

CHAPTER II

SALES TAX

2.1 Results of audit

Test check of the records of the departmental offices conducted during the period from April 2007 to March 2008 revealed underassessments, non-levy of penalty and other observations amounting to Rs. 297.69 crore in 1,386 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	291	194.38
2.	Application of incorrect rate of tax	432	38.07
3.	Non-levy of penalty/interest	333	15.54
4.	Incorrect computation of taxable turnover	165	10.44
5.	Non/short levy of tax	86	12.29
6.	Other irregularities	79	26.97
Total		1,386	297.69

During the course of the year 2007-08, the department accepted under assessments and other deficiencies amounting to Rs. 5.44 crore in 1,049 cases, out of which, Rs. 2.32 crore involved in 421 cases were pointed out during the year and the rest in earlier years. Of these, the department recovered Rs. 3.01 crore during the year.

A few illustrative cases involving Rs. 50.77 crore are discussed in the following paragraphs:

2.2 Incorrect grant of exemption from levy of tax

2.2.1 According to Section 3(2-C) of the Tamil Nadu General Sales Tax Act, 1959 (TNGST Act) read with entry 9 of the eleventh schedule, imported textiles are taxable at the rate of 20 *per cent* at the point of first sale in the State. Surcharge is leviable at the rate of five *per cent* on the tax.

Test check of the records in Thirupparankundram assessment circle revealed that the assessing officer (AO), while finalising the assessment of a dealer for the year 2004-05 in January 2006, had incorrectly exempted imported textiles valued at Rs. 32.97 lakh from levy of tax at the point of first sale. This resulted in non-levy of tax of Rs. 6.87 lakh (inclusive of surcharge).

After the case was pointed out in March 2007, the AO replied that the assessment had been revised in May 2007. Report regarding collection of the additional demand has not been received (November 2008).

The matter was reported to the Government in February 2008; their reply has not been received (November 2008).

2.2.2 Under the TNGST Act, machine made matches are taxable at the rate of 10 *per cent* at the point of first sale inside the State. Hand made matches and partly machine made matches are exempted from levy of tax. The term 'partly machine made matches' has neither been defined in the Act nor any parameters have been set to identify such matches.

Under the Central Sales Tax Act, 1956 (CST Act), exemption on inter state sale is available if the commodities are generally exempted under the State Sales Tax Act. Inter state sale of goods not covered by valid declarations in form 'C' is assessable to tax at the rate applicable to the sale of such goods inside the state or 10 *per cent*, whichever is higher. The element of surcharge is also to be taken into account to arrive the tax.

2.2.2.1 Test check of the records in three¹ assessment circles revealed that the AOs, while finalising the assessments of eight dealers for the years 2003-04 to 2005-06 between December 2004 and March 2007, had exempted the local sale of matches valued at Rs. 43.86 crore from levy of tax treating the matches as partly machine made matches. Similarly, inter state sales turnover of Rs. 41.08 crore was allowed exemption from levy of tax. This resulted in short realisation of revenue of Rs. 9.02 crore.

Audit scrutiny of the accounts of the dealers revealed that the dealers had purchased machinery and utilised the same in the entire processes involved in the manufacture of matches, viz., frame filling, chemical grinding, dipping of the splints in the chemical composition for match heads, inner and outer box making, printing of labels on the match boxes and chemical printing of the sides of match boxes. The packing activities like bundling and filling in boxes of the manufactured matches alone were carried out manually. Thus, the matches were only machine made matches and should have been taxed at the

¹ Sivakasi I, Sivakasi II and Sivakasi IV.

rate of 10 *per cent*. The exemption allowed by the AOs treating them as partly machine made was not in order. The erroneous exemption allowed both on the local sales and inter state sales resulted in short realisation of revenue of Rs. 9.02 crore.

2.2.2.2 Test check of the records in Sivakasi IV assessment circle revealed that two dealers had effected inter state sale of machine made matches under the trade mark ‘Chavi’. The AO, while finalising the assessments of the dealers for the years 2003-04 and 2004-05, erroneously allowed exemption on the inter state sales turnover of Rs. 32.56 crore, treating the matches as partly machine made matches instead of levying tax at the rate applicable to sale of machine made matches. The erroneous allowance of exemption resulted in loss of revenue of Rs. 3.67 crore.

