

## CHAPTER II SALES TAX

### 2.1 Results of Audit

Test check of the sales tax assessments, refund cases and connected documents of the commercial tax offices conducted during the year 2006-07 revealed underassessment of turnover, non-levy of interest, grant of incorrect exemption, application of incorrect rate of tax etc., amounting to Rs. 309.17 crore in 1,004 cases which fall under the following categories:

(Rupees in crore)			
Sl. No.	Category	No. of cases	Amount
1.	Grant of incorrect exemption	121	15.14
2.	Non/short levy of interest	234	5.26
3.	Turnover escaped assessment	156	4.66
4.	Application of incorrect rate of tax	170	2.29
5.	Incorrect grant of concessional rate of tax	38	1.96
6.	Grant of excess credit	9	0.82
7.	Other lapses	276	279.04
<b>Total</b>		<b>1,004</b>	<b>309.17</b>

During 2006-07, the department accepted underassessments and other deficiencies of Rs. 5.21 crore involved in 179 cases. Of these, 54 cases involving Rs. 1.14 crore were pointed out during 2006-07 and the rest in the earlier years. The department recovered Rs. 53 lakh involved in 108 cases during the year of which 23 cases involving Rs. 7 lakh pertained to 2006-07.

After the issue of draft paragraphs, the department recovered Rs. 61.36 lakh in full in eight cases out of which four cases involving Rs. 46.13 lakh were pointed out during 2006-07 and the rest in 2005-06.

A few illustrative cases involving Rs.12.54 crore are mentioned in the succeeding paragraphs.

## **2.2 Incorrect grant of exemption**

Under the Kerala General Sales Tax Act, 1963 (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 the Act. The tax payable shall be increased by an additional sales tax (AST) at the rate of 15 *per cent* of the tax payable from 23 July 2001.

**2.2.1** Test check of the records of the commercial tax office (CTO), special circle, Kottayam revealed that a dealer (a medium and large scale industrial unit) was granted exemption from sales tax of Rs. 40.23 crore for nine years from 14 October 1995 for the manufacture and sale of portland pozzolana cement (PPC). The dealer had acquired the right to sell cement under the brand name “Sidhee Cement” through an agreement dated 12 June 2002 with a dealer of Gujarat and sold cement for Rs. 32.07 crore during 2004-05 under this brand name. Being the first sale in the State, the dealer was liable to pay tax for the sale of “Sidhee Cement”, under the provisions of the Act. The assessing authority (AA) while finalising the assessment in February 2006 levied tax of Rs. 5.53 crore correctly but allowed incorrect adjustment of a part of tax of Rs. 2.67 crore towards the exemption available to the assessee for manufacture and sale of PPC.

After the case was pointed out to the department in July 2006 and reported to the Government in February 2007, the Government stated in December 2007 that the notification in SRO No.1729/93 granting the exemption did not contain any prohibition on beneficiary units using brand name of large and medium scale units. The reply is not tenable as the dealer had sold cement under a brand name, the liability to pay tax was on the brand name holder in accordance with the provisions of the Act and hence the adjustment of tax against the exemption available to the assessee was irregular.

**2.2.2** Test check of the records of the CTO, fourth Circle, Thrissur revealed that an SSI<sup>1</sup> unit was granted exemption from sales tax of Rs. 1.16 crore for seven years from 10 December 2001 to 9 December 2008 for the manufacture and sale of plastic moulded furniture and injection moulded goods. The assessee was manufacturing and selling plastic moulded furniture under the brand name ‘Cello’ from 6 November 2001. The AA while finalising the assessment of the dealer for 2001-02 to 2003-04 between May and June 2005, levied tax and AST of Rs. 1.04 crore on a turnover of Rs. 11.72 crore and adjusted it against the exemption available to the assessee. Since the assessee was manufacturing and selling goods under the brand name, the exemption allowed was not in accordance with the provisions of the Act. This resulted in non-raising of demand of tax of Rs. 1.04 crore.

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<sup>1</sup> Small scale industry

The matter was pointed out to the department in January 2007 and reported to the Government in June 2007; their reply has not been received (December 2007).

**2.2.3** Test check of the records of the CTO, I Circle, Thalassery revealed that an assessee purchased paper and carbon in reels and converted it into computer forms by punching holes on both edges, inserting carbon paper and folding the same along with paper reels using machinery to make it suitable for use in the dot matrix printers as computer continuous stationery. He sold it in packets under the brand name 'sinex'. Hence, the turnover was assessable as first sale by brand name holder in the State. The AA, while finalising the assessment for the years 2003-04 and 2004-05 in December 2005, however, incorrectly exempted the turnover of Rs. 200.51 lakh treating it as second sale of paper. This resulted in short levy of tax of Rs.18.45 lakh including AST.

