

## CHAPTER II

### SALES TAX

#### 2.1. Results of Audit

Test check of sales tax assessments and refunds and connected documents of Sales Tax Offices conducted in audit during the year 2002-03 revealed underassessments of tax, non-levy of penalty, etc., amounting to Rs 43.08 crore in 1287 cases which may broadly be categorised as under:

(Rupees in crore)

Sl. No.	Category	Number of cases	Amount
1.	Incorrect grant of exemption	114	14.19
2.	Non-levy/short levy of interest	395	9.23
3.	Incorrect grant of concessional rate of tax	30	3.80
4.	Turnover escaping assessment	175	3.17
5.	Application of incorrect rate of tax	251	2.22
6.	Excess/ double accounting of remittance	21	0.51
7.	Other items not routed through local audit reports	2	3.96
8.	Other lapses	299	6.00
	<b>Total</b>	<b>1287</b>	<b>43.08</b>

During 2002-03, the Department accepted underassessments, etc., of Rs 3.44 crore involved in 118 cases, of which 72 cases involving Rs 1.69 crore were pointed out during 2002-03 and the rest in earlier years. At the instance of Audit, the Department recovered Rs 24.41 lakh involved in 45 cases during the year. Illustrative cases involving Rs 11.65 crore are given in the following paragraphs.

#### 2.2. Incorrect grant of exemption

**2.2.1.** It has been held<sup>Ⓜ</sup> by the High Court of Kerala that latex and centrifugal latex are different commodities. Under the Central Sales Tax Act, 1956, no tax is assessable on inter-State sale of rubber, provided tax under the Kerala General Sales Tax (KGST) Act, 1963, has been paid. Tax on rubber is assessable at the point of last purchase in the State. Centrifugal latex manufactured out of other varieties of latex is exigible to Central Sales Tax (CST) on inter-State sale by the manufacturers.

<sup>Ⓜ</sup> M/s. Supersonic Industrial Complex, Muvattupuzha Vs. Deputy Commissioner of Sales Tax (Law), Ernakulam (2002) 10 KTR 203 Kerala

- On inter-state sale of goods, CST is assessable at the rate applicable to sale of such goods in the State, i.e., KGST rate, in the absence of prescribed declaration.

In Sales Tax Circle, Kottayam and Agricultural Income Tax and Sales Tax Office, Peermade, in six cases, the Assessing Authorities, while finalising the CST assessment for the year 1997-98, 1998-99 and 1999-2000 between May 2001 and August 2001 incorrectly exempted inter-state turnover of centrifugal latex aggregating Rs 21.78 crore resulting in short levy of tax of Rs 2 crore.

On this being pointed out, the Assessing Authority of Kottayam stated in June 2002 that it had finalised the assessments as per instructions issued by the erstwhile Board of Revenue (Taxes). The reply was not tenable in view of the Kerala High Court decision that latex and centrifugal latex are different commodities. The Assessing Authority of Peermade stated in October 2002 that it would examine the case. Further report has not been received (October 2003).

- CST payable on any goods manufactured by Small Scale Industrial (SSI) Unit is only four *per cent*.

In Sales Tax Special Circle, Thrissur, while finalising the assessment of two SSI units for the year 1997-98 in July and August 2001, Assessing Authority incorrectly exempted inter-state sales turnover of Rs 8.02 crore of creamed/centrifugal latex even though latex did not suffer tax under the KGST Act. This resulted in short levy of tax of Rs 32.10 lakh.

On this being pointed out, the Department in one case stated in August 2002 that it had allowed the exemption based on a Circular of erstwhile Board of Revenue (Taxes). The reply was not tenable in view of Kerala High Court decision that latex and centrifugal latex are different commodities. In another case no reply was received (October 2003).

**2.2.2.** Under the KGST Act, 1963, on rubber, that is to say latex, ammoniated latex, centrifugal latex, etc., tax is assessable at the point of last purchase in the State. Latex/ammoniated latex and centrifugal latex, etc., are different commodities as upheld<sup>∞</sup> by the High Court of Kerala.

Under the Kerala Surcharge on Taxes Act, 1957, as it stood up to 31 December 1999, the tax payable under the KGST Act, 1963, shall be increased by a surcharge of 10 *per cent*, provided the turnover exceeds Rs 10 lakh.

In three Sales Tax Special Circles, the Assessing Authorities incorrectly exempted purchase turnover of Rs 6.65 crore treating latex/ammoniated latex

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<sup>∞</sup> M/s. Supersonic Industrial Complex, Muvattupuzha Vs. Deputy Commissioner of Sales Tax (Law), Ernakulam (2002) 10 KTR 203 Kerala

and centrifugal latex as one and the same commodity. This resulted in short levy of tax of Rs 73.85 lakh including surcharge as under:

(Rupees in lakh)

Sl. No.	Name of office	Assessment year and Month and Year of assessment	Name of Commodity and rate of tax	Nature of irregularity	Tax short levied	Remarks
1.	Sales Tax Special Circle, Alappuzha	<u>1997-98</u> November 2001	Ammoniated <u>latex</u> 10%	While finalising the assessment of a dealer, the Assessing Authority incorrectly exempted the purchase turnover of ammoniated latex for Rs 2.92 crore, used in the manufacture of centrifugal latex, from levy of tax.	32.17	On this being pointed out, Government stated in October 2003 that the Department had revised the assessment against which the assessee filed an original petition in the Hon'ble High Court of Kerala. Further developments are awaited (October 2003).
2.	Sales Tax Special Circle, Kottayam (2 dealers)	i) <u>1999-2000</u> August 2001  ii) <u>1998-99</u> April 2001	<u>Rubber latex</u> 10% up to 31 December 1999 and 12% thereafter	While finalising the assessment of a co-operative society, the Assessing Authority incorrectly exempted the purchase turnover of rubber latex for Rs 2.25 crore, used in the manufacture of centrifugal latex, from levy of tax.  While finalising the assessment of a manufacturer of centrifugal latex, the Assessing Authority incorrectly exempted the purchase turnover of rubber latex for Rs 85.30 lakh, from levy of tax.	25.33  9.38	On this being pointed out, the Department stated that it would examine the case. Further report has not been received (October 2003).  On this being pointed out, the Department stated in July 2002 that it had completed the assessment as per instructions from the erstwhile Board of Revenue (Taxes) and before reporting the judgement <sup>∞</sup> . The reply was not tenable as the Assessing Authority failed to revise the assessment even after eight months of the judgement. Further report has not been received (October 2003).
3.	Sales Tax Special Circle, Palakkad	<u>1998-99</u> March 2002	<u>Rubber latex</u> 10%	While finalising the assessment of a dealer, the Assessing Authority incorrectly exempted the purchase turnover of rubber latex for Rs 63.31 lakh used in the manufacture of centrifugal latex, from levy of tax.	6.97	On this being pointed out, the Assessing Authority stated in July 2002 that latex and centrifugal latex were one and the same commodity. The reply was not tenable as latex and centrifugal latex are different commodity as judicially held <sup>∞</sup> . Further report has not been received (October 2003).
<b>Total</b>					<b>73.85</b>	

**2.2.3.** Under the KGST Act, 1963, tax on rubber is assessable at the point of last purchase in the state. In order to prove that a dealer is not the last purchaser in the state, he shall produce the prescribed declaration obtained from the purchaser.