The cases were pointed out to the department in November 2007 and to the Government in February 2008; their reply has not been received (November 2008).

2.2.3 According to Section 8(2-A) of the 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 will not be eligible for exemption. As per entry 6(viii) of the second schedule to the TNGST Act, coconut including copra 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, other than those falling under the second schedule is exempted. It has been judicially held² by the Supreme Court that “coconut” includes watery coconut.

Test check of the records in six³ assessment circles revealed that the AOs, while finalising the assessments of 11 dealers for the years 2002-03 to 2004-05 between June 2005 and November 2006, had exempted a turnover of Rs. 22.32 crore representing inter state sale of coconuts from levy of tax. This resulted in non-levy of tax of Rs. 1.70 crore.

After the cases were pointed out between October 2006 and September 2007, the AOs contended that the commodity sold was watery coconuts which was generally exempted from levy of tax under the local Act and hence the inter state sales was also exempted. The reply is not tenable as watery coconut is coconut and coconut is only conditionally exempted under the local Act. This view has also been affirmed by the Madras High Court which has held⁴ that exemption granted to coconut under the local Act is not general but a conditional exemption.

The matter was reported to the Government in November 2007 and January 2008; their reply has not been received (November 2008).

² Ganpat Lal Lakhotia Vs. State of Rajasthan – 104 STC P.91 (SC)

³ Dindigul (Rural), Melur, Nilakottai, Sankarankoil, Srirangam and West Veli Street Circle (Madurai).

⁴ N. Jagannathan & Sons Vs. DCTO Vaniyambadi and other – 7 VST 57 (Madras).

2.3 Short levy of tax on goods sold under brand names by trade mark holders

According to Section 3-J of the TNGST Act, whenever a dealer, who holds the trade mark or the patent thereof, sells goods at any point of sale other than the first point of sale, he shall be deemed to be the first seller in the State and shall be liable to pay tax accordingly. For determining the tax due to be paid by him, the tax levied and collected at the immediate preceding point of sale on the same goods shall be deducted from the tax payable by him at the point of sale.

The Commissioner of Commercial Taxes (CCT) clarified in June 2002 that where a dealer purchases goods from any local registered dealer and effects a resale of such goods with a brand name not registered under the Trade and Merchandise Marks Act (T&MM Act), he is not liable to pay tax under Section 3-J of the Act, but is liable to pay resale tax at one *per cent* under Section 3-H of the Act. The clarification of the CCT is not in consonance with Section 3-J of the Act, which does not require registration of brand name under the T&MM Act. The Kerala High Court, while dealing with a similar provision in the Kerala General Sales Tax Act has held⁵ that the expression “trade mark holder” and “brand name holder” cannot be interpreted as intended to cover only registered trade mark holders or registered brand name holders.

Test check of the records in three assessment circles revealed that four dealers had sold goods under brand names. The AOs while finalising the assessments for the years 2004-05 and 2005-06 between April 2006 and December 2006 of these four dealers levied resale tax at one *per cent*, instead of levying tax at the schedule rates applicable to the goods as provided under Section 3-J of the TNGST Act. This resulted in short levy of tax of Rs. 6.63 crore (inclusive of surcharge and additional sales tax) as mentioned below:

(Rupees in crore)

Sl. No.	Assessment Circle (No. of dealers)	Assessment year/ (Month & year of assessment)	Commodity	Turn-over	Rate of tax (<i>per cent</i>)	Amount of tax due including surcharge and additional sales tax	Tax already levied and collected (including resale tax)	Amount of short levy
1.	T.Nagar (North) (1)	2004-05 (August 2006)	'Eureka Forbes' Vacuum cleaner/ water purifier	40.34	12	6.15	2.81	3.34

⁵ Bechu & Company Vs. Assistant Commissioner (Assessment) – 132 STC P.68 (Kerala).