After the case was pointed out in June 2006, the department stated in September 2006 that as there was no manufacturing process, the exemption allowed was in order. The reply is not tenable as the item purchased and sold by the dealer was commercially a different commodity having a different use and it was sold under a brand name for exclusive use as computer stationery.

The matter was reported to the Government in November 2006; their reply has not been received (December 2007).

**2.2.4** By a notification issued in December 1999, the Government exempted the purchase turnover of rubber effected by SSI units for use in the manufacture of rubber products within the State. As per the norms fixed by the Government of India (Ministry of Industry) an industrial unit would continue to enjoy the SSI status so long as the investment in plant and machinery does not exceed Rs. 3 crore. The Government clarified in March 2000 that if the AA finds the order of the DIC<sup>2</sup> as illegal, he can take up the matter with the latter for revision of the eligibility certificate (EC).

It was noticed that in CTO, special circle, Kottayam, an industrial unit engaged in the manufacture and sale of hawai chappals was registered as an SSI unit under the DIC. The AA, while finalising the assessments for the years 2002-03 and 2003-04 in December 2005, exempted the purchase turnover of rubber for Rs. 9.85 crore treating the unit as an SSI unit though the investment in plant and machinery exceeded the prescribed limit of Rs. 3 crore, during these years. Instead of referring back the matter to the DIC, the AA granted exemption which resulted in non-levy of tax of Rs. 67 lakh.

After the case was pointed out to the department in June 2006, the AA stated (July 2006) that at the time of assessment, the assessee was an SSI unit and till the unit was not declared as a medium and large scale unit by the competent authority, he could follow the directions in the order with him. The reply is not tenable, as the assessee crossed the limit on investment in plant

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<sup>2</sup> District Industries Centre

and machinery during the relevant years and hence ceased to be eligible for the benefit of sales tax exemptions/concessions available to SSI units.

The matter was reported to the Government in February 2007; their reply has not been received (December 2007).

**2.2.5** By the notifications issued in November 1993 and December 1999 under the KGST Act, turnover of sale of products of village industries and turnover of purchase of goods which are taxable at the last purchase point for use in the manufacture of products of village industries within the State by the recognised<sup>3</sup> units are exempted from levy of tax. By this notification, the sale of goods manufactured within the State by any charitable institution is also exempted from levy of tax subject to the condition that its annual turnover does not exceed Rs. 10 lakh.

Further, by another notification issued under the KGST Act in November 1993, SSI units are exempted from the payment of sales tax on the turnover of sale of goods manufactured by them within the State. As per the notification, conversion of rubber latex into centrifuged latex shall not be deemed to be 'manufacture'. It has judicially been held<sup>4</sup> that field latex and centrifuged latex are one and the same commodity for the purpose of taxation.

**2.2.5.1** In CTO, Ponkunnam, while finalising the assessments for the years 1996-97 to 1999-2000 between March and April 2004 of an assessee, the AA exempted purchase/sales turnover of products manufactured by units either registered under SSI but not having the requisite EC or the products on which the exemption was granted were other than those recognised by the KVIB. Irregular grant of exemption resulted in short levy of tax of Rs. 51.68 lakh.

After the case was pointed out to the department in December 2005, the department stated (December 2005) that the assessee was a registered unit under SSI and KVIB and hence eligible for exemption from payment of tax for the sale of its products. The reply is not tenable as either the unit did not have EC though it was registered under SSI, or the products on which exemption was granted were other than those included in the recognition certificate issued by the KVIB.

The matter was reported to the Government in June 2007; their reply has not been received (December 2007).

**2.2.5.2** It was noticed that in CTO, special circle, Kottayam, two SSI units engaged in the conversion of field latex into centrifuged latex were granted eligibility certificate by the DIC for exemption from payment of sales tax. The AA while finalising assessments for the years 2002-03 to 2004-05 between

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<sup>3</sup> The units recognised by the Kerala State Khadi and Village Industries Board (KVIB) and/or Khadi and Village Industries Commission are exempted from levy of tax subject to the condition that the exemption shall be for the period during which the industry remains a village industry as per the specification of the Board.

<sup>4</sup> M/s. Kurian Abraham Pvt. Ltd. Vs. State of Kerala and others 12KTR 235(Ker)

July 2005 and March 2006, allowed exemption from payment of tax on the basis of the aforesaid EC instead of referring the matter back to the DIC. This resulted in non-demand of tax of Rs. 46.96 lakh.

After the case was pointed out to the department in May / June 2006, the AA stated (between May 2006 and June 2006) that the exemption was allowed by the Industries Department and he was bound to follow the direction of higher authorities in granting exemption. The reply is not tenable as the assesseees were not entitled to the exemption as per the conditions of the notification. The AA therefore should have referred the case to the DIC for revision of the EC.