<sup>∞</sup> M/s. Supersonic Industrial Complex, Muvattupuzha Vs. Deputy Commissioner of Sales Tax (Law), Ernakulam (2002) 10 KTR 203 Kerala

In Sales Tax Special Circle, Mattancherry, while finalising in February 2001 the assessment for the year 1996-97 of a dealer, the Assessing Authority exempted the purchase turnover of rubber for Rs 38.97 lakh, from levy of tax, even though the dealer failed to produce the prescribed declaration to prove that he was not the last purchaser. This resulted in short levy of tax (including surcharge) of Rs 4.29 lakh.

On this being pointed out, the Department stated that it had revised the assessment in January 2002. Further report has not been received (October 2003).

**2.2.4.** Under the KGST Act, 1963, tax is assessable on 100 *per cent* Export Oriented Units (EOUs) on their purchases of purchase point taxable goods. Again, every dealer, who purchases without payment of tax any sale point taxable goods and consumes such goods in the manufacture of other goods, shall pay tax on the turnover relating to such purchases.

In the Office of the Inspecting Assistant Commissioner, Commercial Taxes, Pathanamthitta, the Assessing Authority incorrectly exempted the turnover aggregating Rs 12.54 crore relating to purchase point taxable goods and also sale point taxable goods purchased without payment of tax resulting in short levy of tax (including surcharge) of Rs 66.46 lakh as under:

**(Rupees in lakh)**

Sl. No.	Assessment year and month and year of assessment	Name of Commodity and rate of tax	Nature of irregularity	Tax short levied	Remarks
1.	<u>1996-97 &amp; 1997-98</u> August and November 1999	<u>Pepper</u> 5% and <u>Ginger</u> 4% at the point of last purchase in the state	While finalising the assessments of a 100 <i>per cent</i> EOU, the Assessing Authority incorrectly exempted the purchase turnover aggregating Rs 11.64 crore relating to pepper and ginger assessable at its hands, from levy of tax.	62.36	On this being pointed out the Department stated that it had revised the assessment in January 2003 for the year 1997-98 and sent the assessment file for the year 1996-97 to the Deputy Commissioner for <i>suo-motu</i> revision. Further report has not been received (October 2003).
2.	<u>1998-99</u> February 2001	<u>Turmeric</u> 4% at the point of first sale in the state	While finalising the assessment of a dealer, the Assessing Authority incorrectly exempted the purchase turnover of turmeric for Rs 57.88 lakh, effected without payment of tax, from levy of tax.	2.55	On this being pointed out, the Department revised the assessment in January 2003. Further report has not been received (October 2003).
3.	<u>1996-97, 1997-98 &amp; 1998-99</u> (between August 1999 and February 2001)	<u>Cardamom</u> 4% and <u>Cloves, nutmeg and mace</u> 5% at the point of first purchase in the state	While finalising the assessment of a 100 <i>per cent</i> EOU, the Assessing Authority incorrectly exempted the purchase turnover of Rs 31.62 lakh assessable at its hands, from levy of tax.	1.55	On this being pointed out, the Department stated that it had revised the assessments in January 2003 for the years 1997-98 and 1998-99 and it had sent the assessment file for the year 1996-97 to Deputy Commissioner for <i>suo-motu</i> revision. Further report has not been received (October 2003).

Sl. No.	Assessment year and month and year of assessment	Name of Commodity and rate of tax	Nature of irregularity	Tax short levied	Remarks
	Total			66.46	

**2.2.5.** Under the KGST Act, 1963, tax is payable by industrial units in Cochin Export Processing Zone (CEPZ) on their purchases of purchase point taxable goods. Rubber, being exigible to tax at the point of last purchase in the State is assessable to tax at the hands of such units, the rate of tax being five *per cent* for rubber based industrial units.

In Sales Tax, Second Circle, Kalamassery, while finalising (between March 2001 and January 2002) the assessments for the years 1995-96 to 1997-98 of an industrial unit and for the year 1996-97 of another industrial unit in CEPZ engaged in the manufacture of latex gloves, the Assessing Authority incorrectly exempted the purchase turnover of rubber latex aggregating Rs 8.63 crore from levy of tax. This resulted in short levy of tax (including surcharge) of Rs 47.44 lakh.

On this being pointed out, the Department stated that units in CEPZ were eligible for exemption on their purchases and hence it allowed exemption of purchase turnover of raw materials used in the manufacture by such units. The reply was not tenable as no exemption was allowable to units in CEPZ on the purchase turnover of goods assessable at their hands. Further report has not been received (October 2003).

The above cases were reported to Government between March and June 2003. Final reply has not been received (October 2003).

### **2.3. Non-realisation of tax due from Central Government Departments/ Institutions**

Under the KGST Act, 1963, every dealer shall pay tax at the rates specified therein on sale of goods unless specified otherwise. Under the Act, the Central Government shall be deemed to be a dealer and shall be entitled to collect tax on sale of goods. It has been held by the Supreme Court in *Rashtriya Ispat Nigam Ltd Vs State of Andhra Pradesh (and other appeals)*<sup>♦</sup> that transfer of property in goods by contractees to contractors for use in the execution of works contracts constitutes a sale provided value of such goods is deducted from bills or other dues of the contractor. Under the Act, the Assessing Authority may direct any dealer to produce any accounts and such dealer shall comply with such direction. Under the Agricultural Income Tax and Sales Tax Manual, the duties of Sales Tax Officers include, *inter alia*, enforcing of filing

<sup>♦</sup> (1998) 109 STC 425

returns by dealers including Government institutions. On cement, tax is assessable at the point of first sale in the state.

**2.3.1.** It was noticed that in eight Works Contract Assessment Offices\*, while finalising between 1 April 1999 and 31 March 2003 81 works-contract assessments of 41 contractors, cement for Rs 4.74 crore supplied to them between 1997-98 and 2001-2002 by five Divisions of Central Public Works Department (CPWD)\* and five Civil Divisions of Telecom Department/BSNL\* in the State was exempted from levy of tax on the ground that these contractors were not first sellers in the state. However, the Assessing Authorities failed to enquire this fact resulting in non-payment of tax of Rs 59.99 lakh due thereon.

**2.3.2.** Further, on cross-verification by audit with the records in these institutions, it was seen that between 1 April 1997 and 31 March 2002 they issued cement valued at Rs 28.12 crore procured from outside the state, to 337 contractors and recovered the value thereof from them. These institutions were liable to pay tax of Rs 3.71 crore on the value of such cement as first sellers in the state. However, the tax was neither collected nor paid to Government as under:

**(Rupees in lakh)**

Sl. No.	Name of central Government Institution	Value of cement issued					Total value of cement	Amount of tax
		1997-98	1998-99	1999-2000	2000-01	2001-02		
1	CPWD Division Office							
	i) Kochi (Ernakulam)	117.70	70.21	98.16	88.88	32.01	406.96	54.39
	ii) Kottayam	38.01	53.73	28.39	78.47	28.28	226.88	31.67
	iii) Kozhikode	121.87	52.93	100.96	47.32	Nil	323.08	41.42
	iv) Thiruvananthapuram	72.31	85.27	43.73	29.97	Nil	231.28	29.66
	v) Thrissur	39.22	31.85	75.29	38.15	Nil	184.51	23.87
2	Telecom Department/ BSNL Civil Divisions							
	i) Ernakulam (Kochi)	62.44	52.43	63.85	23.46	Nil	202.18	25.86
	ii) Kottayam	Nil	77.58	82.02	16.15	Nil	175.75	22.36
	iii) Kozhikode	100.92	109.14	115.22	125.72	48.57	499.57	67.90
	iv) Thiruvananthapuram	79.13	85.02	128.68	94.72	34.02	421.57	56.23
	v) Thrissur	43.02	52.92	23.52	20.92	Nil	140.38	18.07
	<b>Total</b>	<b>674.62</b>	<b>671.08</b>	<b>759.82</b>	<b>563.76</b>	<b>142.88</b>	<b>2812.16</b>	<b>371.43</b>

This was brought to the notice of the Department and the Government in March 2003. The Commissioner of Commercial Taxes stated in September 2003 that he had communicated the audit observation to all the Assessing Authorities and that he would furnish a further reply. Reply from Government has not been received (October 2003).

