

## CHAPTER II

### SALES TAX

#### 2.1 Results of audit

Test check of records of departmental offices conducted during the period from April 2005 to March 2006 revealed under assessments, non levy of penalty etc., amounting to Rs.118.01 crore in 1,409 cases, which broadly fall under the following categories.

**(Rupees in crore)**

Sl.No.	Categories	No. of cases	Amount
1	Incorrect exemption from levy of tax	256	20.33
2	Application of incorrect rate of tax	381	19.34
3	Incorrect computation of taxable turnover	215	19.26
4	Non levy of penalty/interest	352	5.35
5	Escapement of taxable turnover	24	37.73
6	Others	180	15.71
7	Review on <b>Pendency of appeals at various levels and their impact on revenue collection.</b>	1	0.29
	<b>Total</b>	<b>1,409</b>	<b>118.01</b>

During the course of the year 2005-06, the department accepted under assessments, etc. amounting to Rs.2.91 crore in 656 cases, out of which, Rs.1.88 crore involving 521 cases were pointed out during the year and the rest in earlier years. Of these, the department recovered Rs.1.44 crore.

After issue of draft paragraphs the department recovered Rs.8.48 lakh in one case pertaining to 2005-06.

A review on **pendency of appeals at various levels and their impact on revenue collection** and a few illustrative cases involving Rs.28.49 crore are discussed below:

## **2.2 Review on pendency of appeals at various levels and their impact on revenue collection**

### *Highlights*

- At the end of March 2005, 5,972 appeal cases involving disputed revenue of Rs.2,477 crore and 14,221 cases involving disputed revenue of Rs.1,372 crore were pending before the Appellate Assistant Commissioners/Appellate Deputy Commissioners and Sales Tax Appellate Tribunals respectively.

*(Paragraph 2.2.6)*

- In five divisions, 15 appeal cases involving Rs.6.62 crore though filed after the statutory time limit, were incorrectly admitted.

*(Paragraph 2.2.7)*

- Penalty of Rs.16.53 crore required to be collected before admitting appeals was not collected by 14 appellate authorities in 543 cases resulting in non realisation of Government revenue.

*(Paragraph 2.2.8)*

- As on 31 March 2005, 1,392 appeals involving disputed revenue of Rs.73.09 crore were pending before 12 appellate authorities for more than three years.

*(Paragraph 2.2.9)*

- Orders in 138 appeal cases finalised by eight appellate authorities were communicated after a period of 38 to 340 days resulting in delay in collection of Government revenue of Rs.40.57 crore.

*(Paragraph 2.2.11)*

### ***Recommendations***

Government may consider taking the following steps to improve the effectiveness of the system.

- fix administrative norms for timely disposal/finalisation of appeal/remanded cases, and
- ensure strengthening of the internal control system to monitor passing and communication of appeal orders by appellate authorities and proper maintenance of the prescribed registers.

### ***Introduction***

**2.2.1** The Tamil Nadu General Sales Tax Act, 1959 (TNGST Act) and the rules made thereunder provide an assessee the statutory remedy to file an appeal, if he is aggrieved by any order passed by an assessing authority. The first appellate authority in respect of order passed by Assistant Commercial Tax Officers, Deputy Commercial Tax Officers or Commercial Tax Officers is the Appellate Assistant Commissioner (AAC). The first appeal lies with the Appellate Deputy Commissioner (ADC) in respect of order passed by the Assistant Commissioner (Commercial Taxes). The second and higher appeals in all cases rest with the Sales Tax Appellate Tribunal (STAT), High Court and the Supreme Court.

TNGST Act provides that an appeal to the AAC/ADC should be filed by an assessee within a period of 30 days from the date on which the order of assessment was served on him. The AAC/ADC may, however, admit an appeal filed within a further period of 30 days after the expiry of the initial period of 30 days. The Act also provides for payment of prescribed percentage of disputed tax and penalty before filing of appeal.

The Act further provides that AAC/ADC may, while disposing of an appeal, set aside the assessment and direct the assessing authority to make a fresh assessment after such further inquiry as may be directed. The TNGST Act and the rules made thereunder do not specify any time limit for disposal of appeals and for passing orders in respect of remanded cases.

### ***Organisational set up***

**2.2.2** The appellate wing of the department is distinct from the assessment and administrative wings. The State has 20 AACs, two ADCs and four benches of the STAT each headed by a Chairman, who is a judicial officer not below the rank of district judge and two other members also appointed by Government possessing such qualifications as prescribed by Government. The AACs., ADCs. and Tribunals are under the administrative control of the Chairman, STAT and the overall supervisory control is exercised by the Registrar General, High Court, Chennai.

**Audit Objectives**

**2.2.3** This review was conducted with a view to:

- analyse the pendency of appeals at various levels and their impact on revenue collection,
- ascertain the adequacy of the system available to ensure timely disposal of appeal/remanded cases and
- ascertain the effectiveness of the internal control mechanism.

**Scope of Audit**

**2.2.4** During the review conducted from July 2005 to March 2006, data from 14<sup>1</sup> out of 22 first appellate authorities and four benches of tribunal was collected. The review also covered six out of nine divisions and 109 out of 323 assessment circles. Appeal orders passed and remanded cases finalised during the years 2000-01 to 2004-05 were taken up for detailed scrutiny.

