

CHAPTER II

SALES TAX

2.1. Results of Audit

Test check of sales tax assessments and refund cases and connected documents of Sales Tax Offices conducted in audit during the year 2003-04 revealed underassessments of tax, non-levy of penalty, etc., amounting to Rs 170.34 crore in 1,367 cases which may broadly be categorised as under.

Sl. No.	Category	Number of cases	Amount (In crore of rupees)
1.	Exclusion of turnover from assessment	205	6.17
2.	Incorrect grant of exemption	97	2.02
3.	Application of incorrect rate of tax	224	2.50
4.	Incorrect grant of concessional rate of tax	25	4.62
5.	Non-levy of penalty/interest	383	142.16
6.	Review on Exemptions and Concessions under KGST Act and CST Act	1	4.13
7.	Other lapses	432	8.74
	Total	1,367	170.34

During 2003-04, the Department accepted underassessments, etc., of Rs 6.51 crore involved in 296 cases of which 89 cases involving Rs 2.31 crore were pointed out during 2003-04 and the rest in earlier years. At the instance of audit the Department recovered an amount of Rs 1.17 crore involved in 149 cases during the year.

Illustrative cases involving Rs 105.10 crore and the results of a review on **'Exemptions and Concessions under KGST and CST Act'** involving Rs 4.13 crore are given in the following paragraphs.

2.2. Review on Exemptions and Concessions under KGST Act and CST Act

Highlights

- **Objectives/goals in granting exemptions/concessions/deferment of Rs 766.05 crore could not be evaluated**
(Paragraph 2.2.6)
- **Inadmissible grant of exemption led to loss of revenue of Rs 25.73 lakh.**
(Paragraph 2.2.7)
- **Incorrect grant of concession/exemption resulted in short levy of tax of Rs 1.66 crore.**
(Paragraph 2.2.8)
- **Department failed to cross verify declarations of Rs 10 lakh to Rs 6.48 crore in 97 cases.**
(Paragraph 2.2.9)

2.2.1. Introduction

Sales tax is the major source of revenue of the State. The Kerala General Sales Tax Act, 1963 (KGST Act) governs the law relating to the levy and collection of sales tax in the State. The Central Sales Tax Act, 1956 (CST Act) governs the law relating to the levy and collection of CST in the State.

Under the KGST Act, a dealer who deals in the goods specified in III Schedule to the Act shall not be liable to pay tax in respect of the sale or purchase of such goods. The Government is empowered to make exemptions or reduction in rate of tax payable under the KGST Act. Purchase turnover of goods, which are taxable at the last purchase point, is exempted if covered by declaration issued by the purchasing dealer in Form 25. Consignment sales turnover of goods transferred to agent/principal, branch/head if covered by declaration in Form F is also exempted under the CST Act. Under the CST Act, export/import supported by documents, sale/purchase for export covered by declarations in Form H, sales in transit covered by Form E1, E2, etc., are exempted. Concessions are available for goods mentioned in notifications issued under KGST Act and CST Act, interstate sales covered by declarations issued in Form C, purchases by Government departments covered by declarations in Form D, purchase of raw materials/packing materials by industrial units for use in/for packing finished products if covered by declaration in Form 18 etc.

Government of Kerala issued notifications from time to time granting exemption or concession from payment of tax to small scale industries, medium and large scale industrial units. The eligibility certificate to SSI to avail sales tax exemption under specific notifications are issued by district level committee headed by

General Manager, District Industries Centre (GM, DIC) and to medium and large scale industrial units set up on or after 1 April 1993 by the Department of Commercial Taxes.

2.2.2. Organisational set up

The Department of Commercial Taxes which administers the sales tax laws in the State is under the control of the Commissioner of Commercial Taxes (CCT). The Commissioner is assisted by the Deputy Commissioners (DC), Inspecting Assistant Commissioners and Assessing Officers, who are designated as Assistant Commissioners(AC) (Assessment) and Sales Tax Officers (STOs).

2.2.3. Scope of audit

Details were collected from the Directorate of Industries and Commerce and Deputy Commissioner (General), CCT and assessment records relating to 39* assessing offices mainly Special and other Circles where assessment files of industrial units eligible for/availing exemptions are dealt with, were test checked between 27 October 2003 and 31 May 2004.

2.2.4. Audit objectives

A review of the assessments finalised for the years 1998-99 to 2002-03 was conducted to ascertain whether

- Adequate and effective internal control system existed for ensuring compliance with the prescribed Codal /Manual provisions.
- Any infirmity existed in the legislative provisions and the related rules.
- Exemptions and reductions in rate of tax allowed to various commodities/class of beneficiaries were in accordance with conditions/restrictions prescribed by Government and the prescribed declarations were obtained.
- Records showing details of beneficiaries/quantum of exemption availed of were maintained properly.
- Fixed Capital Investment created for grant of exemptions was maintained throughout the period of exemption (five/seven years).

* Sales Tax Offices I Circle Alappuzha , II Circle Alappuzha, Angamaly, Attingal, I Circle Changanacherry, II Circle Changanacherry, Chengannur, Cherthala, I Circle Ernakulam, II Circle Ernakulam, III Circle Ernakulam, IV Circle Ernakulam, Irinjalakuda, I Circle Kalamassery, II Circle Kalamassery, Karunagappally, Kayamkulam, I Circle Kollam, II Circle Kollam, III Circle Kollam, I Circle Kottayam, II Circle Kottayam, I Circle Kozhikode, II Circle Kozhikode, III Circle Kozhikode, IV Circle Kozhikode, V Circle Kozhikode, Neyyattinkara, II Circle Thrissur, III Circle Thrissur, IV Circle Thrissur, Special Circle Alappuzha, Special Circle I Ernakulam, Special Circle II Ernakulam, Special Circle III Ernakulam, Special Circle (Hill Produce) Mattancherry, Special Circle Kollam, Special Circle Kottayam and Special Circle Thrissur.