The matter was reported to the Government in January /February 2007; their reply has not been received (December 2007).

**2.2.5.3** In CTO, special circle, Thrissur, while finalising the assessment for the year 2004-05 in July 2005, the AA incorrectly computed the total tax deferred from 1995-96 to 2004-05 as Rs. 1.41 crore instead of Rs. 1.70 crore. This resulted in the short demand Rs. 28.73 lakh.

The case was pointed out to the department in September 2006 and reported to the Government in March 2007; their reply has not been received (December 2007).

**2.2.6** Under entry 106 (ii), of the first schedule to the KGST Act, read with a notification, issued in March 2001, the sales turnover of note book is taxable at the rate of four *per cent* with effect from 1 January 2000. As per the explanation below the above mentioned entry, tax, if any, paid on the purchase of paper out of which such note book is manufactured shall be deducted. The CCT<sup>5</sup> clarified in May 2005 that the question of set off as per the explanation to the said entry does not arise. The clarification of the CCT was not in conformity with the provisions of the Act.

In CTO, Kunnamkulam, while finalising the assessments of four assesseees engaged in the business of paper, note book, stationery etc., for the years 2000-01 and 2001-02 between July 2005 and December 2005, the entire sales turnover of note book for Rs. 5.15 crore with tax effect of Rs. 21.03 lakh was incorrectly exempted from levy of tax though tax due on the purchase turnover of paper (Rs.4.19 crore) out of which note books were manufactured was Rs. 17.09 lakh only. This resulted in short levy of tax of Rs. 3.94 lakh.

After the case was pointed out in January 2007, and reported to the Government in June 2007, the Government stated in October 2007 that exemption was allowed keeping in view the judicial pronouncement<sup>6</sup> and clarification of May 2005 issued by the CCT. The reply is not tenable in view

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<sup>5</sup> Commissioner of Commercial Taxes

<sup>6</sup> Kunnamkulam Book Co. Vs. State of Kerala 9 KTR 400

of the specific entry in the KGST Act, and the fact that the explanation was inserted with effect from 1 January 2000 and the judicial pronouncement related to assessments for the years 1985-86 to 1988-89.

**2.2.7** Under entry 92 of the first schedule to the KGST Act, milk products are assessable to tax at the rate of 12 *per cent* at the point of first sale in the State. It has been judicially held<sup>7</sup> that Amul Tazza milk is not merely pasteurized or toned milk but after pasteurization it is subjected to ultra high temperature for increasing shelf life besides adding vitamins and hence it is taxable as milk product.

In CTO, special circle I, Ernakulam, it was noticed that while finalising the assessment of a dealer for the year 2000-01 in March 2005, turnover of Rs. 17.30 lakh relating to the sale of Nestle milk sold in tetra pack container having a shelf life of 120 days was exempted from levy of tax, instead of being assessed as milk product. This resulted in non-levy of tax of Rs. 2.08 lakh.

After the case was pointed out in December 2005, the department stated in May 2006 that notice has been issued to the assessee in February 2006. Further reply has not been received (December 2007).

The matter was reported to the Government in August 2006; their reply has not been received (December 2007).

### **2.3 Non/short levy of interest**

**2.3.1** Under the KGST Act, where any dealer has failed to include any turnover in any return filed by him or any turnover has escaped assessment, interest shall accrue on the tax due on such turnover with effect from such date on which the tax would have fallen due for payment had the dealer included it in the return relating to the period to which such turnover related. The interest payable shall be at the rate of one *per cent* per month for the first three months and at the rate of two *per cent* per month for the subsequent months of delay upto 31 March 2005 and at the rate of one *per cent* per month thereafter. It has judicially<sup>8</sup> been held by the apex court that where the dealer has not filed the prescribed return of his turnover, the case is clearly one of “escaped assessment”.

**2.3.1.1** In seven CTOs<sup>9</sup> while finalising the assessments of nine dealers for the years 1998-99 to 2003-04 between October 2004 and February 2006, though the AAs levied tax on the suppressed turnover, they failed to levy interest on the tax due on these turnover. This resulted in non-levy of interest of Rs. 91.86 lakh.