**Revenue involved in appellate fora**

**2.2.5** The position of revenue blocked by appeal cases as furnished by the Chairman, STAT was Rs.3,848.48 crore as on 31.3.2005. The year wise position was as under:

**(Rupees in crore)**

Year ending	AAC		ADC		STAT		Total	
	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
2000-01 as on 31.3.2001	13,804	2,127.15	326	481.70	11,456	1,264.30	25,586	3,873.15
2001-02 as on 31.3.2002	8,758	1,312.39	235	483.27	12,553	1,099.82	21,546	2,895.48
2002-03 as on 31.3.2003	7,029	954.66	230	429.61	13,974	1,325.05	21,233	2,709.32
2003-04 as on 31.3.2004	6,069	529.69	196	440.36	14,041	1,252.82	20,306	2,222.87
2004-05 as on 31.3.2005	5,850	2,053.69	122	422.81	14,221	1,371.98	20,193	3,848.48

<sup>1</sup> AAC-III, Chennai, AAC-IV, Chennai, AAC-VI, Chennai, AAC Coimbatore (Addl.), Coimbatore (Main), Kancheepuram, Madurai (North), Madurai (South), Pollachi, Tirunelveli, Trichy, Virudhunagar, ADC Chennai and Coimbatore.

The details regarding revenue blocked in appeals were not furnished by the department, with the result, the departmental figures could not be cross checked with the figures furnished by the Chairman, STAT.

### *Disposal of appeals*

**2.2.6** No norms for disposal of appeals by AAC/ADC have been prescribed. The details furnished by the Chairman, STAT show that the number of cases pending for disposal before AACs/ADCs during the last five years ranged between 40 and 51 *per cent* and that of tribunals between 74 and 89 *per cent*. The disposal of appeals for the years 2000-01 to 2004-05 is detailed below:

#### *Disposal of appeals by AACs/ADCs*

(Rupees in crore)

Year	Out-standing as on 1April	Additions during the year	Total	Clearance during the year	Out standing as on 31March	Percentage of pendency
	No. of cases/ Amount	No. of cases/ Amount	No. of cases/ Amount	No. of cases/ Amount	No. of cases/ Amount	
2000-01	<u>15,431</u> 2,539.20	<u>12,055</u> 2,082.55	<u>27,486</u> 4,621.75	<u>13,356</u> 2,012.90	<u>14,130</u> 2,608.85	51
2001-02	<u>14,130</u> 2,608.85	<u>8,433</u> 1,242.97	<u>22,563</u> 3,851.82	<u>13,570</u> 2,056.16	<u>8,993</u> 1,795.66	40
2002-03	<u>8,993</u> 1,795.66	<u>7,068</u> 662.80	<u>16,061</u> 2,458.22	<u>8,802</u> 1,074.19	<u>7,259</u> 1,384.27	45
2003-04	<u>7,259</u> 1,384.27	<u>6,086</u> 374.92	<u>13,345</u> 1,759.19	<u>7,080</u> 789.14	<u>6,265</u> 970.05	47
2004-05	<u>6,265</u> 970.05	<u>6,574</u> 2,122.66	<u>12,839</u> 3,092.71	<u>6,867</u> 616.21	<u>5,972</u> 2,476.50	47

#### *Disposal of appeals by the tribunals*

(Rupees in crore)

Year	Out standing as on 1April	Additions during the year	Total	Clearance during the year	Out standing as on 31March	Percentage of pendency
	No. of cases/ Amount	No. of cases/ Amount	No. of cases/ Amount	No. of cases/ Amount	No. of cases/ Amount	
2000-01	<u>8,355</u> 952.99	<u>6,430</u> 500.32	<u>14,785</u> 1,453.31	<u>3,329</u> 189.01	<u>11,456</u> 1,264.30	77
2001-02	<u>11,456</u> 1,264.30	<u>5,493</u> 286.98	<u>16,949</u> 1,551.28	<u>4,396</u> 451.46	<u>12,553</u> 1,099.82	74
2002-03	<u>12,553</u> 1,099.82	<u>4,695</u> 497.49	<u>17,248</u> 1,597.31	<u>3,274</u> 272.27	<u>13,974</u> 1,325.04	81
2003-04	<u>13,974</u> 1,325.04	<u>3,135</u> 242.38	<u>17,109</u> 1,567.42	<u>3,068</u> 314.60	<u>14,041</u> 1,252.82	82
2004-05	<u>14,041</u> 1,252.82	<u>1,985</u> 226.83	<u>16,026</u> 1,479.65	<u>1,805</u> 107.67	<u>14,221</u> 1,371.98	89

The pendency of appeal before the tribunals registered a 70 per cent increase during the five year period. The amount involved in the disputed cases pending before the tribunals increased from Rs.952.99 crore in April 2000 to Rs.1,371.98 crore in March 2005.

### ***Admittance of appeals filed after the statutory time limit***

**2.2.7** The TNGST Act provides that appeal should be filed by the appellant within 30 days from the expiry of the date on which the order was served on him. The Act further provides that the AAC/ADC may, within a further period of 30 days admit an appeal, if he is satisfied that the appellant had sufficient cause for not preferring the appeal within the stipulated period of 30 days.

Test check of records in five<sup>2</sup> divisions revealed that 15 appeal cases filed after the statutory period of 60 days were admitted. The revenue involved in these cases amounts to Rs.6.62 crore. A few illustrative cases are given below:

**(Rupees in lakh)**

Sl.No.	Appeal number	Assessment circle	Date of service of order	Date of filing of appeal	Delay (No. in days)	Revenue involved
1	18/2004	Perur	11.10.03	01.07.04	262	7.60
2	60/2002	West Tower	26.12.00	21.09.01	268	18.85
3	11/2002	Udumalpet	21.08.98	10.12.01	1,217	366.43

Admittance of the appeals filed after the statutory time limit was incorrect, which hindered early realisation of revenue.

Government to whom the matter was reported in May 2006, stated in August 2006 that the audit observations would be conveyed to Chairman, STAT for further necessary action.

### ***Non payment of the prescribed amount of the disputed penalty***

**2.2.8** According to Section 25 of the TNGST Act, any penalty payable under the Act shall be deemed to be tax under the Act, for the purpose of collection and recovery. Section 31 of the TNGST Act provides that no appeal shall be entertained unless it is accompanied by satisfactory proof of payment of tax admitted by the assessee and prescribed percentage<sup>3</sup> of the difference of tax assessed by the assessing authority and the tax admitted by the appellant.