2.2.5. Trend of revenue and extent of exemptions

Total tax revenue raised by the State and receipts from Sales tax during the years 1998-99 to 2002-03 were as shown below:

(Rupees in crore)

Year	Total tax revenue	Sales tax receipts	Percentage of Sales tax to total tax revenue
1998-99	4,649.56	3,366.62	72.40
1999-00	5,193.50	3,853.54	74.20
2000-01	5,870.26	4,344.33	74.01
2001-02	5,923.42	4,440.85	74.97
2002-03	7,302.54	5,343.15	73.17

As per the information supplied by CCT, exemption and deferment of sales tax granted to SSI units and medium and large scale industrial units during the period from 1998-99 to 2002-03 were as under:

(Rupees in crore)

Year	Exemption granted to SSI units*		Exemption granted to Medium and Large Scale Industrial units		Sales Tax deferment		Total
	No. of units	Amount	No. of units	Amount	No. of units	Amount	
1998-99	84	96.53		116.80	3	9.36	222.
1999-00	72	100.77		45.06	Nil	0	145.
2000-01	52	77.24		83.46	1	7.45	168.
2001-02	76	72.40		12.16	2	2.89	87.
2002-03	35	72.89		55.75	1	13.29	141.
Total	319	419.83		313.23	7	32.99	766.

The total amount of exemption/deferment availed by the units in each year was not available.

2.2.6. Lack of monitoring of objectives achieved

• **Small/Medium/Large Scale Industries**

By notifications issued in 1980 and thereafter Government of Kerala exempted the small/medium/large scale industrial units from payment of tax in respect of goods manufactured and sold by them for a period of five/seven years from the date of commencement of production of such goods subject to certain conditions. Though sales tax exemptions of Rs 766.05 crore were granted, monitoring at any

* The figures shown are exclusive of exemptions granted in respect of small scale industries by GM, DICs of Kozhikode, Kasaragod, Idukki and Wayanad. Details in respect of these districts have not been received from the Department of Industries and Commerce.

level to see the total amount availed by units and corresponding achievement of the objectives was done neither by CCT nor by Industries Department.

- **Deferment cases**

The medium and Large Scale Industrial Units, have the option for deferment of taxes for a period of ten years from the date of commencement of commercial production or from the date on which diversification, expansion or modernisation has been completed. The unit which opts for deferment of taxes will not be permitted to avail of exemption, but will be permitted to collect taxes as per rules. The tax so collected by unit shall be remitted to Government in equal monthly instalments over a period of five years from the eleventh year with simple interest at the rate of 15 *per cent per annum*. In case of default penal interest at the rate of two *per cent per annum* shall be charged for the period of delay.

Though sales tax deferment of Rs 32.99 crore was granted from 1998-99 to 2002-03 details of deferment were not readily available in any of the assessment offices. In the absence of maintenance of registers for reference of the details at Assessing Officer's level, repayment of instalments which were due for recovery could not be monitored at any level.

Inadmissible deferment cases

It was noticed in Special Circle, Alappuzha that in the case of an assessee against a total amount of Rs 1.77 crore permitted for deferment, the Department allowed deferment of tax for Rs 2.14 crore while finalising the assessment for 2000-01 and 2001-02 in November 2003. This resulted in non-demand of tax of Rs 36.80 lakh.

2.2.7. Inadmissible exemption allowed resulting in loss of revenue

- **Small Scale Industrial Units**

Exemption can be granted subject to such restrictions and conditions as may be prescribed by the Government in the notifications. The Assessing Officers shall set off the tax due from assessee against the amount available for exemption during the year as per the certificate issued by GM, DIC. In case where certificates issued by GM, DIC are in violation to the conditions stipulated by the Government in their notification, Assessing Officer shall bring the matter to the notice of higher authorities.

Scrutiny of records of seven offices* revealed that the assessing authorities allowed set off of tax of Rs 25.73 lakh in nine cases during the years 1997-2001 by issue of certificates to units manufacturing splints and veneers, packing materials. These products are not mentioned in the table appended to the Khadi and Village Industries Commission's notifications, etc. This resulted in inadmissible exemption of Rs 25.73 lakh.

* STO Alathur, STO Angamaly, STO Attingal, STO Karunagappally, STO II Circle Kollam, STO III Circle Kollam, STO II Circle Kottayam

Instead of allowing exemption based on the certificate issued by GM, DIC, the Assessing Officers should have taken up the matter with higher authorities since the exemptions were against the terms and conditions stipulated in the notification.

2.2.8. Incorrect grant of concession/exemption

- By notifications issued in March 1995, July 1996 and December 1999, Government reduced the rate of tax to four *per cent* on sale of goods within the state manufactured by SSI Units whose total turnover did not exceed Rs 50 lakh in a year. Where the total turnover exceeds Rs 50 lakh, reduced rate will be applicable up to turnover of Rs 50 lakh and normal rate on the turnover above Rs 50 lakh during such first year. In subsequent years normal rates are applicable. The SSI units were eligible for a concessional rate of eight *per cent* from January 2000. This rate was, however, not applicable for processing and sale of mineral water since no manufacturing process was involved as judicially held[♥].

In ten offices the application of incorrect concessional rate of four *per cent* in nine cases and excess exemption allowed in one case resulted in short levy of tax of Rs 95.14 lakh as detailed below.