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<sup>7</sup> M/s. Gujarat Co-operative Milk Marketing Federation Vs. the State of Kerala 13 KTR 184

<sup>8</sup> Malwa Vanaspati and Chemical Co. Ltd. Vs. Regional AC of Sales Tax, Indore 21 STC 431 (Supreme Court)

<sup>9</sup> CTO Special Circles Alappuzha, Kollam and Tirur, CTOs Angamaly, Cherthala, Perumbavur and IV Circle Thrissur

After the cases were pointed out to the department between May 2005 and February 2007 and reported to the Government between November 2006 and May 2007, the department stated (between May 2005 and February 2007) that the dealers at fourth circle Thrissur and Angamaly were liable to pay interest from the date of demand notice only. In respect of the remaining cases, the Government stated between July 2007 and December 2007 that interest of Rs.75.90 lakh has been demanded in six cases and in the case of a dealer at Cherthala, interest was not leviable as he had not admitted the suppressed turnover. The replies, relating to the cases in which interest was not demanded are not tenable as the suppressions were detected either by the intelligence wing or by the AAs and proved. Hence, the assesseees were liable to levy of interest in view of the specific provision of Section 23(3A) of the KGST Act.

**2.3.1.2** In two CTOs<sup>10</sup> while finalising the assessments of four dealers who had not filed returns for the years 1998-99 to 2001-02, between December 2005 and March 2006, though the AAs levied tax on the suppressed turnover, failed to levy interest of Rs. 65.56 lakh on the tax due on these turnover.

After the cases were pointed out to the department between December 2005 and July 2006 and reported to the Government between November 2006 and April 2007; the Government stated in September 2007 that interest was demanded in two cases. The department stated in the other cases that as the assesseees did not file returns, the element of interest does not arise. The reply is not tenable in view of the specific provision of the Act and the judicial pronouncement.

**2.3.2** Under the KGST Act, if tax or any amount assessed or due under the Act is not paid by any dealer within the time prescribed in the Act or any rules made thereunder or within the time specified in the notice of demand, the dealer shall pay by way of interest a sum equal to one *per cent* of such amount for each month for the first three months of delay and two *per cent* for each month up to 31 March 2005 and at the rate of one *per cent* per month thereafter.

**2.3.2.1** In CTO, special circle, Kottayam, while finalising the provisional assessment of a dealer for the year 2002-03, the AA did not consider the purchase tax on old gold payable during 2001-02. Thus, the compounded tax payable by the dealer was incorrectly worked out as Rs.1.43 crore against the tax payable of Rs.1.79 crore. This resulted in loss of interest of Rs.20.83 lakh due on the differential tax of Rs.36.55 lakh.

After the case was pointed out to the department in July 2006, the AA stated in October 2006 that the assessee had filed returns by self assessment and paid tax accordingly. The reply is not tenable as the AA has incorrectly fixed the tax payable in the provisional assessment resulting in short remittance of tax.

The matter was reported to the Government in April 2007; their reply has not been received (December 2007)

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<sup>10</sup> CTOs II Circle Kalamassery and (WC & LT), Kottayam.

**2.3.2.2** In the CTO, special circle, Thiruvananthapuram and CTO Kothamangalam, two dealers either failed to remit the admitted tax in full or did not pay the tax due in time. The AAs while finalising the assessments for the years 1999-2000 and 2002-03 between March 2004 and April 2005 failed to levy interest for the above omissions. This resulted in the non-levy of interest of Rs.9.19 lakh.

After the cases were pointed out to the department between May and December 2006 and reported to the Government between April and June 2007, the Government stated in August 2007 that interest of Rs.6.61 lakh was demanded in June/July 2007 in the case of a dealer at special circle, Thiruvananthapuram. Reply has not been received in the other case (December 2007).

#### **2.4 Incorrect computation of tax**

The KGST Rules, 1963 and the instructions issued in February 1992 by the erstwhile Board of Revenue (Taxes) lay down departmental procedures for verifying and checking of all calculations and credits given in an assessment order.

**2.4.1** Under entry 9 of schedule II to the KGST Act, rice is taxable at one *per cent* at the point of first sale in the State. It has judicially<sup>11</sup> been held that SSI units are not entitled to exemption on purchase tax under the KGST Act. It has also been judicially<sup>12</sup> held that rice and paddy are two distinct commodities.

During the course of audit it was noticed that in six cases mistakes in computation of tax resulted in non/short levy of tax of Rs. 86.93 lakh and interest of Rs. 62.94 lakh. A few illustrative cases are given below:

(Rupees in lakh)					
Sl. No.	Name of the Office No. of cases	Assessment year/ Month of assessment	Nature of irregularity	Amount of non/short levy	Remarks
1.	CTO, special circle I, <u>Kozhikode</u> 1	<u>2000-01</u> December 2005	While finalising the assessment of a dealer, engaged in the business of sandal wood oil, the AA incorrectly computed tax at 20 <i>per cent</i> on Rs. 3.33 crore as Rs. 6.65 lakh instead of Rs. 66.54 lakh. Interest was also due on the differential tax.	<u>59.89</u> (tax)  <u>60.55</u> (interest)	After the cases were pointed out to the department between October 2005 and November 2006 and reported to the Government between March and April 2007, the Government stated between August and September 2007 that