\* Offices of the Deputy Commissioners, Commercial Taxes : Alappuzha, Ernakulam, Kollam, Kottayam, Kozhikode, Mattancherry, Thiruvananthapuram and Thrissur

\* See table ibid

## 2.4. Underassessment of turnover

**2.4.1.** Under the KGST Act, 1963, 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 five offices\*, turnover of Rs 6.29 crore involved in 9 cases was incorrectly excluded from levy of tax, resulting in short levy of tax and surcharge of Rs 45.95 lakh. A few examples by way of illustration are given as under:

(Rupees in lakh)

Sl No	Name of office	Assessment year and month and year of assessment	Name of Commodity and rate of tax	Turnover excluded	Nature of irregularity	Tax short levied	Remarks
1.	Sales Tax Special Circle, Kollam (2 cases)	<u>1985-86</u> January 1998  <u>1989-90</u> January 1998	Cashew nut <u>with shell</u> 5%	357.33	Purchase turnover of cashewnut with shell for producing kernel for Rs 7.69 crore was fixed at Rs 1.56 crore against Rs 5.13 crore normally required at two-third of the value of kernel.	23.47	On this being pointed out, the Department revised the assessments in August 2001 raising additional demand of Rs 23.47 lakh and advised the amount in October 2001 for revenue recovery. Further developments have not been reported (October 2003).
2.	Sales Tax Special Circle III, Ernakulam	<u>1997-98</u> November 2001	<u>Cement</u> 12.5%	100	A dealer in cement conceded taxable turnover of Rs 13.28 crore. The Assessing Authority also accepted this turnover. However, tax was levied only on Rs 12.28 crore.	13.75	On this being pointed out, the Assessing Authority stated in September 2002 that the case would be examined. Further report has not been received (October 2003).

**2.4.2.** Under the KGST Act, 1963, tax is leviable on turnover of property involved in execution of works contract. The taxable turnover shall be arrived at after deducting the amounts specified therefor. If the quantum of deduction towards labour charges and other service charges is not ascertainable from the returns/accounts, deduction of 30 *per cent* shall be allowed. Under the Act, on turnover of civil works of buildings, bridges, etc., tax was leviable at the rate of eight *per cent*. Cost of work-in-progress in a year constituted turnover for the purpose of assessment of that year.

In three offices, in the assessments of five contractors of civil works like construction of building, bridges etc., the Assessing Authorities excluded turnover aggregating Rs 1.23 crore from levy of tax resulting in short demand of tax of Rs 10.07 lakh as under.

\* Office of the Deputy Commissioner, Commercial Taxes, Ernakulam  
Sales Tax Special Circles: III Ernakulam, Kannur and Kollam  
Sales Tax Office: Circle II Mattancherry

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

**(Rupees in lakh)**

Sl. No.	Name of office	Assessment year and month and year of assessment	Name of Commodity/ Nature of sale	Turnover excluded	Nature of irregularity	Tax short levied	Remarks
1.	Deputy Commissioner, Commercial Taxes, Kozhikode	<u>1998-99 &amp; 1999-2000</u> January 2001 (2 cases)	Turnover of works contract	35.70	While finalising the assessment of a contractor in civil works for the year 1998-99 and 1999-2000, no tax was levied on turnover of closing work-in-progress aggregating Rs 35.70 lakh.	3.11	On this being pointed out, the Department stated in January and October 2002 that it would examine the case. No further reply has been received (October 2003)
2.	Deputy Commissioner, Commercial Taxes, Ernakulam	<u>1998-99</u> March 2002	Turnover of works contract	34.31	While finalising the assessment of a building contractor, turnover of Rs 34.31 lakh escaped assessment due to wrong carry forward of work in progress in excess (Rs 17.41 lakh) from the previous year and excess deduction (Rs 16.90 lakh) of cost of labour and materials.	3.02	On this being pointed out, it was stated in June 2002 by the Department that the case would be examined. Further reply has not been received (October 2003).
3.	Deputy Commissioner, Commercial Taxes, Kozhikode	<u>1996-97 &amp; 1997-98</u> June 2000	Turnover of works contract	36.27	While finalising the assessments of a contractor in civil works, after making deduction towards labour and other charges at the prescribed rate for both the years, a further deduction of establishment expenses and value of consumables was allowed resulting in escapement of turnover aggregating Rs 36.27 lakh.	2.83	On this being pointed out, the Department stated in January 2002 that it would examine the case. Further report has not been received (October 2003).
4.	Sales Tax Special Circle, Kottayam	<u>1996-97</u> January 2001	Turnover of works contract	16.88	While finalising the assessment for the year 1996-97 of a dealer, the value of works contract of Rs 16.88 lakh awarded to unregistered contractors escaped assessment.	1.11	On this being pointed out, the Department stated in January 2002 that the assessee was a Central Government autonomous body and hence not a dealer. However, this autonomous body was a registered dealer on the rolls of the same Assessing Authority. Further report has not been received (October 2003).
	<b>Total</b>			<b>123.16</b>		<b>10.07</b>	

**2.4.3.** Under the KGST Act, 1963, with effect from 1 April 1999, a dealer in jewellery may pay tax at the compounded rate of 120 *per cent* of the tax payable as conceded in the returns/accounts for the immediate preceding year. If the dealer has paid compounded tax during the preceding year, the compounded tax for the year shall be 120 *per cent* of the tax calculated as above or 120 *per cent* of the compounded tax of the preceding year paid or payable, whichever is higher.

In Sales Tax Special Circle, Thrissur, a dealer in jewellery conceded in his return/accounts for the year 1999-2000, tax of Rs.14.48 lakh including tax on old ornaments. Instead of fixing tax for the year 2000-01 at Rs 17.37 lakh calculated at 120 per cent of this amount, tax was assessed in December 2001 at Rs 16.04 lakh calculated at 120 per cent of the compounded tax of Rs 13.37 lakh for the year 1999-2000. This resulted in short levy of tax of Rs 1.33 lakh.

On this being pointed out, it was stated in July 2002 by the Assessing Authority that turnover of old ornaments was not to be included for arriving at the compounded tax. The reply is not tenable in view of the provision in the Act, for inclusion of turnover of old ornaments also, for arriving at the taxable turnover. Further reply has not been received (October 2003).