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/Month of assessment	Name of commodity/ Rate of tax (in <i>per cent</i>)	Nature of irregularity	Turn-over	Short levy	Remarks
1.	STO, Special Circle, <u>Mattancherry</u> 1	<u>1997-98</u> February 2002	<u>Wheat Products</u> 4	While finalising the assessment of a company, exemption of tax of Rs 1.92 crore was allowed against the allowable exemption of Rs 1.44 crore.		47.64	After the case was pointed out by audit in December 2002, the Assessing Authority stated that the matter would be examined.
2.	STO, II Circle, <u>Perumbavoor</u> 1	<u>1998-99</u> January 2003	<u>Cement</u> 12.5	While finalising the assessment of a SSI unit, sales turnover of cement was incorrectly assessed at the rate of four <i>per cent</i> against 12.5 <i>per cent</i> . Surcharge was also not levied.		17.99	After the case was pointed out by audit in October 2003, the assessment was revised in December 2003 and additional demand of Rs 17.99 lakh was adjusted against the SSI exemption available.

[♥] 131 STC 538 Teejan Beverages Ltd. Vs State of Kerala and others.

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/Month of assessment	Name of commodity/ Rate of tax (in per cent)	Nature of irregularity	Turn-over	Short levy	Remarks
3.	STO, Special Circle, <u>Thiruvananthapuram</u> 1	1998-99 & <u>1999-2000</u> December 2002 & January 2003	Polythene <u>films</u> 10 for 1998-99 and 6/8 for 1999-2000	While finalising the assessment of a SSI unit the tax was levied at the rate of four per cent instead of prevailing rates.	216.70	9.75	After the case was pointed out by audit in August 2003, the Assessing Authority stated that the goods sold by the assessee were packing materials. The Government stated in November 2004 that the goods sold were tubings, pouches and polythene films with the logo of the purchaser printed on it and so the goods were packing materials. The reply was not tenable as the goods are unsuitable of being used as packing materials without undergoing some manufacturing process. Further report had not been received (December 2004).
4.	STO, Manjeri 1	<u>1998-99</u> March 2002	Plastic water storage <u>tanks</u> 10	While finalising the assessment of a SSI unit, tax was levied at four per cent instead of at 10 per cent.	88.38	5.83	After the case was pointed out by audit in November 2002, the assessment was revised in November 2002 and tax due was set off against the exemption available.
5.	STO, Tirurangadi 1	<u>1998-99</u> February 2003	<u>Furniture</u> 10	While finalising the assessment of a SSI unit engaged in the manufacture and sale of furniture, tax was levied at four per cent instead of at 10 per cent though the total turnover of the unit exceeded Rs 50 lakh during 1995-96	62.20	4.11	After the case was pointed out by audit on 1 January 2004, the Department informed in August 2004 that the assessment was revised on 21 January 2004. Further report had not been received (December 2004).
6.	STO, Alathur 1	<u>2000-01</u> October 2001	Mineral water, <u>soda water</u> 20	Tax due on sales turnover of mineral water was assessed at lower rate and incorrectly adjusted against the exemption.	15.53	3.11	After the case was pointed out by audit in January 2003, the Department informed in May 2004 that the assessment was revised in September 2003. Further report had not been received (December 2004).

Audit Report (Revenue Receipts) for the year ended 31 March 2004

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/Month of assessment	Name of commodity/ Rate of tax (in per cent)	Nature of irregularity	Turn-over	Short levy	Remarks
7.	STO, Special Circle I, Ernakulam 1	1998-99 January 2003	Voltage stabilizer 8 and 2	Tax at four per cent only was levied instead of the normal rate though total turnover exceeded Rs 50 lakh.	68.76	3.03	When the case was pointed out in April 2004, the Assessing Officer stated (April 2004) that notice had been issued. Further report had not been received (December 2004).
8.	STO, North Parur 1	1997-98 and 1998-99 between August and December 2001	Cement paint 8	While finalising the assessment of a dealer in cement paint, turnover of cement paint was taxed at 4 per cent instead of 8 per cent.	46.24	2.03	After the case was pointed out by audit in January 2003, the Department informed in May 2004 that notice had been issued to revise the assessment. Further report had not been received (December 2004).
9.	Office of the IAC, Pathanamthitta 1	1997-98 and 1998-99 June 2001	Alum and Bauxite 10	While finalising the assessment of a SSI unit tax was levied incorrectly at four per cent though the turnover exceeded Rs 50 lakh during 1997-98 and 1998-99.	16.95	1.12	After this was pointed out by audit in December 2002, the Assessing Officer stated in April 2003 that the assessments had been revised and the case was advised for revenue recovery. Government informed in May 2004 that the collection was pending. Further report had not been received (December 2004).
10.	STO, I Circle, Kalamassery 1	1998-99 March 2002	Wiring cables 12.5	Rate of four per cent was applied on total turnover of Rs 58.07 lakh instead of four per cent on the first Rs 50 lakh and normal rate on the turnover exceeding Rs 50 lakh.	58.07	0.53	On this being pointed out the Assessing Officer stated in May 2004 that action was being taken to reopen the assessment. Further reply was awaited (December 2004).
Total						95.14	

- Under the CST Act, 1956, Government reduced in November 1993 tax payable on any goods manufactured by new large and medium scale industries to two per cent for a period of five years from the date of commencement of commercial production by such units. Where a sale of any goods in the course of interstate trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent

sale during such movement effected by a transfer of documents of title to such goods, shall be exempt from tax.