2.	Koyambedu (1)	2005-06 (September 2006)	'Aswini' Hair oil	11.38	20	2.50	1.37	1.13
3.	Coonoor (2)	2004-05 (April 2006)	'Amar' Tea	22.39	8	2.11	1.42	0.69
		2005-06 (December 2006)	'Ooty' Tea	29.96	8	2.94	1.47	1.47
Total				104.07		13.70	7.07	6.63

The matter was reported to the Government between November 2007 and March 2008; their reply has not been received (November 2008).

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 at the rates and at the points mentioned in the relevant schedules to the Act. With effect from 1 July 2002, surcharge is leviable at the rate of five *per cent* on tax.

Test check of the records in eight⁶ assessment circles revealed that the AOs, while finalising the assessments of nine dealers for the years 2003-04 to 2005-06 between April 2005 and January 2007, applied incorrect rates of tax on a turnover of Rs. 4.17 crore. This resulted in short levy of tax of Rs. 27.20 lakh.

After the cases were pointed out between May 2007 and August 2008, the AOs revised the assessments in three cases and raised an additional demand of Rs. 4.52 lakh; of which Rs. 4.02 lakh has been collected and the balance amount is stated to have been covered by stay obtained from the Madras High Court. In one case, the AO contended that paper cones were utilised as packing materials and as such the sales were correctly taxed at four *per cent*. The reply is not tenable as only those packing materials mentioned in entry 44 of Part B of the first schedule are chargeable to tax at four *per cent*. The paper cone does not fall within the purview of this entry and is to be charged to tax at the rate of 12 *per cent* as unspecified goods. Reply in respect of the remaining cases has not been received (November 2008).

The matter was reported to the Government between October 2007 and February 2008. The Government accepted the audit observation in one case in July 2008. Reply in respect of the other cases has not been received (November 2008).

2.4.2 Under Section 8(2)(b) of the Central Sales Tax (CST) Act, 1956, inter state sale of goods other than the declared goods, not covered by valid declarations in form 'C' is assessable to tax at the rate of 10 *per cent* or at the

⁶ Alandur, Ashoknagar, Chintadripet, Guindy, Hosur (North), Kovilpatti-II, Nandanam and T.Nagar (North).

rate applicable to sale of such goods inside the State, whichever is higher. Inter state sale of the declared goods not covered by 'C' form declarations is assessable to tax at double the local rate. The elements of surcharge and additional sales tax, wherever applicable, are also to be taken into consideration to arrive the local rate of tax.

By a notification issued in February 1976 under Section 8(5) of the CST Act, the rate of tax on sale of scientific instruments and appliances to the educational institutions and hospitals was reduced to five *per cent*. Consequent to the amendment of the CST Act with effect from 11 May 2002, prescribing production of the declaration form mandatory for availing the exemption/concessional rate of tax under the CST Act, the concessional rate of tax would not be applicable on sale of scientific equipments and instruments, unless the sale was covered by declaration forms.

Test check of the records in nine assessment circles revealed that the AOs, while finalising the assessments of 13 dealers for the years 2000-01, 2002-03 to 2005-06 between October 2004 and February 2007, applied incorrect rates of tax on the inter state sale of goods valued at Rs. 23.08 crore. This resulted in short levy of tax of Rs. 1.02 crore as mentioned below:

(Rupees in lakh)							
Sl. No.	Assessment circle (No. of dealers)	Year of transaction (Month/Year of assessment)	Commodity	Taxable turn-over	Rate of tax (per cent)		Amount short levied
					Applicable	Applied	
1.	Chintadripet Nandanam Saligramam Tiruvanmiyur (6)	2002-03 2004-05 (between April 2006 and September 2006)	Sale of scientific instruments/ equipments, machinery to educational institutions and hospitals	992.96	10.5 12.6	5 5	60.63
<p>After the cases were pointed out between April 2007 and December 2007, the AO, Chintadripet assessment circle revised the assessment in February 2008 and raised an additional demand of Rs. 1.48 lakh; the collection particulars of which have not been received (November 2008). The AOs in the other cases stated that the concessional rate of tax was allowed on production of certificates required under the notification dated 11 February 1976 granting such concessional rate. The reply is not tenable as consequent to the amendment of the CST Act with effect from 11 May 2002, concessional rate of tax is admissible only on production of the prescribed 'C' form declarations, which were not produced.</p>							
2.	Velandi-palayam (1)	2005-06 (February 2007)	Lubricating oil and greases	144.32	16.8	4	18.47
<p>The concessional rate of four <i>per cent</i> allowed was not in order as the form 'C' declarations were found to be invalid.</p> <p>After the case was pointed out in September 2007, the AO revised the assessment and collected the additional demand of Rs. 18.47 lakh.</p>							