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<sup>2</sup> Chennai (South), Coimbatore, Madurai, Tirunelveli and Trichy.

<sup>3</sup> 25 per cent from 10 June 1999, 12.5 per cent from 26 July 2000 and 25 per cent from 3 June 2002.

A scrutiny of records, however, revealed that though the assessing authorities levied penalty of Rs.72.79 crore in 543 cases, the appeals filed by the assesseees were admitted without payment of the prescribed percentage of penalty amounting to Rs.16.53 crore as detailed below:

**(Rupees in crore)**

Sl. No.	Name of the appellate authority	No. of cases	25%/12.5% of the disputed amount of penalty recoverable
1	AAC-III, Chennai	51	7.82
2	AAC, Madurai(North)	47	0.89
3	AAC, Madurai(South)	54	1.16
4	AAC, Coimbatore(Main)	15	0.17
5	AAC, Pollachi	41	0.46
6	AAC, Virudhunagar	89	0.95
7	AAC-IV, Chennai	29	0.55
8	AAC-VI, Chennai	29	0.76
9	AAC, Kancheepuram	32	1.23
10	AAC, Coimbatore(Addl.)	28	0.64
11	AAC, Trichy	57	0.39
12	AAC, Tirunelveli	60	1.14
13	ADC, Chennai	10	0.32
14	ADC, Coimbatore	1	0.05
<b>Total</b>		<b>543</b>	<b>16.53</b>

After this was brought to the notice of the department in March 2006, the territorial Deputy Commissioners of Tirunelveli, Chennai (East), Chennai (Central) and the AAC Coimbatore replied that ‘tax’ as defined in TNGST Act does not include penalty. The reply was not tenable in view of the specific provision contained in Section 25 of the Act.

Government to whom the matter was reported in May 2006, stated in August 2006 that the audit observations would be conveyed to the Chairman, STAT for further necessary action.

### ***Non fixation of time limit for disposal of appeals***

**2.2.9** The TNGST Act and the Rules made thereunder do not prescribe any time limit for disposal of appeals. The Tamil Nadu Commercial Taxes Manual (TNCT Manual) contemplates that the departmental representative should move the Appellate Deputy/Assistant Commissioner for quick disposal of long pending cases.

The details furnished by the Chairman, STAT indicate that 1,392 appeals involving disputed revenue of Rs.73.09 crore were pending before 12 appellate authorities covered in the review for more than three years as on 31 March 2005. The age wise analysis is given below:

<b>(Rupees in crore)</b>			
<b>Sl.No.</b>	<b>Period of pendency</b>	<b>No. of cases</b>	<b>Amount involved</b>
1	More than 10 years	56	0.67
2	More than 5 years but less than 10 years	396	23.13
3	More than 3 years but less than 5 years	940	49.29
4	Less than 3 years	2,730	1,896.27
<b>Total</b>		<b>4,122</b>	<b>1,969.36</b>

The details furnished by ADC, Chennai revealed that 17 appeal cases involving revenue of Rs.34.96 crore were transferred to ADC, Coimbatore from Chennai in 2001 but were returned undisposed in 2005. The last hearing in all these appeals was held in May 2002 by ADC, Coimbatore. The appeals were finalised by ADC, Chennai between August 2005 and December 2005. Undue delay of more than five years was brought to the notice of department in March 2006.

Government to whom the matter was reported in May 2006, stated in August 2006 that the audit observations would be conveyed to the Chairman, STAT for further necessary action.

#### ***Delay in writing up of appeal orders***

**2.2.10** As per TNCT Manual (Volume I) , an appeal order should normally be written up within 10 days from the date of last hearing of the appeal or of making an enquiry, if any, connected with it. Where a longer time is taken because of any special circumstances, the reasons thereof should be clearly spelt out in the records.

Audit scrutiny revealed that 25 appeal cases involving disputed revenue of Rs.60.99 crore were remanded by AAC-VI, Chennai and AAC, Coimbatore (Main). The orders remanding back the assessment were, however, written up belatedly and the delay ranged between 22 days to 382 days. This resulted in blocking up of revenue and delayed collection of revenue due to Government.

Government to whom the matter was reported in May 2006, stated in August 2006 that the audit observations would be conveyed to the Chairman, STAT for further necessary action.

#### ***Communication of appeal orders***

**2.2.11** After an appeal is decided, the decision is communicated to the assessing officer to enable him to take action as per the orders. No time limit for communication of orders has been laid down in the Act /Rules.



It was noticed that in respect of 138 appeal cases relating to eight appellate authorities, the orders were communicated after a period of 38 to 340 days. This resulted in delay in collection of Government revenue of Rs.40.57 crore as mentioned below:

**(Rupees in crore)**

Sl. No.	Name of the appellate authority	No. of cases	Delay (in days)		Revenue involved
			From	To	
1	AAC-III, Chennai	22	82	153	8.56
2	AAC, Kancheepuram	10	73	120	4.01
3	AAC,Coimbatore(Main)	38	77	340	4.51
4	AAC, Pollachi	19	62	190	2.79
5	AAC, Trichy	7	84	173	0.11
6	AAC, Madurai (S)	12	55	117	4.19
7	AAC, Madurai (N)	21	38	70	1.96
8	ADC, Chennai	9	82	142	14.44
<b>Total</b>		<b>138</b>			<b>40.57</b>

Government to whom the matter was reported in May 2006, stated in August 2006 that the audit observations would be conveyed to the Chairman, STAT for further necessary action.

#### *Non/delay in finalisation of remanded cases*

**2.2.12** The TNGST Act and Rules made thereunder do not specify any time limit for passing orders in respect of remanded cases.

Audit scrutiny revealed that in 76 assessment circles relating to six divisions, 741 remanded cases involving revenue of Rs.375.22 crore were not finalised as on 31 March 2005, resulting in blocking up of Government revenue. The delay ranged from five months to five years.