**2.4.4.** Under the KGST Act, 1963, turnover of sale of products manufactured by village industries recognised by the Kerala Khadi and Village Industries Board is exempted from levy of tax where total turnover does not exceed ten lakh rupees.

In Sales Tax Office, Kothamangalam, while finalising in January 2002, the assessment for the year 1999-2000 of an industrial unit, recognised by the Kerala Khadi and Village Industries Board, the Assessing Authority incorrectly excluded sales turnover of handmade soap for Rs 78.18 lakh for the period 1 January 2000 to 31 March 2000. This resulted in short levy of tax of Rs 3.13 lakh.

On this being pointed out, the Department stated in February 2003 that Government issued a notification exempting Khadi and Village Industries units from payment of tax on goods sold by them. The reply is not tenable as the exemption was effective from 1 April 2000 onwards. Further report has not been received (October 2003).

**2.4.5.** Under the KGST Act, 1963, “goods” means all kinds of movable property. It has been held<sup>▼</sup> by the High Court of Kerala that sale of SIM cards is exigible to tax under the Act.

In Sales Tax Special Circle I, Ernakulam, while finalising in July 2000 the assessment for the year 1996-97 of a dealer, the Assessing Authority

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▼ M/s. Escotel Mobile Communications Ltd. Vs. Union of India and others (2002) 10 KTR 318 (Ker)

incorrectly excluded sales turnover of SIM cards for Rs 17.33 lakh from levy of tax, on the contention that SIM cards did not fall under the definition of “goods”. This resulted in short levy of tax of Rs 1.91 lakh including surcharge.

On this being pointed out, it was stated by the Assessing Authority in September 2002 that the assessment was being revised. Further report has not been received (October 2003).

**2.4.6.** Under the KGST Act, 1963, every dealer, who purchases without payment of tax, any taxable goods and consumes such goods in the manufacture of other goods, shall pay tax on the taxable turnover relating to such purchase. On iron and steel, tax was leviable at the rate of four *per cent* and on articles of iron or steel in combination with other metals at the rate of 10 *per cent*, at the point of first sale in the state.

In Sales Tax Second Circle, Thalasserry, while finalising in March 1998 the assessment for the year 1996-97 of a manufacturer of machinery, turnover of raw materials for Rs 14.56 lakh, purchased without payment of tax and used in the manufacture of machinery for Rs 20.80 lakh, was not assessed to tax. This resulted in short levy of tax and surcharge of Rs 1.26 lakh.

On this being pointed out, the Department revised in November 2001 the assessment and created additional demand of Rs 1.09 lakh. Further report has not been received (October 2003).

**2.4.7.** Under the KGST Act, 1963, tax on sand was assessable at the rate of eight *per cent* at the point of first sale in the state. It has been judicially held<sup>▼</sup> that royalty is consideration for sales tax assessment.

In Sales Tax Special Circle, Kollam, while finalising in February 2001 the assessment for the year 1996-97 of a manufacturer of minerals using mineral sand, the Assessing Authority did not levy tax on royalty of Rs 55.45 lakh paid in consideration for mineral sand on which the dealer paid no tax. This resulted in non-levy of tax and surcharge of Rs 4.89 lakh.

On this being pointed out, the Department revised the assessment in November 2001. Further report has not been received (October 2003).

**2.4.8.** Under the KGST Act, 1963, a transfer of right to use any goods for any purpose (whether or not for a specified period) for consideration shall be

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<sup>▼</sup> Cooch Bihar Contractors' Association & others Vs. State of West Bengal and others (1996) 4 KTR 397 SC

deemed to be a sale and taxed at prescribed rates at all points of such transfers. Lease rent received or receivable is turnover under the Act.

In Sales Tax First Circle, Ernakulam, while finalising in May 2001 and March 2002 the assessments for the years 1997-98 and 1998-99 of a leasing company, the Assessing Authority incorrectly excluded lease equalisation charges aggregating Rs 1.32 crore (transferred to profit and loss account from the gross rental of Rs 3.92 crore) from levy of tax resulting in short levy of tax and surcharge of Rs 8.72 lakh.

On this being pointed out, it was stated by the Department in June 2002 that the deduction was allowed following the accounting principles adopted by the dealer. The reply was not tenable as lease rent received or receivable in a year was liable to levy of tax and the method of accounting had no bearing on the provisions in the Act. Further report has not been received (October 2003).

**2.4.9.** Under the KGST Act, 1963, taxable turnover of works contract in civil works shall be arrived at after deducting the amounts specified therefor. Hire charges for vehicles for transportation of materials to the work site is not an admissible deduction.

In the Office of the Deputy Commissioner, Commercial Taxes, Kozhikode, while finalising the assessment in January 2001 for the year 1999-2000 of a civil works contractor, the Assessing Authority incorrectly exempted hire charges of Rs 30.52 lakh of vehicles used for transportation of materials from levy of tax resulting in short demand of tax of Rs 2.62 lakh including surcharge.

On this being pointed out, the Department stated in January 2002 that it would examine the case.

The above cases were reported to Government between February and June 2003. Government accepted in August 2003 the observations in one case. Replies in respect of the remaining cases have not been received (October 2003).

## **2.5. Non-demand of tax**

**2.5.1.** Under the KGST Act, 1963, SSI Units and Medium/ Large Scale Industries are exempted from payment of tax to the extent quantified by the Industries Department. Tax payable on goods manufactured and sold within the State and on purchase of last purchase-point taxable goods used in the manufacture of other goods for sale within the State or inter-State sale are eligible for exemption. Tax on sale-point taxable goods purchased in

circumstances in which no tax has been paid, has to be remitted to Government as per a judicial decision<sup>#</sup>.

In six offices<sup>♥</sup>, in nine cases, tax and surcharge of Rs 43.76 lakh determined in assessments was incorrectly set off against the quantified tax exemption, instead of demanding it. A few illustrative cases are given below.

**(Rupees in lakh)**

Sl. No.	Name of office	Assessment year and month and year of assessment	Name of Commodity and Rate of tax	Nature of irregularity	Tax not demanded	Remarks
1.	Sales Tax Second Circle, Palakkad	<u>1996-97</u> March 2001	<u>Rubber latex</u> 5% for rubber based industrial units	While finalising the assessment of a medium/large scale industrial unit manufacturing rubber products, the Assessing Authority incorrectly set off the tax due on the purchase turnover of latex amounting to Rs 2.68 crore used in the manufacture of goods exported, against the quantified amount of tax exemption instead of demanding it.	14.72	On this being pointed out, no reply has been received (October 2003).
2.	Sales Tax First Circle, Thiruvananthapuram	<u>1995-96 to 1997-98</u> May 2000	<u>Firewood</u> 12% up to 31 March 1997 and 12.5% thereafter	An SSI unit purchased firewood for Rs 67.19 lakh without payment of tax. While finalising the assessment, the Assessing Authority levied tax at incorrect rates and set off the tax against the quantified amount of exemption instead of demanding it as it did not suffer tax at the purchase stage.	9.93	On this being pointed out, the Department did not furnish any reply (October 2003).
3.	Sales Tax Second Circle, Ernakulam	<u>1998-99 &amp; 1999-2000</u> May 2000 and February 2001	<u>Iron scrap</u> 4%	While finalising the assessments of an SSI Unit, the Assessing Authority levied tax on iron scrap of Rs 1.47 crore purchased without payment of tax and adjusted the tax against the quantified amount of tax exemption, instead of demanding it.	5.90	On this being pointed out, the Department revised in May 2002 the assessment for the year 1998-99 and demanded tax of Rs 4.70 lakh. The details of revision of the assessment for the year 1999-2000 had not been reported (October 2003).
4.	Sales Tax Second Circle, Palakkad	<u>1995-96 to 1998-99</u> between September 2000 and January 2001	<u>Lime shell</u> 4%	While finalising the assessments of four SSI Units, which purchased lime shell aggregating Rs 79.69 lakh without payment of tax, the Assessing Authority levied tax thereon and set it off against the quantified amount of tax exemption, instead of demanding it.	3.51	On this being pointed out, the Assessing Authority revised in December 2001 the assessments creating additional demands. Further report has not been received (October 2003).

