</u> 8	While finalising the assessment of an assessee engaged in the manufacture, export and local sale of cashew kernel, the assessing authority did not levy tax on turnover of raw cashew nut of Rs 13.50 lakh purchased within the State.	1.08	After this was pointed out in September 2003, the assessing authority stated in April 2004 that the assessment was revised and demand notice issued. Government stated in November 2005 that the balance tax was recommended for recovery under the Revenue Recovery Act. Further report was not received (December 2005).
2.	<u>STO. II</u> <u>Circle,</u> <u>Palakkad</u> 1	<u>2001-02</u> July 2003	<u>DEPB licence</u> 8	While finalising the assessment of a dealer, the assessing authority did not assess to tax sale proceeds of DEPB licence amounting to Rs 56.01 lakh.	5.15	After this was pointed out in November 2004, Government informed in November 2005 that the amount pertains to branch transfer and closing stock of DEPB licence not sold on 31 March 2002. In the accounts of the assessee the amount is shown as sale proceeds received and not as branch transfer or closing stock. Hence the reply is not tenable. Further report was not received (December 2005).
	Total				15.03	

2.5.4. Under the KGST Act, in respect of manufactured goods other than tea which are sold under a trade mark or brand name, the sale by the brand name holder or the trade mark holder within the State shall be the first sale for the purpose of this Act.

In Sales Tax Office, Pala, while finalising the assessment in March 2004 for the assessment year 2002-03 of a dealer in coconut oil, turnover of Rs 1.12 crore relating to sale of coconut oil under the brand name "Leader Cook coconut oil" was exempted from levy of tax instead of levying tax at four *per cent*. This resulted in short levy of tax of Rs 5.15 lakh.

After this was pointed out in April 2004, the Department intimated in October 2004 that the assessment was revised in May 2004 and the entire demand had been advised for revenue recovery. Further progress in the case was awaited (December 2005).

The case was reported to Government in September 2004. Further report had not been received (December 2005).

2.5.5. Under the KGST Act, where any dealer after purchasing any goods by furnishing a declaration in Form 18 fails to make use of the same for the purpose for which the declaration was furnished, he shall be liable to pay tax that would have been payable by him had the declaration not been furnished.

In Sales Tax Office, Special Circle, Mattancherry, while finalising the assessments of a dealer for 1998-99 and 1999-2000 in October 2002, the assessing authority failed to demand the differential tax due on raw materials purchased by issuing declarations in Form 18 which were not utilised for the purpose. This resulted in short demand of tax of Rs 4.77 lakh including surcharge. Besides, interest of Rs 3.96 lakh was also leviable.

After this was pointed out in December 2003, the Department revised the assessment creating an additional demand of Rs 2.87 lakh including interest applying concessional rate of five *per cent*. Application of concessional rate of five *per cent* is not correct in the absence of the certificate prescribed in the notification allowing concessional rate of tax.

The matter was referred to Government in May 2004 and reminded in September 2004. Their reply had not been received (December 2005).

2.6. Inadmissible exemption of tax

As per notification issued by the Government in November 1993, medium and large scale industrial units will have the option for deferment of taxes for a period for 10 years from the date of commencement of commercial production or from the date on which diversification, expansion or modernisation has been completed. The unit which opts for deferment of taxes will not be permitted to avail exemption of tax, but will be permitted to collect taxes as per rules. The accumulated taxes so deferred shall be remitted to Government in equal monthly instalments over a period of five years from the eleventh year of the date of commencement of commercial production or the date of completion of such diversification, expansion or modernisation, as the case may be, with simple interest at the rate of 15 *per cent per annum* from the eleventh year. If any instalments are defaulted, penal interest at the rate of two *per cent per annum* shall be charged for the amount so defaulted.