<sup>11</sup> State of Kerala Vs. M/s Vattukalam Chemical Industries 10 KTR 69(SC)

<sup>12</sup> Raja provision Stores Vs. Appellate Tribunal ( Sales Tax) Thiruvananthapuram 105 STC 325(SC)



(Rupees in lakh)					
Sl. No.	Name of the Office No. of cases	Assessment year/ Month of assessment	Nature of irregularity	Amount of non/short levy	Remarks
2.	CTO, Neyyattinkara 1	2000-01 November 2005	While finalising the assessment of a dealer in rice, the balance tax was incorrectly computed as Rs. 1.45 lakh instead of Rs. 14.52 lakh.	13.07 (tax)	mistakes were rectified in two cases by revising the assessments. Reply has not been received from the Government in one case in which the AA rectified the mistake and issued fresh demand notice for balance tax with interest. Further report has not been received (December 2007).
3.	CTO, special circle III, Ernakulam 1	2001-02 February 2006	While finalising the assessment of a dealer, tax and AST due on Rs. 1.91 crore was incorrectly computed as Rs. 13.90 lakh against Rs. 17.06 lakh.	3.16 (tax)  2.39 (interest)	

**2.4.2** In CTO, special circle, Kottayam, while finalising the CST assessment of a dealer for the year 2000-01 in January 2006, credit of Rs. 45 lakh was afforded for the remittance made vide challan dated 2 September 2001, based on entries made in collection register, though the same amount was credited in the GST assessment of the assessee for the year 2000-01 based on the triplicate copy of the challan. This resulted in affording double credit to the assessee and short demand of Rs. 45 lakh.

After the case was pointed out to the department in June 2006 and reported to the Government in January 2007; the Government stated in September 2007 that the AA rectified the mistake in February 2007. A report on recovery has not been received (December 2007).

## **2.5 Underassessment of turnover**

**2.5.1** 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. Further, the AA shall assess the dealer to the best of his judgment, after making such enquiry as it may consider necessary and after taking into account all the relevant materials gathered by him. The Act also provides that every dealer, who purchases without payment of tax, any taxable goods and consumes such goods in the manufacture of other goods for sale, shall pay tax on the turnover relating to such purchase.

In five offices<sup>13</sup> it was noticed that the AAs while finalising the assessments for the period from 2001-02 to 2003-04 between August 2003 and January 2006 failed to consider taxable turnover of Rs.7.94 crore resulting in short levy of tax of Rs. 56.26 lakh including AST, in seven cases. A few illustrative cases are mentioned below:

<sup>13</sup> CTO Special Circles Kannur and Kollam, CTOs Angamaly, Pathanamthitta and Agriculture Income Tax (AIT) & CTO Alappuzha.

(Rupees in lakh)						
Sl. No	Name of Office No. of cases	Assessment year Month/year of assessment	Nature of irregularity	Turnover assessable assessed short assessment	Tax short levied (including AST)	Remarks
1.	Office of the Inspecting Assistant Commissioner, Pathanamthitta 1	2002-03 September 2005	The AA failed to consider and include the differential turnover of spirit of Rs. 1.39 crore as per the annual accounts/ reports and returns submitted by the dealer	<u>219</u> <u>80</u> 139	32.06	After the case was pointed out to the department in August 2006 and reported to the Government in April 2007; the Government stated in August 2007 that the assessment was revised creating an additional demand. Further report on recovery has not been received (December 2007).
2.	CTO Special circle Kannur 1	2001-02 May 2005	The AA failed to consider and include taxable turnover of Rs. 84.33 lakh returned by the dealer in the monthly return but not included in the annual return	<u>183.87</u> <u>99.54</u> 84.33	9.67	After the matter was pointed out to the department in August 2006 and reported to the Government in June 2007, the Government stated in September 2007 that the assessment was revised in October 2006 and the amount with interest was recommended for revenue recovery in January 2007. A report on recovery has not been received (December 2007).
3.	CTO Angamaly 2	2002-03 and 2003-04 (between February and May 2005)	While finalising/ modifying the assessments of two SSI units, the AAs failed to consider and include the purchase turnover of paddy effected from the co-operative societies without paying tax and used for production of rice.	<u>2,801.97</u> <u>2,297.32</u> 504.65	5.69	After the matter was pointed out to the department between January 2006 and February 2007 and reported to the Government between January and May 2007, the Government stated in July/August 2007 that assessments were revised between August 2006 and March 2007 and demand of Rs. 5.69 lakh was raised. A report on recovery has not been received (December 2007).