<sup>#</sup> State of Kerala Vs. M/s. Vattukalam Chemicals Industries (2002) 10 KTR 69 (SC)

<sup>♥</sup> Sales Tax Special Circle, Kasaragod.

Sales Tax Offices: Ernakulam II, Haripad, Muvattupuzha, Palakkad II, Thiruvananthapuram

Sl. No.	Name of office	Assessment year and month and year of assessment	Name of Commodity and Rate of tax	Nature of irregularity	Tax not demanded	Remarks
5.	Sales Tax Special Circle, Kasaragod	1995-96 March 1998	Timber 12%	While finalising the assessment of a SSI Unit, Assessing Authority levied tax on firewood for Rs 23.29 lakh, purchased without payment of tax and set off the tax due thereon against the quantified amount of tax exemption, instead of demanding it.	3.07	On this being pointed out, the Assessing Authority stated in April 2002 that it would examine the case. Further report has not been received (October 2003).

Out of the above nine cases, the Department accepted audit observations in five cases of Rs 14.32 lakh and revised assessments in three cases creating additional demand of Rs 5.98 lakh. Final report has not been received in remaining cases (October 2003).

The above cases were reported to Government between March and June 2003; their reply has not been received (October 2003).

**2.5.2.** Under the KGST Act, 1963, tax payable by any dealer on the sale of industrial raw materials to 100 *per cent* EOU is exempted from levy of tax. However, this exemption is not allowable to EOUs on the purchase of purchase-point taxable goods as clarified by Government in March 1994 that such units were not eligible for exemption from such tax.

In the Office of the Inspecting Assistant Commissioner, Commercial Taxes, Pathanamthitta, the Assessing Authority assessed in February 2001 tax of a 100 *per cent* EOU for the year 1998-99 on turnover of Rs 5.31 crore relating to pepper and ginger taxable at the point of last purchase and nutmeg and mace taxable at the point of first purchase. However, it did not demand tax and surcharge amounting to Rs 23.93 lakh on the plea that the dealer was a 100 *per cent* EOU.

On this being pointed out, the Department revised the assessment in January 2003 creating additional demand of Rs 23.93 lakh. Further report has not been received (October 2003).

The case was reported to Government in June 2003; their reply has not been received (October 2003).

## **2.6. Non-demand/short levy of interest**

Under the KGST Act, 1963, if the tax due is not paid within the time prescribed, the dealer shall, pay interest. Where any dealer has failed to include any turnover in any return filed or any turnover has escaped

assessment, interest shall accrue from such date, on which tax would have fallen due for payment.

In 11 offices\*, the Assessing Authorities either failed to levy or short levied interest amounting to Rs 64.86 lakh in 15 cases.

On this being pointed out, the Department accepted audit observations in nine cases involving Rs 25.61 lakh and raised demand of Rs 22.66 lakh in seven cases. Final reply has not been received in remaining cases (October 2003).

The above cases were reported to Government between March and June 2003; their reply has been received only in three cases. Replies in the remaining cases have not been received (October 2003).

### 2.7. Short levy due to application of incorrect rate of tax

Under the KGST Act, 1963, rate of tax depends on the nature of sale, point of sale and also on the kind of commodity.

In 17 Sales Tax Offices#, tax was levied at incorrect rates in 19 cases resulting in short levy of tax of Rs 60.81 lakh including surcharge. A few illustrative cases are given under:

<b>(Rupees in lakh)</b>								
Sl. No	Name of office	Assessment year and month and year of assessment	Name of commodity	Rate of tax		Turnover subjected to tax at the incorrect rate	Tax short levied	Remarks
				Applicable	Applied			
1.	Sales Tax Special Circle, Thiruvananthapuram	<u>1995-96,</u> <u>1996-97 &amp;</u> <u>1998-99</u> (between March 1997 and March 2000)	Stainless steel kitchen sinks	12.5%	10%	631.08	17.35	On this being pointed out, the Department revised in July 2002 the assessment for the year 1998-99 creating additional demand of Rs 5.19 lakh. Report on revision of assessment for the years 1995-96 and

\* Sales Tax Special Circles : Ernakulam II, Ernakulam III, Mattancherry, Mattancherry (Hill Produce), Kozhikode I

Sales Tax Circle Offices : Ernakulam IV, Kalamassery I, Kozhikode II, Kozhikode V, Tripunithura II and Sales Tax Office, Vaikom

# Offices of the Deputy Commissioner, Commercial Taxes : Kozhikode and Thiruvananthapuram Office of the Inspecting Assistant Commissioner, Commercial Taxes : Pathanamthitta

Sales Tax Special Circles : Alappuzha, II Ernakulam, III Ernakulam, Kannur, I Kozhikode, Mattancherry, Palakkad, and Thiruvananthapuram

Sales Tax Offices : Mavelikkara, Circle I Kalamassery, Circle II Kalamassery, Circle II Kottayam, Kuthiathode and Circle II Palakkad

Sl. No	Name of office	Assessment year and month and year of assessment	Name of commodity	Rate of tax		Turnover subjected to tax at the incorrect rate	Tax short levied	Remarks
				Applicable	Applied			
								1996-97 has not been furnished so far (October 2003).
2.	Sales Tax Special Circle, Mattancherry	<u>1996-97</u> March 2001	Turnover of works contract (a) Supply and fitting/installation of electrical goods/equipments and (b) 'Supporting steel for equipment platform etc., in the new factory building'	7%	5%	262.12	7.29	On this being pointed out, the Department revised the assessment in November 2001. Further reply has not been received (October 2003).
				5%	2%	46.04		
3.	i) Sales Tax Special Circle II, Ernakulam	<u>1997-98</u> January 2001	Firewood	12.5%	6%	16.16	1.16	On this being pointed out, the Department revised in March 2002 the assessment and raised demand for Rs 1.16 lakh. Further report has not been received (October 2003).
	ii) Sales Tax Special Circle, Kannur	<u>1998-99</u> January 2002	Timber	12.5%	4%	41.63	3.54	On this being pointed out, the Department stated in October 2002 that it would revise the assessment. Further report has not been received (October 2003).
4.	Sales Tax Second Circle, Kalamassery	<u>1996-97</u> March 2001	Readymade garments	10 % up to 28 July 1996 and 5% there after.	6%	Tax at 6% was assessed on Rs 6.74 crore instead of levying tax at 10% on Rs 2.19 crore and at 5% on Rs 4.55 crore	4.64	On this being pointed out, the Department issued in September 2001 notice for revision of the assessment. Further report has not been received (October 2003).
5.	Sales Tax Special Circle III, Ernakulam	<u>1997-98</u> September 2000 <u>1998-99</u> March 2001	<i>Kolinchi</i> (wild ginger), Mango ginger and Kasturi turmeric	10%	4%	65.64	4.33	On this being pointed out, the Department revised the assessment in December 2001 and raised demand for Rs 4.33 lakh. Further report has not been received (October 2003).