**(Rupees in crore)**

Sl. No.	Division	No.of circles	No. of cases	Revenue involved
1	DC, Chennai (South)	19	79	19.06
2	DC, Chennai (Central)	9	77	130.28
3	DC, Chennai (East)	8	71	71.77
4	DC, Coimbatore	22	359	69.49
5	DC, Madurai	10	49	52.21
6	DC, Tirunelveli	8	106	32.41
<b>Total</b>		<b>76</b>	<b>741</b>	<b>375.22</b>

Audit scrutiny revealed that AAC, Madurai, while remanding the assessment in three cases in February 2003 issued directions to pass orders within 60 days. These assessments involving revenue of Rs.42.47 lakh were yet to be finalised. In one case, though the AAC directed the assessing authority to finalise the case within eight weeks, order involving tax of Rs.15.08 lakh was passed after a delay of 130 weeks.

Government to whom the matter was reported in May 2006, stated in August 2006 that the Act does not prescribe any time limit and finalisation of remanded cases is being monitored by the Assistant Commissioners, Deputy Commissioners and Commissioner of Commercial Taxes during review meetings. However, delay in finalisation which ranges from five months to five years indicates that this requires effective monitoring and concerted efforts

***Incorrect finalisation of remanded cases***

**2.2.13** It was noticed in review that in four cases, which were remanded by the appellate authorities, assessments were finalised incorrectly, resulting in short/non levy of tax of Rs.28.62 lakh (inclusive of penalty) as detailed below:

**(Rupees in lakh)**

Sl. No	Assessment circle	Assessment year/ Month of assessment	Amount	Remarks
1	P.N. Palayam	1993-94 (July 2003)	3.06	Electronic emergency lamps were assessed to tax at three <i>per cent</i> , instead of 12 <i>per cent</i> as provided in the Act.
2	Udumalpet (South)	1996-97 (October 2000)	20.92	The AAC upheld levy of tax made under the TNGST Act, disallowing the claim of exemption as sale to local exporters. However, the assessment already made under TNGST Act was subsequently revised allowing the exemption which was incorrect.
3	Bodinayakanur	1996-97 (January 2002)	2.38	Exemption was allowed without verification of proper documentary evidence in proof of stock transfer. After this was pointed out in August 2005, the department stated that assessment would be revised.
4	Bodinayakanur	1997-98 (January 2002)	2.26	Exemption was allowed without proper documentary evidence in proof of export sales. After this was pointed out, the department stated that assessment would be revised.
<b>Total</b>			<b>28.62</b>	

***Defective maintenance of registers***

**2.2.14** In order to have an effective control over the appeal cases sent to appellate fora and for followup action, the assessment circles have to maintain appeal registers and registers of remanded cases.

In the course of the review, it was noticed that in 21 assessment circles, the above mentioned registers were not updated, disposals not noted, were not closed periodically and the remanded cases were not entered in the registers. Due to improper maintenance of registers, the total number of appeals filed during the period from 2000-01 to 2004-05 in each assessment circle and their

disposal could not be ascertained. This indicated that internal control system of the department was lacking.

Government to whom the matter was reported in May 2006, replied in August 2006 that suitable circular instructions had been given to the deputy commissioners in July 2006.

### ***Acknowledgement***

**2.2.15** The review was discussed with the Government/department in the Audit Review Committee meeting held in July 2006. The views of Government/department have been incorporated in the respective paragraphs.

### ***Conclusion***

**2.2.16** The review revealed that Government has not periodically addressed the issue of pendency of appeals in appellate fora and consequential blocking up of Government revenue. The delay in finalisation of remanded cases was also not looked into and norms and time limit fixed. The internal control system for pursuing pending appeals and for early finalisation of remanded cases was inadequate.

## **2.3 Incorrect grant of exemption from levy of tax**

**2.3.1** Under Section 3(2) of the TNGST Act, in case of goods mentioned in the first schedule, tax under this Act shall be payable by a dealer, at the rate and only at the point specified therein on the turnover in each year relating to such goods, whatever be the quantum of turnover in that year. It has been judicially held<sup>4</sup> by the Supreme Court that dealers who supply wood for manufacture of pulp are not eligible for exemption, though goods sold may be described as firewood. By notification issued in April 1998, exemption has been granted on sale of raw materials, packing materials and consumables to 100 *per cent* export oriented units (EOU) registered in the State.

Test check of records in six<sup>5</sup> assessment circles revealed that exemption was incorrectly granted between June 2001 and January 2005 to seven dealers on a turnover of Rs.3.80 crore during the years 1996-97, 1999-2000 and 2001-02 to 2003-04. The tax exemption allowed incorrectly in these cases amounted to Rs.34.85 lakh.

A few illustrative cases are mentioned below:

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<sup>4</sup> Tvl. A. Subramaniam Vs. State of Tamil Nadu – 130 STC P.41(SC)

<sup>5</sup> Avinashi Road (Coimbatore), Nungambakkam, Palani-I, Ramnagar, Tirunelveli (Junction) and Tiruvanmiyur.