**2.5.2** Under Section 59(4) of the KGST Act, goods which were liable to tax at the point of last purchase in the State and are held as closing stock on the date preceding the date of coming into force of the Kerala Value Added Tax (KVAT) Act, 2003, shall be deemed to have acquired the quality of last purchase in the State on such date and tax is to be levied at the rate of four *per cent*.

In CTO, special circle, Kottayam, an assessee engaged in the business of conversion of field latex into centrifuged latex, had a closing stock of latex of Rs. 1.04 crore on 31 March 2005. The AA while finalising the assessment for 2004-05 in March 2006, failed to assess the turnover of closing stock, which resulted in short levy of tax of Rs. 4.17 lakh.

After the matter was pointed out to the department in June 2006 and reported to the Government in January 2007, the Government stated in August 2007 that the assessment was reopened and tax demanded in March 2007. A report on recovery has not been received (December 2007).

## **2.6 Incorrect computation of compounded tax and interest**

Under the provisions of the KGST Act, any dealer in gold or silver ornaments or wares may at his option, pay tax for 2001-02 at 120 *per cent*, for 2002-03 and 2003-04 at 200 *per cent* of the tax payable by him as conceded in the return or accounts for the immediate preceding year or the tax paid for immediate preceding year whichever is higher. The rate applicable for 2004-05 is 130 *per cent* as conceded in the return or accounts or the tax paid for the previous three consecutive years whichever is higher. As per the explanation below the provision, tax payable for the preceding year shall mean tax payable on the sales turnover under Section 5(1) and tax payable on the purchase turnover assessable under Section 5A of the Act. It has judicially<sup>14</sup> been held that an assessee is not entitled to exemption in respect of tax payable at the compounded rate on the purchase tax component of the compounded tax paid for the previous year. The CCT clarified in October 1998 that while computing tax payable by any dealer who has opted for payment of compounded tax, purchase turnover of the preceding year under Section 5A is exempted. The clarification of the CCT was, however, not in conformity with provisions of the KGST Act.

**2.6.1** In three CTOs<sup>15</sup>, while finalising, between January 2004 and October 2005, the assessments of three dealers of gold who had opted for compounded system for the years between 2000-01 and 2003-04, the AAs incorrectly computed the tax payable without considering the purchase turnover of old gold assessable under Section 5A of the Act, for the immediate preceding year. This resulted in short levy of tax of Rs. 54.83 lakh besides interest of Rs. 17.20 lakh.

After the cases were pointed out to the department between June and November 2006 and reported to the Government in March and April 2007, the Government stated between July and December 2007 in the cases of dealers of Ernakulam and Nedumangad that as per the circular of CCT of October 1998 tax payable would not include tax under Section 5A. The reply is not tenable

<sup>14</sup> Prakash Jewellery and another Vs. State of Kerala 12KTR 543(Ker)

<sup>15</sup> CTO Special Circle I Ernakulam, Special Circle Kottayam and CTO Nedumangad

in view of the fact that the circular of 1998 was not in conformity with the provisions of the Act. In the case of the dealer of Kottayam, the department stated in October 2006 that the revision of final assessment was in progress. Further report has not been received (December 2007).

**2.6.2** In CTO, Koothuparamba, while finalising the assessments of two dealers for 2004-05 in March 2006, the AA failed to consider the highest amount of tax assessed for the previous three years for computing the tax at the compounded rate. This resulted in short levy of tax of Rs. 2.04 lakh.

After the matter was pointed out to the department in July 2006 and reported to the Government in December 2006, the Government stated in June 2007 that as the words used in the section are 'tax payable' and 'tax paid' there was no illegality or impropriety in the assessment. The reply is not tenable as tax assessed in previous year would have been paid had effective steps taken for realisation. Further report has not been received (December 2007).

### **2.7 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. As per explanation to entry 64 of first schedule to the KGST Act, even slotted angles when assembled to form furniture or rack shall be deemed to be furniture for the purpose of the entry. Moreover, as per Webster's Encyclopedia even cabinet would also form part of furniture.

In seven offices<sup>16</sup>, it was noticed that while finalising the assessments between January 2002 and December 2005, the AAs short levied tax and additional sales tax of Rs. 65.51 lakh in 11 cases due to application of incorrect rate of tax. A few illustrative cases are mentioned below:

							(Rupees in lakh)
Sl. No.	Name of Office/ No. of cases	Commodity	Assessment year/ Month of assessment	Rate applicable applied	Turn-over	Tax short levied including AST	Remarks
1.	CTO, Angamaly 1	Veneer	1999-2000 March 2004	12/12.5 10	666.00	11.42	After the matter was pointed out to the department in February 2005 and reported to the Government in May 2007, the Government stated in August 2007 that tax was demanded and RR action initiated. Further report has not been received (December 2007).