Sl. No	Name of office	Assessment year and month and year of assessment	Name of commodity	Rate of tax		Turnover subjected to tax at the incorrect rate	Tax short levied	Remarks
				Applicable	Applied			
6.	Sales Tax Office Second Circle, Kottayam	<u>1996-97</u> October 2000	Tread Rubber	10%	3%	46.40	3.57	On this being pointed out, Government stated that the Department had revised the assessment in January 2002 and advised the amount due to Government for revenue recovery in January 2003. Collection particulars are awaited (October 2003).
7.	Sales Tax Special Circle I, Kozhikode	<u>1996-97</u> , <u>1997-98 &amp; 1998-99</u> February 2002	Soda and Cola	12.5% up to 28 July 1996 and 20% up to 31 March 1999	6%	21.95	3.25	On this being pointed out, the Department stated in September 2002 that the turnover of beverages like soda and soft drinks sold/served in bar attached hotels/restaurants, along with cooked food was taxable at six <i>per cent</i> . The reply is not tenable in view of the specific entry for soda and cola in the Schedule to the Act. Further report has not been received (October 2003).

On this being pointed out, the Department accepted audit observations in 15 cases of Rs 54.01 lakh and revised assessments in 11 cases creating additional demand of Rs 25.54 lakh. Final reply has not been received in remaining cases (October 2003).

The above cases were reported to Government between February and June 2003; their reply has been received in two cases in September 2003 and reply in other cases was pending (October 2003).

## 2.8. Non-levy of penalty

**2.8.1.** Under the KGST Act, 1963, the Assessing Authority 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 Assessing Authority shall impose penalty at thrice the amount of such difference. Under the Act, if a dealer other than

the above has submitted an untrue return, the Assessing Authority may impose penalty not exceeding twice the amount of tax evaded or sought to be evaded.

In an office<sup>♦</sup>, penalty for filing of untrue return in a case and in four offices<sup>♦</sup>, penalty on additional demand arising on reopening the assessments originally completed without detailed scrutiny of accounts in five cases, was not imposed resulting in non-levy of penalty of Rs 34.59 lakh. A few examples by way of illustration are given below.

(Rupees in lakh)

Sl. No.	Name of office	Assessment year/month and year of revision	Nature of irregularity	Amount of penalty	Remarks
1.	Office of the Inspecting Assistant Commissioner, Commercial Taxes, Wynad at Sultan Bathery	<u>1998-99</u> November 2000 and August 2001	The Assessing Authority on reopening the original assessment completed in October 2000 without detailed scrutiny of accounts created additional demand of Rs 6.48 lakh on levying tax on concealed turnover. However, it did not levy penalty.	19.43	On this being pointed out, the Department stated in January 2002 that it was not mandatory to impose penalty. The contention was not correct as the Act provides for imposition of penalty on reopening an assessment which was finalised without detailed scrutiny. Further report has not been received (October 2003).
2.	Sales Tax First Circle, Kannur	<u>2000-01</u> May 2002	The Assessing Authority on reopening the original assessment completed in December 2001 without detailed scrutiny of accounts created additional demand of Rs 2.38 lakh on levying tax on concealed turnover. However, it did not levy penalty.	7.13	On this being pointed out, the Department stated in November 2002 that it would take action to impose penalty. Further report has not been received (October 2003).
3.	Agricultural Income Tax and Sales Tax Office, Kuthiathode	<u>1996-97</u> January 2001	The Assessing Authority disallowed the incorrect exemption of Rs 14.38 lakh claimed by the assessee and levied tax of Rs 1.80 lakh. However, it omitted to impose penalty.	3.60	On this being pointed out, Government stated in August 2003 that the Department had imposed penalty of Rs 3.60 lakh in October 2002 and had advised the amount for revenue recovery. Further report has not been received (October 2003).

On this being pointed out, the Department accepted audit observations in three cases involving Rs 12.37 lakh and imposed penalty of Rs 5.24 lakh in two cases. Final report has not been received in remaining cases (October 2003).

The cases were reported to Government between March and June 2003; their reply has been received in August 2003 in two cases and in other cases reply was pending (October 2003).

<sup>♦</sup> Agricultural Income Tax and Sales Tax Office, Kuthiathode

<sup>♦</sup> Office of the Inspecting Assistant Commissioner, Commercial Taxes, Wynad at Sultan Bathery

Sales Tax Offices: Circle II Alappuzha, Circle I Kannur and Kottarakkara

**2.8.2.** Under the Central Sales Tax Act, 1956, if a registered dealer purchases any goods not covered by his certificate of registration, the Assessing Authority may impose, by way of penalty, a sum not exceeding one and a half times of KGST as if the purchase had been made without the support of the prescribed declaration i.e., Form 'C'.

In Sales Tax Special Circle, Mattancherry, a dealer in rubber chemicals, purchased during the year 1996-97 stainless steel storage tank valued at Rs 5.52 lakh, an item which was not included in his certificate of registration, issuing the prescribed declaration in Form 'C'. The Assessing Authority while finalising the assessment in February 2001 did not impose any penalty which could extend up to Rs 1.04 lakh.

On this being pointed out, the Department imposed penalty of Rs 1.08 lakh in March 2002. Further report has not been received (October 2003).

The case was reported to Government in June 2003; their reply has not been received (October 2003).

## **2.9. Non-realisation of sales tax on royalty for right to use water**

Under the KGST Act, 1963, a transfer of right to use any goods for any purpose (whether or not for a specified period) for consideration shall be deemed to be a sale, the rate of tax being six *per cent* up to 31 December 1999 and eight *per cent* thereafter at all points of such transfers. It has been held by the Supreme Court in Cooch Bihar Contractors' Association and others Vs State of West Bengal and others<sup>^</sup> that royalty is consideration for sales tax assessment.

On direction issued in January 1991 from the Government, Kerala State Electricity Board (KSEB), a registered dealer on the rolls of Sales Tax Special Circle, Thiruvananthapuram, collected Rs 3.41 crore during the period March 1994 to March 2002 from M/s Carborandum Universal Ltd., (CUMI) towards royalty and cost for controlled release of water from the Maniyar Hydro Electric Project in Pathanamthitta District of KSEB for use in the production of electrical energy. Allowing one *per centum* towards cost of controlled release of water (adopting the rate for charges of collection of electricity duty) royalty on water released to CUMI amounted to Rs 3.38 crore. However, tax of Rs 25.03 lakh on this amount including surcharge and/or additional sales tax was neither collected from CUMI nor paid to Government by KSEB.

The case was brought to the notice of the Department and the Government in July 2003; their reply has not been received (October 2003).

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<sup>^</sup> (1996) 4 KTR 397 (SC)

**2.10. Incorrect grant of concessional rate of tax**

**2.10.1.** Under the KGST Act, 1963, tax payable on the sale of industrial raw materials which are liable to tax at a rate higher than four *per cent* when sold to industrial units for use in the production of finished products inside the state for sale shall be three *per cent* subject to certain conditions. It has been specified that this concession is not admissible, if the finished products are exported out of the territory of India. Where any dealer fails to make use of the goods for the purpose for which such goods were purchased, he shall be liable to pay the differential tax.