In the office of the Inspecting Assistant Commissioner, Commercial Taxes, Kattappana, it was noticed that an industrial unit was allowed sales tax deferment in January 2003 for seven years from March 1999 to February 2006. While finalising the assessment of a dealer for the years 1998-99, 1999-2000 and 2000-01 between March and June 2003, the assessing authority granted tax exemption of Rs 1.15 crore which was fully availed of although the assessee was permitted to avail the deferment of payment of tax. This resulted in inadmissible exemption of tax of Rs 1.15 crore.

After this was pointed out in audit in May 2004, the assessing officer stated in August 2004 that necessary steps would be taken to rectify the mistake by revising the assessment. Further reply was awaited (December 2005).

The case was reported to Government in November 2004. Their reply had not been received (December 2005).

2.7. Incorrect grant of exemption

2.7.1. Under the CST Act, Government exempted tax on interstate sale of declared goods, which had suffered tax under the KGST Act on its purchase or sale. It was judicially held[♥] that raw hides and dressed hides are commercially different commodities and dealers who paid tax on purchase of raw hides and skins are liable to pay tax on sale of dressed hides and skins.

In Sales Tax Office, Special Circle, Mattancherry, while finalising the assessment in July 2002 of a dealer in hides and skins for the year 1998-99, turnover of dressed hides and skins for Rs 3.13 crore was exempted from CST assessment on the ground that purchase turnover of raw hides was assessed under the KGST Act. This resulted in short levy of tax of Rs 12.52 lakh.

After this was pointed out in November 2003, Government informed that the Department had revised the assessment in December 2004. The position of recovery had not been received (December 2005).

2.7.2. Under the CST Act, every dealer shall be liable to pay tax on all sales effected by him in the course of interstate trade or commerce. Where any dealer claims that he is not liable to pay tax under the 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, the burden of proving that the movement of those goods so occasioned shall be on the dealer. In such cases, he shall furnish a declaration in Form 'F' duly filled in and signed. It was judicially held[♦] that in order to grant exemption under the CST Act, the dealer has to produce a delivery note in Form 26.

In Sales Tax Office, Neyyattinkara, while finalising the assessment for 1999-2000 in March 2004 of a dealer, transferred goods valued at Rs 90.46 lakh to his branch office on the strength of Form 'F' declaration alone without copy of delivery note in Form 26 duly sealed in at check post was incorrectly exempted from levy of tax. This resulted in non levy of tax of Rs 9.05 lakh.

The matter was reported to Department in April 2004 and Government in September 2004. Government informed that as the branch transfer was proved otherwise, declaration in Form 26 need not be insisted upon for granting exemption. However, in the judicial decision referred to in this paragraph, the High Court of Kerala held that despatch of goods in the course of interstate movement under section 6A should be

[♥] K.A.K.Anwar & Co. Vs State of Tamil Nadu 108 STC 258 (SC)

[♦] Esab India Limited Vs State of Kerala 12 KTR 34 (Ker)

despatch of goods from the business place of the dealer across the boundary of the State, and therefore, proof of crossing of goods through the boundary check posts is a necessary precondition for granting exemption. Hence the reply is not tenable. Further reply had not been received (December 2005).

2.7.3. Under the CST Act, where a sale of any goods in the course of interstate trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of document 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 shall be exempted from tax subject to production of prescribed certificates in Form C and E1. Government clarified in February 2004 that when goods are delivered directly to the ultimate purchaser, exemption under the provision cannot be allowed as there is no interstate sale during the movement of goods.

In Sales Tax Office, Third Circle, Ernakulam, the assessing authority finalised the assessment of two dealers for 1999-2000 and 2000-01 between June 2003 and December 2003 and exempted interstate sales of goods transferred direct to ultimate purchaser by the first seller as 'sale in transit'. Scrutiny of records revealed that the original seller despatched the goods from outside the State not to the assessee but directly to the ultimate purchaser before movement of goods. Hence, the sale was not a 'sale in transit'. Incorrect exemption granted to the assessee as 'sale in transit' resulted in short levy of tax of Rs 7.66 lakh.