(Rupees in lakh)

Sl. No.	Assessment circle (No. of dealers)	Year of transactions/ (Month/Year of assessment)	Commodity	Tax-able turn-over	Tax leviable
1	2	3	4	5	6
1	Nungambakkam Tiruvanmiyur (Three)	2001-02 to 2003-04 (between June 2004 and January 2005)	Industrial sewing machines and spares, machinery and electrical panel boards.	144.52	17.54
After this was pointed out, the department revised the assessments in July/December 2005 and raised additional demand of Rs.17.54 lakh; out of which an amount of Rs.3.18 lakh has been collected. Appeal filed against revision of assessment is stated to be pending in one case. Report on recovery of the balance amount is awaited (November 2006).					
2	Tirunelveli (Junction) (One)	1999-2000 (June 2001)	Sale of firewood to a paper mill.	82.80	6.62
After this was pointed out, department revised the assessment in September 2005 and raised an additional demand of Rs.6.62 lakh; the collection particulars of which are awaited (November 2006).					
3	Ramnagar (Coimbatore) (One)	2002-03 2003-04 (August/ December 2004)	Agro shading mesh <sup>6</sup> (a commodity classifiable as article of plastic under the Central Excise Tariff Act)	53.41	6.71
After this was pointed out, the department revised the assessments in December 2005 and raised an additional demand of Rs.6.71 lakh; of which a sum of Rs.2.24 lakh was collected by way of adjustment. Particulars of recovery of the balance amount are awaited (November 2006).					

After this was pointed out, the department revised the assessment in six cases and raised additional demand of Rs.33.54 lakh; out of which an amount of Rs.5.42 lakh was collected. Report on recovery of the balance amount and final reply in respect of other case is awaited (November 2006).

The matter was reported to Government between November 2005 and May 2006. Government accepted the audit observations in six cases. Reply of Government in respect of remaining case is awaited (November 2006).

**2.3.2** According to Section 8(2-A) of the Central Sales Tax Act, 1956 (CST Act), inter State sale of goods is exempted from levy of tax, if the same is generally exempted under the local Act. If the goods under the local Act are exempted only in specified circumstances or under specified conditions, inter State sale of such goods is not eligible for exemption. As per entry 6(viii) of the second schedule to the TNGST Act, copra coconut is taxable at the rate of four *per cent* at the point of last purchase in the State by a dealer for crushing oil. Under entry 17 of Part B of the third schedule to the Act, coconut, copra other than those falling under the second schedule are exempted.

<sup>6</sup> Agro shading mesh is made of 100% high density polyethylene and is used for providing shade from harsh rays of sunlight. It controls temperature, reduces evaporation and keeps out birds and insects.

In Omalur assessment circle, while finalising the assessment of nine dealers for the year 2003-04 in February/March 2005, turnover of Rs.2.05 crore representing inter State sale of coconut, conditionally exempted under the local Act was erroneously exempted from levy of tax under CST Act. Incorrect allowance of exemption resulted in non levy of tax of Rs.16.37 lakh.

After this was pointed out in June 2005, the assessing authority(AA) replied that the exemption allowed on inter State sale was in order as watery coconut is generally exempted from tax under the local Act. The reply is not tenable as watery coconut is coconut and coconut is only conditionally exempted under the local Act.

The matter was reported to Government in November 2005; reply is awaited (November 2006).

## 2.4 Application of incorrect rate of tax

**2.4.1** Under the provisions of the TNGST Act, tax is leviable on the sale or purchase of goods, as the case may be, at the rates and at the points mentioned in the relevant schedules to the Act.

In 15<sup>7</sup> assessment circles, while finalising the assessments between January 2000 and March 2005, tax was levied short due to application of incorrect rates of tax on a turnover of Rs.20.21 crore involving 19 dealers during the years 1995-96, 1997-98 and 2000-01 to 2003-04. The short levy of tax worked out to Rs.1.35 crore.

A few illustrative cases are mentioned below:

(Rupees in lakh)

Sl. No	Assessment circle (No. of dealers)	Year of transaction (Month/ Year of assessment)	Commodity	Tax-able turn over	Rate of tax (per cent)		Amount short levied
					Appli cable	App- lied	
1	2	3	4	5	6	7	8
1	T.Nagar (South) (One)	2003-04 (December 2004)	Sweets and savouries sold under a brand name.	454.99	16	2	66.88
Under the TNGST Act, sale of branded sweets and savouries is taxable at the rate of 16 per cent. It was, however, taxed at two per cent.							
After this was pointed out in December 2005, the department replied that the goods were not covered by any registered trade mark and that the dealer was selling the goods in retail in small quantities and the packing materials were provided only to enable the customers to take the sweets in packed condition. The reply is not tenable as the goods were sold under brand name "Archana Sweets" and should be taxed at the rate of 16 per cent.							

<sup>7</sup> Annathanapatty, Chengalpattu, Fast Track Assessment Circle-II(Chennai), Harur, Luz, Mandaveli, Nungambakkam, Rattan Bazaar, Royapettah-I, Saibaba colony, Shevapat (North), Singarathoppu, Tiruppur (South), Tiruvanmiyur and T.Nagar (South).

1	2	3	4	5	6	7	8
2	Harur  Annathapatty (Two)	1997-98 (January 2000)  2000-01 (November 2003)	Polyester yarn	481.90	8	2 4	19.72
After this was pointed out, the department in the case pertaining to Harur, revised the assessment in January 2004 and raised additional demand of Rs.1.33 lakh; the collection particulars of which are awaited (November 2006).							
3	Luz, Chennai (One)	2003-04 (October 2004)	'DOMEX' Home care liquid cleaner	276.53	16	12	11.61
The department revised the assessment in May 2006 and raised an additional demand of Rs.11.61 lakh; the collection particulars of which are awaited (November 2006).							
4	Nungambakkam (One)	2002-03 (March 2005)	Body shampoo kits	259.53	20	16	10.90
5	Rattan Bazaar (One)	2002-03 (April 2004)	Printed materials	130.01	10	3	9.56
The department revised the assessment in November 2005 and raised an additional demand of Rs.9.56 lakh; the collection particulars of which are awaited (November 2006).							

After this was pointed out, the department revised the assessment in 10 cases between January 2004 and May 2006 and raised an additional demand of Rs.43.09 lakh; out of which an amount of Rs.5.90 lakh has been collected. The department did not accept audit observations in six cases and suitable rejoinders were given to the department. Final reply of the department in respect of these cases is awaited (November 2006).