In Sales Tax Second Circle, Mattancherry and Agricultural Income Tax and Sales Tax Office, Kuthiathode, five dealers exported between 1997-98 and 1999-2000, out of the territory of India, goods manufactured using raw materials purchased for Rs 1.28 crore paying tax at the concessional rate of three *per cent*. While finalising the assessments (between June 2000 and March 2002) for the years 1997-98, 1998-99 and 1999-2000 the assessing authorities failed to levy the differential tax which resulted in short levy of tax and surcharge of Rs 10.19 lakh.

On this being pointed out, the Assessing Authority of Kuthiathode stated in July 2002 that it would examine the cases. The Assessing Authority of Mattancherry issued notice in July 2002 to rectify the defect. Further report has not been received (October 2003).

**2.10.2.** SSI Units with turnover up to Rs 50 lakh, shall be eligible for the concessional rate of four *per cent* on the goods manufactured and sold by them. In cases where the turnover exceeds Rs 50 lakh, the concessional rate shall be available on Rs 50 lakh and tax on the turnover in excess thereof shall be levied at the appropriate rate and no concession shall be available in the subsequent years in which the total turnover exceeds Rs 50 lakh.

- In Sales Tax Office, Angamali, while finalising in May 2000 the assessment for the year 1998-99 of a dealer, the Assessing Authority levied tax at the rate of four *per cent* against 12.5 *per cent* on the turnover of Rs 40.52 lakh, though the turnover of the dealer had exceeded Rs 50 lakh during 1997-98. This resulted in short levy of tax and surcharge of Rs 3.79 lakh.

On this being pointed out, the Department stated in July 2002 that it had issued notice to rectify the defect. Further report has not been received (October 2003).

- In three offices<sup>▼</sup>, while finalising between November 2000 and March 2001 the assessments for the year 1997-98 of three SSI Units, the Assessing Authorities levied tax at the rate of four *per cent* against the correct rate of eight/ten *per cent* on turnover of sale of manufactured goods valued at Rs 67.15 lakh, though the turnover exceeded Rs 50 lakh during 1996-97 as well as 1997-98 in all the cases. This resulted in short levy of tax of Rs 3.82 lakh.

On this being pointed out, the Assessing Authorities of two offices issued in February and July 2002 notices to revise the assessments. The Assessing Authority of the other office has not furnished any reply (October 2003).

The above cases were reported to Government during March and April 2003; their reply has not been received (October 2003).

### **2.11. Incorrect accounting of remittance**

Under the KGST Rules, 1963 the Assessing Authority, while making a final assessment, shall examine what amount is due from the dealer on final assessment after deducting tax already paid and demand the amount from the dealer. Instructions issued in February 1992 by erstwhile Board of Revenue (Taxes), lay down Departmental procedure for verifying and checking of all calculations of turnover and tax and credits given in an assessment.

**2.11.1.** In Sales Tax, Special Circle (Hill Produce), Mattancherry, while finalising the reassessment in October 2001 of a dealer for the year 1990-91, tax of Rs 10.64 lakh remitted by the dealer in December 1990, was incorrectly reckoned as Rs 16.64 lakh. This resulted in affording of excess credit of Rs 6 lakh.

On this being pointed out, the Assessing Authority stated in April 2002 that it had allocated Rs 6 lakh to rectify the mistake from another remittance in March 1999 of Rs 15 lakh made by the dealer and hence there was no excess credit in the revised order. The reply was not tenable since Rs 15 lakh remitted by the dealer related to turnover tax. Further report has not been received (October 2003).

**2.11.2.** In Sales Tax Special Circle II, Ernakulam, while finalising in March 2001 the assessment of a dealer for the year 1995-96, the Assessing Authority excluded from assessment turnover of works contract involving tax of Rs 3.42 lakh. This amount of tax remitted by the dealer was incorrectly adjusted

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<sup>▼</sup> Sales Tax Special Circle, Mattancherry, Sales Tax Office Haripad and Sales Tax Office, Kodungallur

against the tax on sale of goods resulting in short demand of tax of Rs 3.42 lakh.

On this being pointed out, the Assessing Authority stated in October 2001 that it would withdraw the excess credit, but it had taken no action to rectify the same so far (October 2003).

**2.11.3.** In Sales Tax Special Circle (Hill Produce), Mattancherry, while finalising in December 2001 the assessments of a dealer for the year 1997-98, Rs 1.67 lakh remitted towards CST for January 1998 was given credit in both CST and KGST assessments resulting in short demand of KGST of Rs 1.67 lakh.

On this being point pointed out, the Assessing Authority stated in June 2002 that it would rectify the defect. Further report has not been received (October 2003).

The above cases were reported to Government during March and June 2003; their reply has not been received (October 2003).

## **2.12. Incorrect computation of tax**

Under the KGST Act, 1963, a dealer in jewellery may pay compounded tax which shall be 150 *per cent* of the maximum amount of tax payable for a period of 12 months in a financial year as conceded by him in any of the three financial years immediately preceding the assessment year. With effect from April 1998, where a dealer has paid compounded tax during the preceding year, the compounded tax for the succeeding year shall be 125 *per cent* of such tax paid or the tax calculated as above whichever is higher.

**2.12.1.** In Sales Tax Office, Pala, while finalising in September 2000 the assessments for the years 1997-98 and 1998-99 of a jeweller, tax payable at compounded rate was computed as Rs 3.55 lakh against Rs 4.95 lakh due. This resulted in short levy of tax and surcharge of Rs 1.54 lakh.

On this being pointed out, Government stated in September 2003 that the Department had revised the assessments raising an additional demand of Rs 1.54 lakh. It was further stated that an amount of Rs 0.90 lakh was collected through revenue recovery and the balance amount was pending collection. Further report has not been received (October 2003).

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

In Sales Tax Special Circle, Kasaragod, while finalising in November 2001 the assessment of a dealer for the year 1997-98, the Assessing Authority erroneously interchanged the turnovers of raw rubber taxable at the rate of 10 *per cent* and dry ginger taxable at the rate of four *per cent* as Rs 1.29 lakh and Rs 20.20 lakh respectively. This resulted in short levy of tax and surcharge of Rs 1.25 lakh.

On this being pointed out in June 2002, the Department has not furnished any reply (October 2003).

**2.12.3.** Under the Central Sales Tax Act, 1956, on inter-state sale of goods other than declared goods not supported by the prescribed declaration in Form 'C', tax is leviable at the rate of 10 *per cent* or at the rate applicable to sale within the state whichever is higher.

In Special Circle, Kollam, while finalising the CST assessment for the year 1996-97 of a dealer in March 2001, the Assessing Authority did not levy tax at the prescribed rates on turnover of goods worth Rs 34.43 lakh not supported by valid Form 'C'. This resulted in short levy of tax of Rs 1.16 lakh.

On this being pointed out, the Department issued notice in November 2001 to rectify the defect. Further report has not been received (October 2003).

The above cases were reported to Government between February and April 2003; their reply has not been received (October 2003).