3.	Sivakasi-I (1)	2003-04 (July 2005) 2004-05 (May 2006)	Sale of tele- phone directory to M/s.Bharat Sanchar Nigam Limited (BSNL)	182.18	10.5	4	11.84
<p>AS BSNL is not a Government department, the adoption of the rate of four <i>per cent</i> on the sale of telephone directory to BSNL was not in order.</p> <p>After the case was pointed out in November 2006 and July 2007, the AO revised the assessment for the year 2003-04 in June 2007 and raised an additional demand of Rs. 8.15 lakh. Report regarding collection of the additional demand for 2003-04 and action taken in respect of the assessment year 2004-05 has not been received (November 2008).</p>							
4.	Nilakottai Mylapore (3)	2000-01 2002-03 2003-04 (between October 2004 and January 2006)	Printing and writing paper Medical appliances	415.33 23.94	11.5 10	10.5 4	5.59
<p>The element of additional sales tax was omitted to be taken into account while arriving the tax applicable on inter state sale of printing and writing paper not covered by 'C' form declarations. Similarly, inter state sale of medical appliances, though not covered by 'C' form declarations was erroneously assessed to tax at the rate of four <i>per cent</i>.</p> <p>After the cases were pointed out in May/June 2007, the AOs revised the assessments and collected the additional demand of Rs. 5.59 lakh.</p>							
5.	Tiruvanmiyur Hosur (North) (2)	2002-03 (August 2006) 2004-05 (December 2006)	Electronic load cell Furniture	18.10 144.05 386.84	12 12.6 12.6	10 10.5 12	5.71
<p>Electronic load cells are assessable to tax under the specific entry relating to parts of weighing machines. The assessment made treating the same as electronic goods was not in order. Similarly, the element of surcharge was not taken into account while arriving the tax on inter state sale of furniture not covered by declaration forms.</p> <p>After the cases were pointed out in August 2007 and January 2008, the AO of the Tiruvanmiyur assessment circle replied that load cells were electronic goods and the assessment made was in order. The reply is not tenable as electronic load cells are taxable under the specific entry relating to parts of weighing machines. Reply in respect of the other case has not been received (November 2008).</p>							
Total				2,307.72			102.24

The matter was reported to the Government between August 2007 and March 2008. The Government accepted the audit observation in one case pertaining to Mylapore assessment circle. Reply in respect of the other cases has not been received (November 2008).

2.5 Escapement of taxable turnover

2.5.1 According to Section 3-A of the TNGST Act, every person engaged in the business of transfer of right to use any goods for any purpose (whether or not for a specified period) for cash or deferred payment or other valuable consideration, shall pay a tax on the taxable turnover relating to the transfer of right to use any goods at the rates specified in the schedules to the Act. Under the Act, patents, trademarks and goods of incorporeal or intangible nature are taxable at the rate of four *per cent* at the point of first sale in the State. Producers of teleserials and telefilms lease out their serials/films in a medium called “Beta tapes” to the television companies for telecasting and receive valuable consideration. The valuable consideration is in the form of a share in the advertisement revenue from the television channels.

Scrutiny of the annual accounts filed by eight producers of teleserials and telefilms with the Income Tax Department, Chennai revealed that they had earned valuable consideration in the form of share in the advertisement revenue from various television satellite channels to the extent of Rs. 165.34 crore during the years 2000-01 to 2003-04. Cross verification of the records in the concerned assessment circles⁷ under whose jurisdiction the business of the producers was situated, however, revealed that the producers had not registered themselves under the TNGST Act as assessees.

Thus, there was escapement of taxable turnover and corresponding non-levy of tax of Rs. 19.94 crore including penalty of Rs. 11.96 crore.