The matter was reported to Government between November 2005 and April 2006. Government accepted audit observations in nine cases; reply in respect of other cases is awaited (November 2006).

**2.4.2** Under the CST Act, inter State sale of goods to registered dealers and Government departments is assessable to tax at the rate of four *per cent* on production of prescribed declarations. If inter State sale of goods is not covered by valid declarations in form 'C' or certificate in form 'D', tax is leviable at the rate of 10 *per cent* or at the rate applicable to sale of such goods inside the State, whichever is higher.

In three<sup>8</sup> assessment circles, it was noticed that inter State sale of bearings, gear boxes, coir machinery and vegetable oils valued at Rs.2.78 crore made by four dealers between 1998-99 and 2002-03 were not supported by prescribed declarations/certificates. However while finalising the assessments between October 2002 and March 2005, AAs incorrectly applied concessional rate of tax instead of the rate specified. Thus, application of incorrect rate of tax resulted in short levy of tax of Rs.11.06 lakh.

<sup>8</sup> Fast Track Assessment Circle-I, Coimbatore, Ganapathy and Velachery.

After this was pointed, department revised the assessment in three cases and raised an additional demand of Rs.5.99 lakh; out of which an amount of Rs.3.89 lakh has been collected. Report on recovery of balance amount and reply in respect of the other case is awaited (November 2006).

The matter was reported to Government between November 2005 and January 2006. Government accepted the audit observation in two cases; reply in respect of other cases is awaited (November 2006).

## 2.5 Erroneous treatment of contract of sale as works contract

‘Sale’ means every transfer of property in goods by one person to another in the course of trade or business, for cash, deferred payment or for any valuable consideration. ‘Works contract’ includes any agreement for carrying out for cash, deferred payment or for any valuable consideration, building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning, of any movable or immovable property. Supreme Court held<sup>9</sup> that in a contract of sale the main object is the transfer of property and delivery of possession of the property, whereas the main object in a contract for work is not transfer of property but it is one for work and labour.

During the course of audit, it was noticed between November 2004 and November 2005 that AAs while finalising between December 2003 and January 2005 assessment of five dealers for the years 2001-02, 2002-03 and 2003-04, incorrectly treated contracts of sale as contracts for work. This resulted in short levy of tax and surcharge of Rs.21 lakh as detailed below:

(Rupees in lakh)

Sl. No.	Assessment circle (No. of dealers)	Year of transaction (Month/Year of assessment)	Nature of transaction	Taxable turnover	Rate of Tax (per cent)		Amount short levied
					Applicable	Applied	
1	2	3	4	5	6	7	8
1	Thiruvanimiyur (One)	2002-03 (July 2004)	Contract for sale and installation of heat exchangers	85.96	12	4	7.22

After this was pointed out in July 2005, the assessing authority replied that transaction was one of works contract involving erection and installation of heat exchangers and hence the assessment made at four per cent was in order. The reply was not tenable as the contract involved sale and installation of heat exchangers and as such it should have been taxed as contract for sale and not as contract for work. This was clear from scrutiny of invoices which indicated manufacture and sale of heat exchangers.

<sup>9</sup> Hindustan Shipyard Ltd. Vs. State of A.P.- 119 STC P.533 (SC).

1	2	3	4	5	6	7	8
2	Harbour II Nandanam (Two)	2002-03 (December 2003) 2003-04 (January 2005)	Contracts for supply and installation of generators	84.84	16	4	10.60
<p>After this was pointed out in November 2004/November 2005, the department in one case contended that the contract was for supply, installation, erection and commissioning of generators and, therefore, the assessment made by treating it as works contract was in order. The reply was not tenable as major portion of contract involved sale of generator and installation was only incidental. As such it should have been treated as sale contract and taxed accordingly. The department in the other case revised the assessment and raised an additional demand of Rs.8.72 lakh; the collection particulars of which are awaited (November 2006).</p>							
3	Nungam-bakkam (Two)	2001-02 (June 2004)  2003-04 (December 2004)	Contract for erection and installation of transmission towers.  Contract for supply of modern aluminium partitions.	20.59  18.23	12  12	4  4	1.65  1.53
<p>After this was pointed out in July 2005, the department revised the assessment in one case and raised additional demand of Rs.1.65 lakh; the collection particulars of which are awaited. Reply of the department in respect of the other case is awaited (November 2006).</p>							
<b>Total</b>				<b>209.62</b>			<b>21.00</b>

The matter was reported to Government between January and April 2006. Government accepted the audit observation in two cases; reply in respect of other cases is awaited (November 2006).

## 2.6 Non/Short levy of additional sales tax

Under Section 2(1)(aa) of the Tamil Nadu Additional Sales Tax Act, 1970 (TNAST Act), additional sales tax is leviable at the rates prescribed from time to time, depending upon the taxable turnover. Explanation I to the said section envisages that "taxable turnover" in respect of a principal selling or buying goods through agents shall be the aggregate taxable turnover of all his agents relating to the sale or purchase of the goods of such principal within the State.

In Virudhunagar-I assessment circle, while finalising assessments of five dealers for the year 2002-03 between April 2004 and December 2004, the turnover representing sales effected through local consignment agents was not considered for levy of additional sales tax at the hands of the principal. Audit scrutiny revealed that while the principals were liable to pay additional sales tax of Rs.2.76 crore on the taxable turnover including that of their agents, the agents had paid additional sales tax of Rs.1.30 crore only. This resulted in non/short levy of additional sales tax of Rs.1.46 crore.



After this was pointed out, the territorial Assistant Commissioner accepted the audit observation and stated that necessary revision of assessment would be considered after recheck of accounts. Further report is awaited from the department (November 2006).

The matter was reported to Government in April 2006; reply is awaited (November 2006).