Scrutiny of assessment records revealed that in three circles, the exemptions granted were incorrect resulting in non-levy of tax of Rs 15.39 lakh in three cases as per details given below:

(In lakh of rupees)

Sl. No.	Name of office No. of cases	Assessment year/ Month of assessment	Commodity/ Rate of tax (in per cent)	Nature of irregularity	Amount of short levy	Remarks
1.	STO, Second Circle, <u>Palakkad</u> 1	<u>1998-99</u> September 2002	Heat Resistant Latex Rubber Thread (<u>HRLRT</u>) 2	While finalising the assessment of a medium/large scale industrial unit engaged in the manufacture of HRLRT, tax of Rs 10.56 lakh was set off against the exemption limit available to the unit though the assessee was not eligible for the exemption.	10.56	After the case was pointed out by audit in November 2003, the Department informed in August 2004 that the assessment had been modified and demand notice issued. Further report had not been received (December 2004).
2.	STO, Second Circle, <u>Kalamassery</u> 1	<u>1992-93</u> March 1999	Winter <u>garments</u> 10	While finalising the assessment of a dealer, the Assessing Authority exempted the turnover of Rs 25.80 lakh relating to the sale of raw materials of garments to exporters in Chennai.	2.58	After the case was pointed out by audit in December 1999, the Department revised the assessment in October 2003 creating additional demand of Rs 2.58 lakh. Government informed in May 2004 that notice for revenue recovery had been issued. Further report had not been received (December 2004).
3.	STO, Special Circle (HP), <u>Mattancherry</u> 1	<u>1995-96</u> March 2000	Welding <u>rods</u> 4	While finalising the assessment of a dealer, inter-state sale of welding rods for Rs 56.17 lakh was incorrectly exempted as sale in transit. As the transfer of documents had taken place before the movement of goods, subsequent sale could not be treated as transit sale. The despatch of goods was not to the assessee but directly to the subsequent purchaser and hence the sale was not in the course of movement of goods.	2.25	After the case was pointed out by audit in June 2000, the Assessing Authority stated that the requirements of Section 6(2) of CST Act was satisfied in this case. The matter was referred to Government (September 2001) and they reported that transaction in this case was not covered by Section 6(2) and the dealer was not eligible for exemption. Further report had not been received (December 2004).
Total					15.39	

Audit Report (Revenue Receipts) for the year ended 31 March 2004

The above cases were reported to Government between December 2003 and April 2004; their final reply was awaited (December 2004).

- Government by notifications exempted new SSI units from payment of tax due on goods produced and sold by them for a period of five/seven years from the date of commencement of commercial production. Exemption from sales tax was admissible only for goods manufactured and sold by the unit. It has been judicially held* that rice and paddy are two distinct commodities, distinct in nature and character and that a dealer is liable to pay purchase tax on the purchase of paddy procured in circumstances in which no tax has been paid. It was also held♦ that SSI units are not entitled to get SSI exemption on purchase tax.

In five offices purchase tax on purchase turnover on paddy was incorrectly allowed to set off against the SSI exemption in 20 cases. This resulted in grant of incorrect exemption of Rs 51.84 lakh including surcharge as detailed below.

(In lakh of rupees)

Sl. No.	Name of office/ No. of cases	Assessment year/ Month of assessment	Commodity/ Rate of tax in per cent	Nature of irregularity	Amount of short levy of tax including surcharge	Remarks
1.	STO, <u>Angamaly</u> 3	1997-98 to <u>1999-00</u> Between October 2001 and March 2002	<u>Paddy</u> 1	While finalising the assessments of seven SSI units engaged in the manufacture of rice, the tax on the purchase turnover of paddy for Rs 13.34 crore was incorrectly set off against SSI exemption.	14.67	After the cases were pointed out in January 2003, the Department stated in January 2003 that the cases would be examined. Further report had not been received (December 2004).
		<u>1998-99</u> September 2001	<u>Paddy</u> 1	While finalising the assessments of a SSI unit engaged in the manufacture of rice, the tax levied on the purchase turnover of paddy for Rs 3.95 crore was set off against SSI exemption.	4.35	After the case was pointed out by audit in January 2003, the Assessing Authority stated that even though turnover of paddy was not assessed, there was no short levy as the assessee was eligible for SSI exemption. The reply is not tenable as tax was to be levied on purchase of paddy. Further report had not been received (December 2004).
2.	STO, First Circle, <u>Perumbavoor</u> 12	1999-2000 to <u>2001-02</u> between June 2002 and July 2003	<u>Paddy</u> 1	While finalising the assessments of 12 dealers engaged in the manufacture of rice, the tax levied on the purchase turnover of paddy for	18.15	After the cases were pointed out by Audit in July 2003, the Department stated in October 2004 that the assessments had been revised in all cases. Further

* Raja Provision Stores Vs Appellate Tribunal (Sales Tax), Thiruvananthapuram 105 STC 225 (SC)

♦ State of Kerala Vs M/s Vattukalam Chemicals Industries (2002) 10 KTR 69 (SC)

(In lakh of rupees)

Sl. No.	Name of office/ No. of cases	Assessment year/ Month of assessment	Commodity/ Rate of tax in per cent	Nature of irregularity	Amount of short levy of tax including surcharge	Remarks
				Rs 17.22 crore was incorrectly set off against SSI exemption.		report had not been received (December 2004).
3.	STO, Third Circle, Palakkad 3	1999-00, 2000-01, 2001-02 October 2002	Paddy 1	While finalising the assessment of three SSI units manufacturing rice, purchase turnover of Rs 10.33 crore on purchase of paddy was set off against SSI exemption.	10.93	After the cases were pointed out by audit in September 2003, the Department informed in September 2004 that action had been taken to revise the assessment in one case. Further report had not been received (December 2004).
4.	STO, North Parur 1	1999-2000 and 2000-01 March 2002	Paddy 1	While finalising the assessments of a SSI unit engaged in the manufacture of rice, the tax levied on the purchase turnover of paddy for Rs 1.13 crore was set off against SSI exemption.	1.97	After the case was pointed out by audit in January 2003, the Assessing Authority stated that the exemption given on purchase turnover of paddy was in the form of rebate. It is true that tax payable can be deducted from the tax on rice which alone need be adjusted against SSI exemption. But the assessee had to pay purchase tax which was not demanded. Further report had not been received (December 2004).
5.	STO, Aluva 1	1997-98 October 2001	Paddy 1	While finalising the assessments of a SSI unit engaged in the manufacture of rice, the tax levied on the purchase turnover of paddy for Rs 1.61 crore was set off against SSI exemption.	1.77	After the case was pointed out by audit in October 2002, the Assessing Authority stated that assessments in the case of all rice mills were completed as done in this case. The reply is not tenable in view of the decision that purchase tax cannot be adjusted against SSI exemption. Further reply was awaited (December 2004).
	Total				51.84	

The above cases were reported to Government in April 2004.