After this was brought to the notice of the department between June 2007 and March 2008, the AO, T.Nagar (East) assessment circle replied that the notification issued in March 2000 granting exemption in respect of the tax payable on the right to use feature films would apply to teleserials as well. The reply is not tenable as the exemption stated in the said notification is only for exposed cinematographic films and does not apply to teleserials and telefilms transferred in “Beta tapes”. Reply from the other AOs has not been received (November 2008).

The matter was reported to the Government in March 2008; their reply has not been received (November 2008).

2.5.2 Standing Orders 225 and 226 of the Tamil Nadu Commercial Taxes (TNCT) Manual envisage interaction with other departments such as Income Tax, Central Excise, etc. by way of periodical exchange of information to enable detection of new cases and suppression of facts.

Scrutiny of the records in the office of the Additional Director General, Directorate General of Central Excise Intelligence, Chennai revealed that the central excise wing had detected suppression of value of goods amounting to Rs. 1.72 crore during the years 1999-2000 and 2000-01 and the dealer accepting his liability had paid the excise duty of Rs. 31.55 lakh. Cross verification of records of the dealer with the assessment records in Ambattur

⁷ Alwarpet, Luz, Nungambakkam, Saligramam, Royapettah-I & T.Nagar (East)

assessment circle revealed that the AO, while finalising the assessments of the dealer for the years 1999-2000 and 2000-01 in December 2005 and February 2006, had omitted to bring to assessment the suppressed sales turnover of Rs. 2.03 crore involving tax and penalty of Rs. 52.40 lakh. Thus, the failure to interact with the Central Excise Department as envisaged in the TNCT Manual resulted in escapement of taxable turnover.

After the case was pointed out in December 2006, the AO issued notice to the assessee in June 2007. Further report has not been received (November 2008).

The matter was reported to the Government in February 2008; their reply has not been received (November 2008).

2.6 Erroneous treatment of sale as works contract

According to Section 3(2) of the TNGST Act, tax is leviable on the sale of goods at the rates mentioned in the relevant schedules to the Act. According to Section 7 C of the Act, in respect of works contract, a dealer has the option of paying tax at four *per cent* of the total contract value of the works executed.

The Supreme Court has held⁸ that if a thing to be delivered has any individual existence before the delivery as the sole property of the party who is to deliver it, then it is a sale. If the major component of the end product is the material consumed in producing the chattel to be delivered and skill and labour are employed for converting the main components into the end products but the skill and labour are only incidentally used, then the delivery of the end product by the seller to the buyer will constitute a sale.

Test check of the records in 11 assessment circles revealed that the AOs, while finalising the assessments of 13 dealers for the years 2001-02 to 2005-06, between December 2003 and March 2007, incorrectly treated sales as contracts for work and levied tax as applicable for works contract. This resulted in short levy of tax of Rs. 4.51 crore (inclusive of surcharge) as mentioned below:

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.	Annasalai-III (1)	2002-03 (December 2003) 2003-04 (February 2005)	Erection and commissioning of telecom shelters.	98.54	12	4	8.06
<p>Remarks: The assessee had received the telecom shelters in completely knocked down condition from their factory at Bangalore and assembled the same at the customer's premises. The goods had individual existence as the sole property of the assessee and material was the major component of the end product. Hence the transaction is one of sale of telecom shelters and not works contract. This was pointed out to the department in July 2007; their reply has not been received (November 2008).</p>							

⁸ Hindustan Shipyard Ltd. Vs. State of Andhra Pradesh – 119 STC P.533 (SC)
State of Andhra Pradesh Vs. Kone Elevators – 140 STC P.22 (SC)