After this was pointed out between October and November 2004, Government stated that all the conditions of 'sale in transit' were fulfilled in these cases. The reply was not tenable as the sales were not a transit sale in view of the clarification from Government. Further reply was awaited (December 2005).

2.7.4. Under the KGST Act, cooked food served in bar attached hotels and/or star hotels is taxable at the rates prescribed with effect from 1 January 2000. 'Bar attached hotel' means a hotel or restaurant, which is licenced under the Foreign Liquor Rules to serve foreign liquor. It has been judicially[▼] held that club is not entitled for exemption from tax.

In Sales Tax Office, First Circle, Thiruvananthapuram, while finalising the assessments of two clubs for the years 1999-2000 and 2000-01 between August 2002 and November 2003 licence fee on cooked food was levied instead of levying tax on cooked food served in bar attached hotels. This resulted in non levy of tax of Rs 8.85 lakh.

The matter was reported to Department in February 2004 and Government in October 2004. Government informed in November 2005 that cooked food served in club was liable to be taxed only with effect from 1 April 2005. The reply is not tenable in view of the above court decision. Further reply was not received (December 2005).

2.7.5. Government by notifications in 1980 and thereafter exempted new small scale industrial (SSI) units from payment of tax due on goods produced and sold by them

[▼] Trivandrum Club Vs State of Kerala (1999) 7 KTR 90 (Ker)

for a period of five/seven years from the date of commencement of production. Exemption from sales tax is admissible only for goods manufactured and sold by the unit. It has been judicially held[♦] that rice and paddy are two separate commodities, distinct in nature and character and that a dealer is liable to pay purchase tax on the purchase of paddy procured in circumstances in which no tax has been paid. It was also judicially held[♦] that SSI units are not entitled to exemption on purchase tax under KGST Act.

In Sales Tax Offices, Angamaly, Aluva, Kozhikode and Sales Tax Office Special Circle Palakkad, it was noticed that while finalising the assessments of 15 dealers of paddy, timber and ayurvedic medicines for the years from 1998-99 to 2001-02 during the period between July 2002 to March 2003 the assessing authority levied purchase tax of Rs 62.54 lakh and incorrectly adjusted against the SSI exemption. This resulted in non recovery of purchase tax of Rs 62.54 lakh.

After this was pointed out between August 2003 and March 2004, Government/ Department informed that the assessment had been revised in three cases and notices issued in other cases. Final action in other cases was awaited (December 2005).

2.8. Irregular refund of surcharge

Under the KGST Act, when an assessing authority finds, at the time of final assessment, that the dealer had paid tax in excess of what is due from him, it shall refund the excess tax to the dealer. Further under Sub Section (2) of Section 44 of the Act, when the assessing authority receives an order from any appellate or revisional authority to refund tax or penalty paid by a dealer it shall effect the refund. According to Agricultural Income Tax and Sales Tax Manual, Vol. III (Administration and Procedures), erstwhile Board of Revenue alone is competent to sanction refunds of revenue against original credits.

Government issued notification^{*} exempting Kerala State Beverages Corporation from payment of surcharge on sales tax payable by it for six months from 1 October 2002 to 31 March 2003 so as to set off the loss sustained by the corporation. As per the Annual Reports for 1999-2000, 2000-2001 and 2001-2002, the corporation had necessary surplus of Rs 30.74 crore after payment of tax and duties. According to the provisional balance sheet as on 31.03.2003 filed before the assessing authority, there was a surplus of Rs 3.40 crore with the corporation even before granting the aforesaid exemption for setting off the loss sustained by it. Hence, grant of exemption of surcharge without taking into account the accumulated reserve of profit of the corporation was detrimental to the interest of revenue.