- Under the first schedule to the KGST Act, 1963, tax on soda is leviable at the rate of 20 per cent at the point of first sale in the State by a dealer who is liable to tax under the Act.

In STO Kodungallur, while finalising the assessment of two assesseees engaged in hotel business the sales turnover of Rs 14.75 lakh of soda was exempted from tax

during the years from 1999-2000 to 2001-02 assessed between April 2002 and September 2002 treating it as second sales. But the assessee had purchased soda from registered dealers who were not liable to tax as the turnover was below the assessable limit. So the sale by the assessee is to be treated as first sale in the State. The incorrect exemption allowed has resulted in short levy of tax of Rs 3.16 lakh.

After the cases were pointed out by audit in January 2004, the Government stated in November 2004 that the assessee was second seller of the commodity and hence not exigible to tax. The reply is not tenable in view of the fact that the commodity had not been taxed at any point. The first sale effected was by a dealer not liable to tax and it has been judicially[♥] upheld by the High Court of Kerala that in such cases the sales by dealer is treated as first sale.

The cases were reported to Government in February 2004; their reply had not been received (December 2004).

2.2.9. Declarations

- **Non-conducting of cross verification of declarations in Form 25**

Under the KGST Act, 1963 and Rules made thereunder a dealer who purchases goods taxable at last purchase point shall not be liable to pay tax, if he proves that he is not the last purchaser within the State. For this he shall file the originals and duplicates of declarations in Form 25 issued by the purchasing dealer. The correctness of exempted turnover accounted in the purchasing dealer's turnover can be ascertained by the Assessing Officer, only if the duplicate of the declaration filed by the selling dealer is sent to the assessing circle of the purchasing dealer for cross verification.

In seven assessment cases test checked in five offices[♦] during the period from 1999-2000 to 2002-03, duplicates of declarations in Form 25 had not been sent for cross verification in 97 cases where amount covered by declarations varied from Rs 10 lakh to Rs 6.48 crore.

2.2.10. Concession/exemption allowed without stipulated declarations/with defective declarations

- Under the KGST Rules, any dealer in goods taxable at the point of last purchase in the State, shall, if he is not liable to tax on such goods if he not being the last purchaser, obtain a declaration in Form 25 from the person to whom he has sold goods and shall submit in duplicate to the Assessing Authority.

[♥] 102 STC 143 M.S. Raja Mohammed Vs State of Kerala

[♦] Special Circle (Hill Produce) Mattancherry, Sales Tax Offices Irinjalakuda , Neyyattinkara, Circle I Ernakulam and Circle I Kozhikode

Test check of STOs IV Kozhikode, Special Circle (Hill Produce) Mattancherry and Karunagapally revealed that in two cases the exemption of turnover was allowed on the basis of duplicate/triplicate Form 25 instead of original and duplicate. In one case the turnover of Rs 5.06 crore was exempted though Form 25 valued at Rs 4.18 crore were available. This resulted in irregular exemption of tax of Rs 53.65 lakh.

- The CST Act, 1956 read with rules made thereunder provides that branch transfer of goods are exempted from tax provided the same is covered by declaration in Form F. Rules provide that single declaration shall cover on transactions pertaining to one calendar month.

It has been noticed in audit that while finalising the assessments for the years from 1998-99 to 2001-02 between December 2001 and June 2003 three[^] assessing authorities have accepted Form F declarations covering transactions for whole year from dealers of coconut oil, rubberised coir, fibre foam, medicines, cashew and vacuum flask in violation of Act/rules. This resulted in incorrect exemption of tax of Rs 29.22 lakh.

- The KGST Act and Rules provide that a dealer is liable to purchase industrial raw material, component parts, containers or packing materials for use in the production of finished products for sale inside the state or in the course of inter-state sale, trade and commerce at concessional rate of tax provided he furnishes a certificate in declaration Form 18 duly filled in.

It was noticed in Special Circle, Thrissur that in one case the concessional rate of tax was allowed to dealers by accepting declarations in Form 18 in which column numbers 1 to 5 of the certificates were not filled in. This resulted in short levy of tax of Rs 5.52 lakh.

- Under the CST Act, 1956 the sale or purchase preceding the sale or purchase in the course of export shall be deemed to be in the course of such export if such last sale or purchase took place after and was for the purpose of complying with the agreement or order for or in relation to such export. Form of declaration prescribed under KGST Rules in proof of sale for export is Form 18 A and that under CST Act is Form H. A scrutiny revealed that exemptions were allowed accepting defective declarations in many cases test checked.

Acceptance of defective Form 18 A declarations

In 13 cases test checked defective declarations in Form 18A were accepted for giving exemption for Rs 7.65 crore. Tax effect involved amounted to Rs 51.04 lakh as shown in Annexure II:

[^] Special Circle Thrissur, Alappuzha, Ernakulam

Acceptance of defective Form H declarations

In two offices exemption was allowed on turnover of Rs 1.09 crore accepting defective declaration in Form H in 4 cases, tax effect involved amounted to Rs 11.35 lakh as shown in Annexure III.

These show that the declarations were not scrutinised properly before accepting them for allowing tax concession/exemption.

2.2.11. Internal control

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.

- There is an Internal Audit Wing functioning in the Commercial Taxes Department under the supervision and control of DC (A&I) with Zonal offices at Ernakulam and Kozhikode. The STOs attached to the Zonal office are to conduct Internal Audit of the circles annually. According to the Department, there was no pendency in internal audit and all internal audits were completed before the audit was done by the Accountant General.