2.	Tambaram-I Velachery Tiruvanmiyur (3)	2004-05 (June 2006) 2005-06 (June 2006)	Supply and installation of diesel generator sets.	369.76	16	4	46.59
<p>Remarks: After this was pointed out, the AO, Tambaram-I assessment circle issued notice to the dealer and stated that the assessment would be revised, if necessary. Further report has not been received. The AOs in respect of the other two cases replied that the assessee had opted to pay tax under Section 7C of the Act and the contracts involved indivisible works, which were carried out at the site of the customers. The reply is not tenable as the major portion of the contracts involved supply of generator sets and installation was only incidental. The transactions should, therefore, have been treated as sale and taxed accordingly.</p>							
3.	Harbour-I (1)	2001-02 to 2004-05 (between October 2003 and October 2006)	Design, manufacture, supply, erection, commissioning and handing over of wharf cranes.	1,287.10	12	4	108.12
<p>Remarks: The contract consists of two parts, one for design, manufacture and delivery of the cranes in fully erected/knocked down condition and the other for erection, testing and commissioning of the cranes. Thus, erection was only incidental to the supply of cranes. The transactions should, therefore, have been treated as sale and taxed accordingly. This was pointed out to the department in September 2007; their reply has not been received (November 2008).</p>							
4.	Rockfort Tiruvanmiyur (2)	2004-05 (October 2006) 2005-06 (March 2007)	Supply and erection of communi- cation towers.	560.86	12	4	47.11
<p>Remarks: The assessee had utilised his own materials in the fabrication of the transmission towers, which had existed as the property of the assessee before transfer to the customers. As such it should have been treated as sale and taxed accordingly. This was pointed out to the department in October/December 2007; their reply has not been received (November 2008).</p>							
5.	Mandaveli Ashok Nagar (3)	2003-04 to 2005-06 (between June 2006 & January 2007)	Supply, installation and commissioning of air conditioning system.	626.81	20	4	105.30
<p>Remarks: The AOs stated that the dealers were engaged in the work of supply, installation, testing and commissioning of air conditioning systems of various capacity and the labour charges include ducting, refrigerant piping, electrical cabling etc. and therefore, the assessments made at four <i>per cent</i> treating the same as works contract was in order. The reply is not tenable as the contracts involved supply of air conditioning units, which had individual existence as the property of the assessee before incorporation in such works and the installation was only incidental to the supply of air conditioning units.</p>							
6.	Alwarpet Alandur (2)	2004-05 2005-06 (February 2007)	Fabrication, supply and installation of modular kitchen.	522.02	12	4	43.85

Remarks: The major portion of the contract involved supply of materials and the amount of labour involved was only minimal and incidental to such supply. The transactions should have been treated as sale and taxed accordingly. This was pointed out to the department in August/October 2007; their reply has not been received (November 2008).							
7.	T.Nagar (East) (1)	2004-05 (June 2006) 2005-06 (March 2007)	Supply, laying and fixing of carpets.	549.46	20	4	92.31
Remarks: The AO stated that the assessment made at four <i>per cent</i> as works contract was in order as the contract was not for outright sale of carpets but involved supply, fixing and laying of the carpets and pasting of carpets in the room spaces. The carpets had to be cut into size according to the specification and the same had to be fixed in the floor of customers as required by them and then only the transfer of property took place. The reply is not tenable as major portion of the contract involved supply of materials and the amount of labour involved was only minimal and incidental. The goods, viz., carpets had individual existence as the property of the assessee before incorporation in the works.							
Total				4,014.55			451.34

The matter was reported to the Government in February 2008; their reply has not been received (November 2008).

2.7 Non/short levy of additional sales tax

As per the provisions of the Tamil Nadu Additional Sales Tax Act, 1970, every dealer whose taxable turnover for a year exceeds Rs. 10 crore is liable to pay additional sales tax at the prescribed rate on such turnover. The levy is subject to the condition that the aggregate of sales tax and additional sales tax on the declared goods should not exceed four *per cent*. It has been held⁹ by the Supreme Court that amalgamation of companies takes effect on the date of transfer specified in the scheme and not on the date of Court's order.

Test check of the records in five¹⁰ assessment circles revealed that the AOs while finalising the assessments of seven dealers for the years 2001-02 to 2005-06 between January 2003 and November 2006 had either short levied or omitted to levy additional sales tax of Rs. 1.03 crore.