## **2.7 Evasion of tax noticed through cross check of records**

Cross verification of details gathered from Central Excise Department and Southern Railways with the records maintained in Commercial Taxes Department revealed evasion of sales tax, inclusive of penalty, amounting to Rs.23.76 crore due to suppression of sales turnover and misclassification of goods as detailed below:

### ***Central Excise Department***

#### ***Suppression of sales turnover:***

**2.7.1** As per the adjudication orders passed by Central Excise Department between November 2001 and May 2005, nine dealers suppressed sales valued at Rs.83.05 crore during the years 1998-99 to 2002-03. Cross verification of records maintained in nine commercial taxes assessment circles<sup>10</sup> with the above information revealed that the dealers did not disclose the said sales turnover to Commercial Taxes Department.

Out of these, seven dealers were registered dealers and had suppressed sales turnover of Rs.77.77 crore in their books of accounts and thereby evaded payment of tax of Rs.22.30 crore. The remaining two dealers were unregistered dealers. They had effected sales of Rs.5.27 crore involving tax of Rs.53.02 lakh. They were not assessed to tax at all. The department did not detect suppression of sales resulting in non realisation of tax and penalty of Rs.22.83 crore.

This was brought to the notice of the department between May and December 2005. The department in one case revised the assessment in January 2006 and raised additional demand of tax and penalty of Rs.3.58 lakh, the collection particulars of which are awaited (November 2006). Reply of the department in respect of other cases is awaited (November 2006).

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<sup>10</sup> Avarampalayam, Big Bazaar-Coimbatore, Chokkikulam, Hosur (South), Karur (East), P.N.Palayam-Coimbatore. R.S.Puram (West), Saligramam and Tiruchengode (Town).

**Misclassification of sales turnover**

**2.7.2** Cross verification of records in three<sup>11</sup> assessment circles of Commercial Taxes Department with adjudication orders passed during the period between April 2005 and June 2005, by Central Excise Department, revealed that three dealers sold cotton cone yarn<sup>12</sup> valued at Rs.14.33 crore during the years 1999-2000 to 2001-02 but declared it as cotton hank yarn<sup>13</sup> in their sales tax returns and paid tax at lesser rate. This misclassification was also not noticed by the commercial tax authorities at the time of final assessment. This resulted in short levy of tax of Rs.28.66 lakh.

This was pointed out to the department in July/August 2005. Reply of the department is awaited (November 2006).

**Railways**

**2.7.3** Cross verification of records in railways pertaining to supply of stone ballast with the assessment records in Commercial Taxes Department revealed that taxable turnover of Rs.10.06 crore in respect of nine assessees, pertaining to nine assessment circles escaped assessment. The amount of tax and penalty involved in these cases worked out to Rs.63.69 lakh as detailed below:

**(Rupees in lakh)**

Sl. No.	Assessment Circle (No.of dealers)	Assessment Year	Turnover escaped assessment	Revenue involved (inclusive of penalty)	Remarks
1	2	3	4	5	6
1	Arakonam (One)	2000-01	10.74	1.07	In all these cases, the dealers were registered under the TNGST Act and assessments were finalised between March 2002 and February 2005. The dealers suppressed sales turnover of Rs.6.73 crore, involving tax and penalty of Rs.30.01 lakh.
2	Mayiladuthurai-I (One)	2002-03 2003-04	22.46	2.36	
3	Tirumangalam (One)	2002-03	8.98	0.95	
4	Adyar-I (One)	2002-03 2003-04	260.37	10.63	
5	Mandaveli (One)	2001-02 2002-03	248.63	9.95	
6	Tambaram-II (One)	2002-03 2003-04	122.25	5.05	

<sup>11</sup> Dharapuram, Perundurai and Singanallur.

<sup>12</sup> Cotton yarn twisted and reeled on paper cone and used in power loom.

<sup>13</sup> Cotton yarn wound on hand operated charka, used in hand loom.

1	2	3	4	5	6
7	Arisipalayam (One)	2000-01 2001-02	249.65	24.97	The dealer was registered under the TNGST Act, but did not disclose the turnover in his assessment, and the assessment was finalised as 'O' case <sup>14</sup> .in August 2003.
8	Thanjavur-II (One)	2002-03 2003-04	19.64	2.06	The dealers were liable for registration, but had not registered themselves under the Act and no assessment was made by the department.
9	Pudukottai-I (One)	2002-03 2003-04	63.17	6.65	
<b>Total</b>			<b>1,005.89</b>	<b>63.69</b>	

This was brought to the notice of the department between May and October 2005; reply is awaited (November 2006).

The matter was reported to Government in March/April 2006; reply is awaited (November 2006).

## 2.8 Non levy of tax

**2.8.1** Under the TNGST Act, pesticides, chemicals and electrical goods are taxable at the point of first sale in the State, while waste paper and plastic scrap are taxable at the point of last purchase in the State. Section 3-H of the Act provides for levy of resale tax of one *per cent* on the turnover of resale of goods with effect from 1 July 2002.

In four<sup>15</sup> assessment circles, while finalising the assessment of six dealers for the years 1996-97, 2001-02 and 2002-03 between October 2002 and March 2005, turnover of Rs.2.93 crore representing first sale of pesticides and chemicals, last purchase of waste paper/plastic scrap and resale of electrical goods was omitted to be assessed to tax. This resulted in non levy of tax of Rs.10.51 lakh.

After this was pointed out, the department revised the assessments in three cases between May 2005 and May 2006 and raised an additional demand of Rs.4.79 lakh, out of which an amount of Rs.2.96 lakh has been collected. Report on recovery of the balance amount and reply in respect of other cases is awaited (November 2006).

<sup>14</sup> 'O' case refers to assessments finalised with 'nil' taxable turnover.

<sup>15</sup> Dindigul-III, Koyambedu, Manali and Sattur.

The matter was reported to Government between December 2005 and April 2006. Government accepted the audit observation in one case; reply in respect of other cases is awaited (November 2006).