Details of internal audit conducted during the years from 1999-2000 to 2002-03 were as follows:

Year	1999-00	2000-01	2001-02	2002-03
No. of assessments completed	1,57,035	1,86,692	1,48,951	1,80,182
Coverage of assessment files in Internal Audit	Not furnished	Not furnished	65,177	97,927
Percentage of coverage	Not furnished	Not furnished	43.76	54.35

This shows that internal audit was not completed before audit was done by Principal Accountant General (Audit), Kerala.

- Under the Agricultural Income Tax and Sales Tax Manual (AIT and ST Manual) Vol. III, a Demand, Collection and Balance Register (DCB) has to be maintained by each Sales Tax Officer dealer wise. After correctly fixing the arrear position of the office, a certificate should be sent to the CCT with copies to the Inspecting Assistant Commissioner (IAC) and Deputy Commissioner (DC). Any delay in this regard should be reported to the CCT by the IAC and DC with suitable recommendation for disciplinary action. However DCB registers were not maintained properly in any of the 39 offices test checked. The DCB statement so prepared were not giving a proper reflection of the demand, collection and balance of the concerned offices and there was no internal control mechanism to cross check or verify the correctness of the balance shown therein.

In four* STOs against the demand of Rs 30.32 lakh created during the period between 2000-01 and 2002-03, the remission of tax of Rs 64.26 lakh was given resulting in excess credit of Rs 33.94 lakh.

- **Non-reconciliation of remittances**

As per the Kerala Financial Code Vol.I, the Departmental sub controlling officers should reconcile the Departmental figures with the treasury figures and obtain the signature of the Treasury Officer on the statement prepared by them in token of the agreement of their figures with those of the treasury. The reconciliation of remittances made into treasury by the Sales Tax Officers based on daily collections of sales tax revenue in their respective offices were not being properly done. A statement prepared by the respective offices was furnished every month to the Commissioner of Commercial Taxes without any reconciliation and without authentication by Treasury Officer. Of late, to avoid delay in furnishing the statement of revenue, it was reported that, the triplicate copy of the challans were being collected by the Office of the Inspecting Assistant Commissioner (IAC) and distributed to concerned circles with a statement of revenue for the respective month for onward transmission to the Commissioner of Commercial Taxes, that too without any reconciliation or certification of the correctness of the figures booked under each circle by the concerned Sub Treasury Officer.

- **Delay in realisation of Cheques**

A review of Cheque Registers revealed that there was delay ranging from 30 days to 159 days in crediting cheques for Rs 19.26 crore to government account causing blockage of government money in 29 offices as shown in Annexure IV.

These deficiencies clearly indicate lack of internal control mechanism in the Department.

2.2.12. Recommendations

Control mechanism should be put its place to ensure

- Maintenance of DCB and all other registers are in the prescribed format
- Reconciliation of remittances into the treasury
- All valuables are promptly brought into the Government account
- Internal Audit machinery needs to be strengthened so as to improve overall efficiency and effectiveness of the department
- The assessing officer should insist on the prescribed declarations before granting exemptions/deferment/set off. Continued maintenance of fixed capital assets created for availing the SSI exemptions throughout the period of exemption should be ensured

All these points were communicated to the Department and Government in June 2004; their replies have not been received (December 2004).

* Changanacherry, Kayamkulam, Kottayam and Thrissur

2.3. 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 11[♦] offices, there was short levy of tax and surcharge of Rs 1.23 crore in 16 cases as per details given in Annexure V. Additional demand of Rs 72.39 lakh was created in 10 cases. The amount was pending collection.

The cases were reported to Government between August 2003 and April 2004. Further report had not been received (December 2004).

2.4. Non-forfeiture of unauthorised collection of surcharge

Under the Kerala Surcharge on Taxes Act, 1957, if any person collects any sum by way of surcharge, he shall be liable to pay penalty not exceeding Rs 5,000 and any sum so collected shall be liable to be forfeited to Government.

In STO, Special Circle I, Ernakulam, while finalising the assessment for 1999-2000 in October 2003, of an assessee, surcharge of Rs 2.50 crore collected in excess by the unit was not forfeited to Government by the Assessing Officer. On this being pointed out in audit in March 2004, the Assessing Authority stated in April 2004 that the amount related to surcharge was collected by the assessee.

The case was reported to the Department in June 2004 and to Government in August 2004. Further report had not been received (December 2004).

2.5. Underassessment of turnover

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 nine[♥] offices turnover of Rs 11.48 crore in nine cases was incorrectly excluded from levy of tax resulting in short levy of tax of Rs 64.90 lakh including surcharge as per details given in Annexure VI.

[♦] STOs Special Circle III Ernakulam, Special Circle I Ernakulam, Special Circle Mattancherry, Angamaly, Circle I Ernakulam, Circle I Kollam, Special Circle II Ernakulam, WC & LT Alappuzha, Deputy Commissioner Ernakulam, Circle II Palakkad, Nedumangad.

[♥] STO Pathanamthitta, Kasaragod, STO Special Circle (Hill Produce) Mattancherry, Special Circle Tirur, Special Circle Mattancherry, STO Circle II Mattancherry, AIT&STO Kuthiathode, STO Circle I Kozhikode, STO Circle II Thripunithura.

2.6. Non/Short-levy of interest

2.6.1. Under the KGST Act, 1963, if the tax or any amount due under the Act is not paid by any dealer within the time prescribed, the dealer shall pay, by way of interest a sum equal to one *per cent* of such amount for each month or part thereof for the first three months of delay and two *per cent* of such amount for each month or part thereof for subsequent months.

In six offices, the assessing authorities either failed to levy or short levied interest amounting to Rs 75.10 lakh in the following six cases.