After the cases were pointed out between December 2003 and November 2007, the department revised the assessments in five cases between April 2007 and June 2008 and raised an additional demand of Rs. 51.63 lakh; of which Rs. 30.30 lakh has been collected. In one case, the AO contended that the clubbing of turnovers was not warranted as the Court's approval for merger came only in August 2001 and the assessment made treating the companies as separate entities was in order. The reply is not tenable in the light of the Supreme Court's decision that the scheme of merger takes effect from the date of transfer mentioned in the scheme and in the instant case, such date has been

⁹ Marshall Sons and Co. (India) Ltd. Vs. Income Tax Officer ITR Vol.223 P.809

¹⁰ Amaindakarai, Annasalai-II, Egmore-II, Fast Track Assessment Circle-II (Chennai), and Tiruvottiyur.

mentioned as 1 April 2000. Reply in respect of the remaining case has not been received (November 2008).

The matter was reported to the Government between July 2007 and February 2008. The Government accepted the audit observations in four cases in August/ September 2008. Reply in respect of the other cases has not been received (November 2008).

2.8 Incorrect computation of taxable turnover

Under the TNGST Act, the taxable turnover of a dealer is determined on the basis of sales turnover shown in the returns after allowing the permissible deductions. The sales tax is leviable at the prescribed rates on the taxable turnover. With effect from 1 July 2002, surcharge at five *per cent* is leviable on the tax. The Tamil Nadu Taxation Special Tribunal (TNTST) has held¹¹ that the freight charges though shown separately in the invoices are liable to tax, as in the case of supply of liquid gas in safe containers, the consideration of price payable by the buyers includes the value of gas as well as the freight charges incurred for despatch of the gas cylinders and to get back the empty cylinders.

Test check of the records in seven¹² assessment circles revealed that while finalising the assessments of seven dealers for the years 2000-01, 2001-02, 2002-03, 2004-05 and 2005-06 between January 2004 and March 2007, there was incorrect computation of taxable turnover of Rs. 1.49 crore. This was on account of omission to consider levy of tax on turnover relating to sale of assets, incorrect treatment of first sales as second sales, non-levy of tax on freight charges, etc. This resulted in short levy of tax and surcharge amounting to Rs. 11.55 lakh.

After the cases were pointed out between March 2006 and November 2007, the department revised the assessments in six cases between April 2007 and January 2008 and raised an additional demand of Rs. 9.03 lakh; of which Rs. 3.42 lakh has been collected. Report on recovery of the balance amount has not been received (November 2008). The AO in a case pertaining to Adyar-II assessment circle did not accept the audit observation stating that the dealer had charged transport charges separately in the invoices and hence not liable to tax. The reply is not tenable as in the case of supply of gases in cylinders, the freight charges even if paid separately, form a part of taxable turnover and are liable to be taxed.

The matter was reported to the Government between August 2007 and February 2008. Government accepted the audit observations in two cases. Reply in respect of the remaining cases has not been received (November 2008).

¹¹ Ram Oxygen (P) Ltd Vs. Joint Commissioner (CT) 134 STC P.240 (TNTST)
Indian Oxygen Ltd. Vs. Commercial Tax Officer, Central Assessment Circle-I
Chennai – 132 STC P.337 (TNTST)

¹² Adyar-II, Ambattur, Erode (Rural), Gandhipuram, Palayamkottai, Sriperumbudur and Tenkasi.

2.9 Incorrect grant of concessional rate of tax

According to Section 3(2) of the TNGST Act, in the case of goods mentioned in the first schedule, the tax shall be payable by a dealer at the rate and at the point specified therein. Section 3(5) of the TNGST Act, however, provides for levy of tax at the concessional rate of three *per cent* on sale of goods mentioned in the eighth schedule against declaration forms. Imported machinery is taxable at the rate of 20 *per cent* at the point of first sale in the State under entry 9 of the eleventh schedule to the Act. Sewing machines are taxable at the rate of 10 *per cent* at the point of first sale in the State. The concessional rate of tax is not applicable to the sale of sewing machines and imported machinery as these are not specified in the eighth schedule to the Act.

Test check of the records in four¹³ assessment circles revealed that the AOs, while finalising the assessments of five dealers for the years 2004-05 and 2005-06 between November 2006 and March 2007, allowed concessional rate of tax on the sale of imported machinery and industrial sewing machines for Rs. 2.08 crore. This resulted in short levy of tax of Rs. 35.23 lakh.