**2.8.2** TNGST Act provides that a dealer who had purchased goods at concessional rate of tax against form XVII fails to make use of the goods for the purpose for which these were purchased shall pay the difference of tax payable on the turnover relating to sale of such goods at the rate prescribed and three *per cent*. The Act also provides for levy of penalty not exceeding one and half times of the tax payable on the turnover.

In Trichy road assessment circle, while finalising the assessment of a dealer for the year 2003-04 in January 2005, tax with penalty amounting to Rs.6.40 lakh was not levied by the assessing authority, though timber valued at Rs.34.87 lakh purchased against Form XVII declaration, was sold without being used in any manufacturing activity.

After this was pointed out in September 2005, the department replied that the dealer had sold packing cases to 100 *per cent* EOU and, hence levy of tax and penalty was not warranted. The reply was not tenable as scrutiny of sale invoices revealed that the goods purchased were sold in original form to 100 *per cent* EOU. Hence tax and penalty were leviable.

This was brought to the notice of the Government in January 2006; their reply is awaited (November 2006).

**2.8.3** Section 3(4) of the TNGST Act provides that a dealer who after purchasing goods at concessional rate, does not sell the goods so manufactured, but despatches them to a place outside the State either by branch transfer or transfer to an agent or in any other manner, except as a direct result of inter State sale or purchase, shall be liable to pay tax at one *per cent* of the value of goods so purchased.

In four<sup>16</sup> assessment circles, while finalising assessments of four dealers for the years 2000-01 to 2003-04 between March 2003 and March 2005, tax at one *per cent* on the value of goods purchased at concessional rate amounting to Rs.10.77 crore was either not levied or short levied, though the dealers, apart from local sales, had sent the manufactured goods outside the State otherwise than by way of sale or had exported the same. This resulted in non/short levy of tax of Rs.10.77 lakh.

This was pointed out to the department between December 2004 and March 2006; reply is awaited (November 2006).

The matter was reported to Government between December 2005 and April 2006. Government accepted the audit observation in three cases and stated that necessary revision of assessment had been made; reply in respect of remaining case is awaited (November 2006).

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<sup>16</sup> Aruppukottai, Panruti (Rural), Sivakasi-III and T.Nagar (South).

## **2.9 Non levy of interest for belated payment of tax**

Tax under sub section 2 of Section 13 of the TNGST Act shall become due without any notice of demand to the dealers on the date of receipt of the return or on the last due date as prescribed, whichever is later. According to the provisions of Section 24(3) of the TNGST Act, in case of any amount remaining unpaid after the date specified for its payment, the dealer or person shall pay, in addition to the amount due, interest at two *per cent* per month of such amount, for the entire period of default. According to Section 9(2) of the CST Act, the provisions relating to interest on belated payment of tax under TNGST Act shall apply in respect of interest leviable under the CST Act.

In six<sup>17</sup> assessment circles, tax of Rs.94 lakh relating to assessment years 1994-95, 1995-96, 1997-98, 1998-99, 2000-01, 2001-02 and 2003-04 was paid belatedly by seven dealers between March 2003 and March 2005; the delay ranging from 19 days to 87 months. Interest amounting to Rs.36.84 lakh leviable for such belated payment of tax was, however, not levied.

After this was pointed out between December 2004 and January 2006, the department levied interest of Rs.2.62 lakh in two cases in February/June 2005 and collected the same in October 2005. Reply of the department in respect of other cases is awaited (November 2006).

The matter was reported to Government between November 2005 and February 2006. Government, in one case, accepted the audit observation in March 2006; reply in respect of other cases is awaited (November 2006).

## **2.10 Non levy of penalty for excess collection of tax**

According to Section 22(1) of the TNGST Act, only registered dealers shall collect any amount by way of tax, and such collection shall be in accordance with the provisions of the Act or the rules made thereunder. The Act provides for levy of penalty at prescribed rate for excess collection of tax.

In three<sup>18</sup> assessment circles, three dealers effected unauthorised/excess collection of tax during the years 1999-2000, 2001-02 and 2002-03, for which penalty amounting to Rs.6.47 lakh, though leviable, was not levied while finalising the assessments between October 2003 and March 2004.

After this was pointed out between July 2004 and March 2006, the department levied penalty of Rs.5.28 lakh in two cases in March/July 2005 and collected an amount of Rs.2.82 lakh. Report on recovery of the balance amount and reply in respect of the other case are awaited (November 2006).

<sup>17</sup> Aruppukottai, Fast Track Assessment Circles II & III, Chennai, Salem (Bazaar), Tiruppur (Rural) and Tiruvanmiyur.

<sup>18</sup> Guindy, Koyambedu and Nungambakkam.

The matter was reported to Government between December 2005 and March 2006. Government accepted audit observation in two cases; reply in respect of remaining case is awaited (November 2006).

### **2.11 Non levy of penalty under the CST Act**

Under the CST Act, a registered dealer buying goods from other States is entitled to a concessional rate of tax of four *per cent*, provided he furnishes to the seller, a declaration in form 'C'. If the goods indicated in the declaration are not covered by the certificate of registration, the assessee renders himself liable to penalty not exceeding one and half times of the tax due.

In two<sup>19</sup> assessment circles, three dealers purchased goods such as load cell, cement, cement board and paint for Rs.50.71 lakh during the years 1992-93, 2001-02 and 2003-04 from other States by furnishing 'C' form declarations, though the commodities purchased were not covered by their certificate of registration. Penalty amounting to Rs.9.35 lakh leviable for misuse of declarations in form 'C' was, however, not levied while finalising the assessments between December 2002 and December 2004.

After this was pointed out between January 2004 and August 2005, the department levied penalty of Rs.9.35 lakh between April and December 2005; the collection particulars of which are awaited (November 2006).

The matter was reported to Government between January and March 2006. Government accepted the audit observations.

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<sup>19</sup> Dindigul (Rural) and Valluvarkottam.