<sup>16</sup> CTO Special circles I Kozhikode, II Ernakulam, CTOs Angamaly, II Circle Trivandrum, II Circle Palakkad, WC & LT Kottayam & Malappuram.

(Rupees in lakh)

Sl. No.	Name of Office/ No. of cases	Commodity	Assessment year/ Month of assessment	Rate applicable applied	Turn-over	Tax short levied including AST	Remarks
2.	CTO, Special Circle II, <u>Ernakulam</u> 2	Diamond Jewellery	<u>2003-04</u> December 2004	<u>8</u> 4	252.00	11.22 <sup>17</sup>	After the matter was pointed out to the department in December 2005 and reported to the Government in August 2006; their reply has not been received (December 2007).
		Water Filters	<u>2000-01</u> November 2004	<u>12</u> 8	275.00	11.00	After the matter was pointed out to the department in December 2005 and reported to the Government in August 2006, the Government stated in August 2007 that water filter was taxable as electrical goods in view of the direction of Sales Tax Appellate Tribunal in respect of an assessment for the year 1993-94. The reply is not tenable in view of the specific entry for water filter at serial number 116 of the first Schedule.
3.	CTO, Special Circle I <u>Kozhikode</u> 1	Safe and allied products	<u>2001-02</u> November 2005	<u>12</u> 8	192.00	8.41 <sup>18</sup>	After the matter was pointed out to the department in November 2005 and reported to the Government in March 2007; the Government stated in September 2007 that the goods sold by the dealer were security products to suit the specification of RBI for use in banks and were never used as furniture. The reply is not tenable in view of the explanation under the entry 'furniture' in the schedule as well as in Webster's encyclopedia.
4.	CTO, Second Circle, <u>Palakkad</u> 1	Stainless steel household utensils	2003-04 and <u>2004-05</u> Between April and November 2005	<u>12</u> 8	99.30	4.50 <sup>19</sup>	After the matter was pointed out to the department in January 2007 and reported to the Government in April 2007, the Government stated in June 2007 that the assessments were revised in March 2007 creating additional demand of Rs. 4.50 lakh. Further report has not been received (December 2007).

<sup>17</sup> Tax Rs.10,08,100 plus AST Rs.1,13,411 at the rate of 15 per cent from 1 July 2003 to 31 March 2004

<sup>18</sup> Tax Rs.7,67,086 plus AST Rs.73,455 at the rate of 15 per cent from 23 July 2001 to 31 March 2002.

<sup>19</sup> Tax Rs.3,97,209 plus AST Rs.52,386 at the rate of 15 per cent from 1 July 2003 to 31 March 2004/2005.

## **2.8 Loss due to non-issue of modified order and RRC**

Under the provisions of KGST Act, any tax assessed or any other amount due under the Act from a dealer or other person may be recovered as if it were an arrear of land revenue.

In CTO, special circle I, Ernakulam a penalty of Rs. 76.20 lakh was imposed in March 2001 for misuse of 'F' forms and 'C' forms by a dealer during 1996-97 and the amount was advised for revenue recovery in June 2001. In a revision petition filed by the assessee, the revisional authority stayed the collection of penalty, in July 2001, till the disposal of the petition on condition of remittance of Rs. 38 lakh in cash and furnishing of security for the balance within three weeks. The assessee paid the amount of Rs. 38 lakh in August 2001 but security for the balance amount was not furnished. Without obtaining the security, the revenue recovery certificate (RRC) was withdrawn by the AA. While disposing the revision petition in November 2001 the revisional authority reduced the penalty to Rs. 66.20 lakh. Incorrect action of withdrawing the RRC without obtaining security resulted in non-realisation of penalty of Rs. 28.20 lakh and interest of Rs. 31.57 lakh.

After the case was pointed out in October 2006, the department stated in May 2007 that modified order giving effect to the direction of the revisional authority had been issued in February 2007. Further report has not been received (December 2007).

The matter was reported to the Government in January 2007; their reply has not been received (December 2007).

## **2.9 Incorrect grant of concessional rate of tax**

Under the KGST Act, tax payable on sale of industrial raw material which are liable to tax at a rate higher than three *per cent* when sold to industrial units for use in the production of finished goods inside the State for sale shall be at the rate of three *per cent* provided the purchasing dealer issues valid declaration in form 18. Timber is taxable at the rate of 12 *per cent* under entry 8 of the fifth schedule to the KGST Act.