(In lakh of rupees)

Sl. No.	Name of office/ No. of cases	Assessment year/Month and year of assessment	Nature of irregularity	Non/short levy of interest	Remarks
1.	STO, Special Circle, Kollam 1	1997-98 April 2002	While finalising the assessment of an exporter of cashew, the Assessing Officer levied interest of Rs 5.46 lakh instead of Rs 50.62 lakh on the unpaid tax of Rs 50.12 lakh.	45.16	After the case was pointed out by audit in May 2003, Government stated in October 2004 that interest of Rs 45.16 lakh was demanded and advised for revenue recovery. Further report had not been received (December 2004).
2.	STO, Special Circle, Mattancherry 1	1996-97 March 2001	While finalising the assessment of a local authority, the Assessing Authority failed to levy interest for the non-payment of tax of Rs 17.57 lakh from May 1997 to March 2001.	15.99	After the case was pointed out by audit in November 2001, the Department stated in September 2004 that interest was recomputed and demand raised. Further report had not been received (December 2004).
3.	STO, Special Circle (Hill Produce), Mattancherry 1	1997-98 October 2001	While finalising the assessment in October 2001 of a dealer in tyres, tubes, etc., rubber cess paid was excluded from the turnover in the monthly return for April 1997 to January 1998. Subsequently, the assessee returned the turnover and paid tax. Interest due on the tax amount was not demanded.	6.10	After this was pointed out in May 2002, the Department levied in June 2002 an interest of Rs 6.24 lakh and adjusted it against the refund due to the dealer. Adjustment details had not been received (December 2004).
4.	STO, Kothamangalam 1	1992-93 April 2001	While finalising the assessment of a dealer, interest on unpaid amount of admitted tax of Rs 1.85 lakh was not demanded.	3.20	After the case was pointed out by audit in November 2002, Assessing Authority stated that the case would be examined. Further report was not received (December 2004).
5.	STO, I Circle, Ernakulam 1	1997-98 December 2002	While finalising the assessment of a dealer, interest was not levied for non-payment of tax due on conceded taxable turnover of Rs 34.62 lakh.	3.02	After the case was pointed out by audit in May 2003, the Department stated in July 2004 that the demand notice had been issued to collect interest. Further report had not been received (December 2004).

(In lakh of rupees)

Sl. No.	Name of office/ No. of cases	Assessment year/Month and year of assessment	Nature of irregularity	Non/short levy of interest	Remarks
6.	STO, Special Circle, Alappuzha 1	1998-99 March 2003	While finalising the assessment, the Assessing Authority did not levy interest due to non-payment of tax of Rs 1.79 lakh.	1.63	After the case was pointed out by audit in August 2003, the Assessing Authority levied interest in August 2003. The Department stated in August 2004 that the awardee of works contract were effecting tax deduction at source and remitting to Government. There was no evidence to show that the tax had been deducted at source and remitted to Government. Further report had not been received (December 2004).
			Total	75.10	

The Department revised the assessment in five cases raising an additional demand of Rs 71.90 lakh.

2.6.2. Under the KGST Act, 1963, if the sales tax due is not paid within the time prescribed, the dealer shall pay interest at the rates prescribed. 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 the tax would have fallen due for payment.

In 11 offices[♦], the Assessing Authorities had either failed to levy or levied short the interest of Rs 99.16 crore in 11 cases on the tax assessed between August 2000 and March 2003 on the escaped or on suppressed turnover during the period from 1998-99 to 2001-02 as per details given in Annexure - VII.

On this being pointed out between October 2001 and January 2004 the Assessing Authorities revised the assessment in five cases and raised demand of Rs 43.49 lakh.

The above cases were reported to Government between December 2003 and April 2004. Further report had not been received (December 2004).

2.7. Non-levy of penalty

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

[♦] STO Special Circles – Thiruvananthapuram, Kollam, Kottayam, STO Pathanamthitta, Special Circle (Hill Produce) Mattancherry, Circle II Mattancherry, Circle III Thrissur, Special Circle III Kozhikode, STO Tirurangadi, STO Thiruvalla and STO IV Kozhikode.

liable to pay, the Assessing Authority shall impose penalty at thrice the amount of such difference.

In five such cases in four offices penalty of Rs 55.17 lakh on additional demand created was not imposed.

(in lakh of rupees)					
Sl. No	Name of office/ No. of cases	Assessment year/month and year of revision	Nature of irregularity	Amount of penalty	Remarks
1.	STO, V Circle, Kozhikode 2	2000-01 March 2003	The assessment of a dealer was reopened and tax of Rs 6.22 lakh was levied on the sales turnover of closing stock of timber of previous year for Rs 51.87 lakh that was not disclosed by the assessee. However, penalty was not levied and demanded.	18.67	After the case was pointed out in August 2003, the Department in August 2004 stated that the assessment was revised levying penalty and the amount was recommended for revenue recovery. Further reply had not been received (December 2004).
		2001-02 October 2002	The assessment of a dealer was reopened and tax was levied on the sales turnover of Rs 24.30 lakh on the turnover of timber purchased inter-state and not reported by the assessee in the return. However, penalty was not levied and demanded.	8.75	The case was pointed out by audit in August 2003. No reply had been received (December 2004).
2.	STO, II Circle, Mattancherry 1	1999-2000 January 2002	While reopening the assessment to assess escaped turnover of sale/transfer of export incentives of Rs 81.67 lakh, penalty was not imposed.	24.50	After this was pointed out by audit in November 2002, the Assessing Authority stated that penalty need not be levied in doubtful cases and interest was leviable only from the date of issue of demand notice. The reply was not tenable in view of the clear provisions in the Act to levy penalty in such cases. Further reply had not been received (December 2004).
3.	STO, Ottappalam 1	1999-2000 November 2002	While reopening the assessment of a dealer, though additional demand for tax of Rs 0.67 lakh was created, penalty was not imposed.	2.02	After this was pointed out by audit in August 2003, the Department stated in September 2004 that the assessment was revised. Further report had not been received (December 2004).
4.	STO, II Circle, Tripunithura 1	2000-01 November 2001	While completing the assessment of a dealer the entire turnover was exempted. The assessee had not returned sales turnover of DEPB licence for Rs 5.14 lakh which was assessable to tax. Penalty leviable was not imposed.	1.23	After this was pointed out, the Assessing Authority stated in January 2003 that the case would be examined. Further reply had not been received (December 2004).
Total				55.17	

The above cases were reported to Government in April 2004. Further report had not been received (December 2004).