### **2.13. Non-forfeiture of surcharge collected**

Under the Kerala Surcharge on Taxes Act, 1957, the tax payable under the KGST Act, 1963, shall be increased by a surcharge of 10 *per cent* provided the turnover exceeds Rs 10 lakh and the same shall not be passed on to the purchaser. Under the Act, if any person collects any sum by way of surcharge, he shall be liable to pay penalty not exceeding five thousand rupees and any sum so collected shall be liable to be forfeited to Government.

In the Office of the Deputy Commissioner, Commercial Taxes, Kozhikode in finalisation in April 2001 of the assessment for the year 1999-2000 of a works contractor by the Assessing Authority, surcharge of Rs 1.51 lakh illegally collected by the dealer was not forfeited to Government. Penalty up to Rs 5,000 for illegal collection was also leviable.

The matter was pointed out to the Department in October 2002; no reply has been received (October 2003).

The above case was reported to Government in March 2003; their reply has not been received (October 2003).

#### **2.14. Non-forfeiture of excess tax collected**

Under the KGST Act, 1963, a registered dealer may collect the tax payable by him. Under the Act, if any person collects, any tax, in contravention of the provision in the Act, the sum so collected shall be liable to be forfeited to Government and he shall be liable to pay penalty not exceeding Rs 5,000.

In Sales Tax Office, Kunnamkulam, in finalisation of the assessments in March 2001 for the year 1996-97 of a SSI Unit, by the Assessing Authority, tax of Rs 1.22 lakh collected in excess by the unit was not forfeited to Government.

On this being pointed out, the Department stated (June 2002) that it had issued notice to rectify the mistake. Further report has not been received (October 2003).

The case was reported to Government in June 2003; their reply has not been received (October 2003).

#### **2.15. Internal audit system of Sales Tax Department**

Internal controls are intended to provide reasonable assurance of proper enforcement of laws, rules and departmental instructions. They also help in prevention of loss of revenue and in the creation of reliable financial and management information system for prompt and efficient services and for adequate safeguards against evasion of duties. Internal audit is expected to provide an assurance regarding the adequacy and effectiveness of internal controls.

According to Chapter IV of Agricultural Income Tax and Sales Tax Manual Vol.III, the object of internal audit in Sales Tax Department is to check the departmental receipts and refunds and to see that no loss of revenue by way of omission, short levy of tax, excess credit, wrong application of law and such other irregularities is caused to Government. The programme of audit is required to be chalked out in such a way that each Sales Tax Office is audited at least once in three years. The designated officer is expected to audit 20 assessment files per day.

Government created six posts of Inspecting Assistant Commissioners (Audit) [IAC (A)] in April 1994, 62 posts of Sales Tax Officers (Audit) [STOs (A)] in May 1994 and two posts of Deputy Commissioners (Audit and Inspection) in August 2001 for the conducting of internal audit of 16 Special Circles, five Inspecting Assistant Commissioners' (Assessment) Offices, 106 ordinary circles, 14 works contract assessment wings attached to Deputy Commissioner's Offices and for test audit of 17 Intelligence Offices and 46 Sales Tax Check Posts.

For the purpose of audit, the IAC (A) shall group two STOs (A) in one batch and shall audit all assessment files. The IAC (A) shall personally audit the assessment files in Special Circles, and Inspecting Assistant Commissioners' Offices with the assistance of STOs. In cases, where escapement of tax amounting to Rs 5,000 or above is noticed, special reports shall be sent to the Commissioner of Commercial Taxes. The IAC(A) may furnish a list of cases involving tax effect of less than Rs.5,000 as and when the audit note is finalised. The Department has refixed the periodicity of audit as annual (against triennial specified in the Manual). According to the Department, there was no pendency in internal audit and the internal audits were completed before the audit by the Accountant General.

Year-wise details of internal audit paragraphs pending as at the end of each year from 1999-2000 to 2002-03 were as under.

Sl. No.	Period	Details of Inspection Report paragraphs				Per cent of disposal
		Opening balance	Addition	Clearance	Closing balance	
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1.	1999-2000	1,218	147	254	1,111	19
2.	2000-01	1,111	492	244	1,359	15
3.	2001-02	1,359	1,590	462	2,487	16
4.	2002-03	2,487	1,480	280	3,687	7

Increasing incidence of outstanding objections indicates the absence of a proper supportive and responsive environment for Internal Audit within the Sales Tax Department. Reports of the Accountant General for the years 1999-2000 to 2002-03 revealed underassessment of tax etc., as under:

Sl No	Category	(Rupees in crore)							
		1999-2000		2000-01		2001-02		2002-03	
		No of cases	Amount	No of cases	Amount	No of cases	Amount	No of cases	Amount
1	Incorrect grant of exemption	168	5.45	211	37.08	136	4.69	114	14.19
2	Turnover escaping assessment	234	8.27	214	6.63	187	5.29	175	3.17
3	Application of incorrect rate of tax	448	2.71	326	2.05	268	2.19	251	2.22

SI No	Category	1999-2000		2000-01		2001-02		2002-03	
		No of cases	Amount	No of cases	Amount	No of cases	Amount	No of cases	Amount
4	Incorrect grant of concessional rate of tax	104	30.00	76	1.25	52	1.05	30	3.80
5	Non/short levy of interest	191	2.88	226	5.13	205	4.88	395	9.23
6	Excess/double accounting of remittance	21	0.08	33	0.27	17	0.09	21	0.51
7	Other lapses	447	13.40	538	13.60	343	20.50	299	6.00
8	Other items not routed through Local Audit Reports							2	3.96
	<b>Total</b>	<b>1613</b>	<b>62.79</b>	<b>1624</b>	<b>66.01</b>	<b>1208</b>	<b>38.69</b>	<b>1287</b>	<b>43.08</b>

An analysis of the results of test check by the Accountant General revealed the following:

- ◆ Under 'Incorrect grant of exemption,' short levy increased from Rs 4.69 crore (136 cases) in 2001-02 to Rs 14.19 crore (114 cases) in 2002-03.
- ◆ 'Non/Short levy of interest' increased from Rs 2.88 crore (191 cases) in 1999-2000 to Rs 9.23 crore (395 cases) in 2002-03.
- ◆ Under 'Excess/double accounting of remittance' the amounts of excess/double credits ranged from Rs 8 lakh to Rs 51 lakh between 1999-2000 and 2002-03.

In addition to the matters reported in the Audit Reports submitted to the Legislature, the following table indicates the pendency of outstanding inspection reports and observations made by Accountant General's audit parties

(Rupees in crore)

Sl. No.	Year	Number of Inspection Reports issued up to the end of December of the year	Number of audit observations outstanding as at the end of June of the subsequent year	Amount
1.	1999-2000	1414	7341	994.98
2.	2000-2001	1413	10798	1032.89
3.	2001-2002	1459	7789	855.79
4.	2002-2003	1385	7884	440.32

Observations made by the Accountant General's audit parties do not receive proper attention from the Sales Tax Department. These matters should also fall within the scope of functions of the Internal Audit Wing.

The above reveals the general inadequacy of internal audit to meet the requirements stipulated in Chapter IV of the Agricultural Income Tax and Sales Tax Manual Vol.III. The Manual has not been updated since 1968. Government may consider strengthening the Internal Audit Wing suitably so

that assurances are available regarding the adequacy and effectiveness of internal controls.