In Sales Tax Office, Special Circle, Thiruvananthapuram the Assistant Commissioner (Assessment) refunded Rs 34.76 crore on 5 May 2003 on the request of the Managing

[♦] Raja Provision Stores Vs Appellate Tribunal (Sales Tax), Trivandrum 105 STC 225 (SC)

[♥] State of Kerala Vs M/s Vattukalam Chemical Industries (2002) 10 KTR 69 (SC)

^{*} SRO No. 325/03 dated 31 March 2003

Director of the corporation, citing the exemption notification, in violation of the authority entrusted to him under sub section (1) of Section 44 of the KGST Act. At the time of refund of the amount, the general sales tax assessment of the corporation for the years 2000-01 to 2002-03 were pending. Further, the refund was effected in the absence of a provisional/final (original) assessment for the year 2002-03.

After this irregularity was pointed out in September 2004, Government stated that the refund order was issued in strict obedience to the sovereign order.

The reply is not sustainable as the notification had only exempted the corporation from payment of surcharge under FL9 licence and had not authorised the assessing authority to make any refund in the absence of finalisation of the assessment of the corporation for the year 2002-03. According to sub section (3) of Section 44 of KGST Act, the assessing authority shall have power to adjust the amount due to be refunded towards the recovery of any amount due on the date of adjustment. Instead of finalising the pending assessments and adjusting the tax due, the assessing authority resorted to an irregular refund of surcharge of Rs 34.76 crore.

2.9. Short demand of tax/interest due to non liquidation of interest

Under the KGST Act, if the tax due is not paid within the time prescribed, the dealer shall pay interest. Further, where any tax or any other amount due or demanded is paid by any dealer, the payment so made shall be appropriated first towards interest accrued on such tax or other amount under sub section (3) of Section 23 on such date of payment and the balance available shall be appropriated towards principal outstanding.

In two offices in two cases, non liquidation of interest resulted in non/short demand of tax/ interest of Rs 9.64 lakh as detailed below.

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/Month and year of assessment	Nature of irregularity	Non/short levy of tax/ interest	Remarks
1.	<u>AIT & STO</u> <u>Kuthiathode</u> 1	<u>1999-2000</u> April 2003	An assessee did not pay the balance tax of Rs 7.56 lakh for the year 1999-2000 within the prescribed time. However, while finalising the assessment in April 2003 and revising it in June 2003 to rectify the mistake in the original assessment, the assessing authority failed to levy interest and adjust the payment subsequently made by the assessee towards interest. This	8.03	After this was pointed out in December 2004, Government informed in December 2005 that the assessment had been revised. Further report had not been received (December 2005).

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/Month and year of assessment	Nature of irregularity	Non/short levy of tax/ interest	Remarks
			resulted in short demand of tax of Rs 5.82 lakh and interest of Rs 2.21 lakh (Total Rs 8.03 lakh).		
2.	STO, Thiruvalla 1	1999-2000 February 2004	Payment of Rs 2.50 lakh made by an assessee in December 2003 was adjusted fully towards the tax due instead of adjusting Rs 2.35 lakh against interest due from the assessee.	1.61	After this was pointed out in audit in June 2004, the assessing officer stated in September 2004 that notice had been issued in June 2004 to realise the amount. Government informed in November 2005 that the assessment had been revised. Further report had not been received (December 2005).
	Total			9.64	

2.10. Incorrect raising of demand

The KGST Rules, and instructions issued in February 1992 by the erstwhile Board of Revenue (Taxes), lay down the departmental procedure for verifying and checking calculations and credits given in an assessment order.

In Sales Tax Office, Special Circle, Thrissur the assessing officer finalised the modified assessment of a dealer for 1990-91 in March 2004 and incorrectly worked out the balance tax due from the assessee as Rs 31.62 lakh instead of Rs 33.62 lakh and issued demand notice on 16 March 2004. This resulted in short raising of demand of tax of Rs 2 lakh.

After this was pointed out in August 2004, the assessing authority revised the assessment in July 2005 and raised the demand. Further progress of the case was awaited (December 2005).