2.8. Non-levy of surcharge

Under the Kerala Surcharge on Taxes Act, 1957, the tax payable under the KGST Act, shall be increased by a surcharge of 10 *per cent* in the case of a dealer whose turnover exceeds Rs 10 lakh in a year.

In STO, Second Circle, Palakkad, the Assessing Officer while finalising the assessment of an individual unit for the year 1995-96 in February 2002 omitted to levy surcharge on the tax due on a turnover of Rs 7.71 crore. The tax stood adjusted against the eligible exemption. This resulted in non-levy of surcharge of Rs 3.86 lakh.

On this being pointed out in December 2002, the Assessing Officer stated in December 2002 that final reply would be submitted. Further report had not been received (December 2004).

The case was reported to Government in December 2003; their reply had not been received (December 2004).

2.9. Non-forfeiture of excess tax collected

Under the KGST Act, no registered dealer shall collect any sum purporting to be by way of tax in respect of sale of any goods, at a rate exceeding the rate at which he is liable to pay tax. If any person collects any sum in contravention of the provision he shall be liable to pay penalty not exceeding five thousand rupees and any sum collected by the person by way of tax or purporting to be by way of tax shall be liable to be forfeited to Government by an order issued by the Assessing Authority. Cardamom is taxable at first purchase point and cashew is taxable at last purchase point.

In Sales Tax Office, Special Circle, Kottayam, a dealer in timber and hill produce had irregularly collected tax on cardamom and cashew to the tune of Rs 0.94 lakh. But the Assessing Authority did not forfeit the collection made by the assessee, while finalising the assessment for 1997-98 in November 2002.

Similarly, in the same Circle, while finalising in May 2002 the assessment of a dealer in surgical gloves for the year 1998-99, the excess collection of tax of Rs 0.50 lakh was ordered to be adjusted against future dues instead of forfeiting the amount to Government.

Non-forfeiture of tax collected in the above cases amounted to Rs 1.44 lakh.

On these being pointed out, the Assessing Authority stated in May 2003 that notices had been issued. The Department informed in August 2004 that the assessment was revised in July 2004 and collected tax was forfeited to Government.

2.10. Mistake in computation of tax

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.

During the course of audit it was noticed that in two cases mistakes in computation of tax resulted in non/short levy of tax of Rs 3 lakh as detailed below:

(In lakh of rupees)					
Sl. No.	Name of Office No. of cases	Assessment year/ Month of assessment	Nature of irregularity	Amount of short levy	Remarks
1.	STO, I Circle, Palakkad 1	2000-01 June 2002	While finalising the assessment of a SSI unit, taxable sales turnover of Rs 21.21 lakh was taken as Rs 1.67 lakh and assessed accordingly. The tax due was adjusted against the exemption available.	1.56	After the case was pointed out in December 2003, the assessment was revised and the additional demand created was adjusted against the exemption available.
2.	STO, Manjeri 1	2001-02 October 2003	While completing the revised assessments of a dealer levying tax on the turnover suppressed by the assessee as revealed in the inspection conducted by the Intelligence Wing of the Department; although the turnover of Rs 64.83 lakh already assessed as per the original assessment was excluded, tax of Rs 1.44 lakh given credit in the original assessment, was again afforded credit in the revised assessment order.	1.44	After the case was pointed out in March 2004, the Assessing Authority rectified the mistake. Further report had not been received (December 2004).
			Total	3.00	

The above cases were reported to Government in March and April 2004. Further report had not been received (December 2004).

2.11. Short levy of turnover tax

Under the KGST Act, any dealer in foreign liquor (Indian Made Foreign Liquor and Foreign Liquor) should pay turnover tax on the turnover at all points of sales at five *per cent* with effect from 1 April 1995. KGST Rules, 1963 and the instructions issued in June 1989 and February 1992 lay down departmental procedure for verifying and checking of all calculations of turnover, tax and credits in an assessment order.

In STO, Manjeri, while finalising in July 2002 the assessment for the year 2000-01 of an assessee running a hotel, turnover tax was levied only on a turnover of Rs 17.91 lakh although the turnover assessable was Rs 1.18 crore. This had resulted in short levy of turnover tax of Rs 5 lakh.

After the case was pointed out by audit in February 2004, the Department stated in September 2004 that the assessment was revised. Further report had not been received (December 2004).

2.12. Misclassification of goods

Under the KGST Act, tax on centrifugal pumps (including mono block pump sets), electrically operated or engine operated was at the rate of 12.5 *per cent*. The rate was reduced to two *per cent* in respect of mono block pump sets up to 1 HP and to 10 *per cent* in respect of other pump sets vide Schedule II to SRO 1728/93.

In Sales Tax Office, Special Circle, Thrissur, while finalising the assessment for 1998-99 of a dealer in August 2001, turnover of jet pumps amounting to Rs 1.38 crore was assessed to tax at two *per cent* instead of at the correct rate of 10 *per cent* applicable to all pumps other than mono block pump sets up to 1 HP. This resulted in short levy of tax of Rs 12.17 lakh.

After this was pointed out by audit in August 2002, the Assessing Officer stated that mono block pumps included jet centrifugal pumps also. This is not correct as mono block pumps and jet centrifugal pumps work on different technology. The mono block pump works on a single suction hose pipe while jet centrifugal pump work on two suction hose pipes joined at the foot valve. Hence jet pumps cannot be classified as mono block pumps.

The matter was referred to Government in February 2004. Further reply had not been received (December 2004).