Scrutiny of the records of CTO, Thirurangadi revealed that a dealer had sold timber for Rs. 23.46 lakh against declaration in form 18 to a dealer under CTO, Perumbavur. The RC<sup>20</sup> of the dealer at Perumbavur was cancelled with effect from 31.12.2002 and the information was available in the file of the dealer at Thirurangadi. While finalising the assessment for 2003-04 in February 2005 of the dealer at Thirurangadi, the AA instead of declaring the said form 18 declaration as invalid, incorrectly accepted it and allowed

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<sup>20</sup> Registration certificate

concessional rate of three *per cent*. This resulted in short levy of tax of Rs. 2.43 lakh.

After the matter was pointed out to the department in October 2005 and reported to the Government in March 2007; the Government stated in June 2007 that the assessment was revised and the assessee has filed an appeal against the revised assessment before Deputy Commissioner (Appeals), Ernakulam in June 2007. Further report has not been received (December 2007).

### **2.10 Non-levy of penalty**

Under the KGST Act, the AA shall finalise the assessment of certain specified category of dealers without detailed scrutiny. On reopening such assessment, if the tax paid by the dealer is less than the amount of tax he is liable to pay, the AA shall impose penalty at thrice the amount of such difference.

In CTO, Thaliparamba, while reopening the assessment of a dealer for 2002-03 in December 2005, penalty at thrice the amount of difference between the original and revised amount of tax was not levied. This resulted in non-levy of penalty of Rs. 4.75 lakh.

After the matter was pointed out to the department in April 2006 and reported to the Government in May 2007; the Government stated in July 2007 that penalty had been imposed and the whole amount had been advised for revenue recovery. A report on recovery has not been received (December 2007).

### **2.11 Incorrect compounding**

Under entry 84(i) of the first schedule to the KGST Act, diesel generating sets are taxable at the rate of 12 *per cent* at the point of first sale in the State. It has judicially been held<sup>21</sup> that in the case of divisible contract, the price payable for supply of material is distinct from the consideration payable for installation, commissioning and maintenance.

In CTO, special circle II, Ernakulam while finalising the assessment of a contractor and dealer in generator and pump sets for the year 2001-02 in February 2006, the entire contract amount of Rs. 97.17 lakh for supply and erection of diesel generating sets in respect of six contracts was assessed at the compounded rate of five *per cent* applicable to works contract. Though each of these contracts was clearly divisible into two, one for supply of generating set and another for its erection, failure on the part of the AA to assess the turnover of Rs. 86.53 lakh relating to supply portion of the contract

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<sup>21</sup> State of Tamil Nadu Vs. Titanium Equipments and Anode Manufacturing Corporation Ltd.-  
110 STC 43 (Madras)

at the rate of 12 *per cent*, treating as sale, resulted in short levy of tax and AST of Rs. 6.77<sup>22</sup> lakh.

After the matter was pointed out to the department in December 2006 and reported to the Government in May 2007, the Government stated in September 2007 that the contracts were composite in nature involving transfer of goods and transfer of service which could not be separated. The reply is not tenable as it was noticed from the agreements that the contracts were for supply and delivery of generators with accessories and components at the agreed price and for mechanical erection of generators at a separate agreed erection price. Hence these contracts were divisible into supply and erection contracts. Further report has not been received (December 2007).

### **2.12 Omission to include interest in RRC**

In CTO, Chengannur, while finalising the assessment of a dealer for the year 2001-02 in December 2004, though interest of Rs. 5.61 lakh due upto the date of assessment was worked out and demanded, the AA failed to include the amount of interest in the RRC issued in July 2005. This resulted in short demand of interest of Rs. 5.61 lakh in the RRC.

After the case was pointed out to the department in July 2006 and reported to the Government in April 2007; the Government stated in June 2007 that the original RRC issued in July 2006 was returned by the District Collector with the remarks that the dealer had left India. Further report has not been received (December 2007).

### **2.13 Short levy of surcharge**

Under section 3(1) of the Kerala Surcharge on Taxes Act, 1957, the tax payable under the KGST Act, shall be increased by a surcharge at the rate of 10 *per cent* of the tax payable for the period upto 31 December 1999.

In CTO, special circle, Kottayam, while finalising the assessment of a dealer in coffee for the year 1999-2000, surcharge of Rs.32,000 was levied against the correct amount of Rs. 2.38 lakh. This resulted in short levy of surcharge of Rs. 2.06 lakh.

After the case was pointed out to the department in June 2006 and reported to the Government in January 2007, the Government stated in November 2007 that the mistake was rectified by re-opening the assessment. A report on recovery has not been received (December 2007).

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<sup>22</sup> Tax Rs. 6,05,717 plus AST Rs.71,543 at the rate of 15 *per cent* from 23 July 2001 on Rs. 4,76,956