After the cases were pointed out between July 2007 and February 2008, the AOs in the cases pertaining to Adyar II and Guindy assessment circles stated that the concessional rate allowed on sale of imported machinery was in order as “machineries of all kinds” are mentioned in the eighth schedule to the Act. The reply is not tenable as imported machinery, falling under the eleventh schedule is assessable to tax at the rate of 20 *per cent* instead of three *per cent*. The AO, Alandur assessment circle in the case pertaining to sewing machines stated that declaration forms were furnished by the purchaser and as such the concessional rate allowed was in order. The reply is not acceptable as sewing machines are not eligible for the concessional rate of tax. Reply in respect of the remaining case has not been received (November 2008).

The matter was reported to the Government between November 2007 and February 2008; their reply has not been received (November 2008).

2.10 Non/short levy of tax

2.10.1 Under Section 3-B of the TNGST Act, in respect of works contract, the value of goods involved in the execution of such works contract is assessable to tax at the rates applicable to the respective goods.

2.10.1.1 The Supreme Court has held¹⁴ that the measure for the levy of tax would be the value of goods at the time of their incorporation in the works and the profits which are relatable to the supply of the materials shall be included.

Test check of the records in T.Nagar (North) assessment circle revealed that two contractor dealers had earned a profit of 36.6 *per cent* and 42.71 *per cent* during 2005-06. The AO while finalising the assessments of the two civil

¹³ Adyar-II, Alandur, Guindy and Velandipalayam

¹⁴ Gannon Dunkerley & Co. Vs. State of Rajasthan – (1993) 88 STC P.204 (SC)

works contractors for the year 2005-06 in March 2007, however, determined the deemed sale value of materials utilised in the execution of such works contract by addition of gross profit of 10 *per cent* to the cost of the goods. The mistake resulted in incorrect computation of taxable turnover and corresponding short levy of tax of Rs. 5.73 lakh.

After the cases were pointed out in November 2007, the AO in one case revised the assessment in December 2007 and raised an additional demand of Rs. 1.25 lakh. Report on recovery of the demanded amount and action taken in the other case has not been received (November 2008).

The matter was reported to the Government in February 2008; their reply has not been received (November 2008).

2.10.1.2 Section 3-G of the TNGST Act provides an option to a dealer who carries on the business of printing, to pay tax at the rate of three *per cent* on the total turnover, instead of paying tax in accordance with Section 3(2) or Section 3-B of the Act. The option once exercised under the Act is final for the year.

Test check of the records in Royapettah-II and Sivakasi-I assessment circles revealed that two dealers (printers) had exercised option to pay tax under Section 3-G for the years 2002-03, 2003-04 and 2005-06. The AOs, while finalising the assessments (March 2007) of the dealers had allowed exemption for Rs. 2.43 crore as labour charges. As the dealers had exercised option to pay tax on the total turnover under Section 3-G, the exemption allowed towards labour charges was not in order. The incorrect computation of turnover for levy of tax under Section 3-G resulted in short levy of tax of Rs. 7.66 lakh (inclusive of surcharge).

After the cases were pointed out in May 2007 and July 2007, the AO, Sivakasi-I assessment circle stated in September 2007 that revision notice was issued and order would be passed on expiry of the notice period. Further report regarding revision of the assessment has not been received (November 2008). In the case pertaining to Royapettah-II assessment circle, the Assistant Commissioner contended that since the materials other than printing ink were supplied by the customers, it was a labour contract and the exemption allowed was in order. The reply is not tenable as the dealer had utilised his own printing ink in the execution of the printing work and hence the exemption allowed as labour charges is not in order.

The matter was reported to the Government in February 2008; their reply has not been received (November 2008).

2.10.1.3 The definition of 'sale' under the CST Act was amended with effect from 11 May 2002 to include transfer of property in goods involved in the execution of works contract. Accordingly, goods involved in the execution of inter state works contract is assessable to tax at the rate applicable to the sale of such goods inside the State, if not covered by 'C' form declarations.

Test check of the records in Sivakasi-I assessment circle revealed that a dealer had undertaken inter state printing works contract and had utilised locally purchased printing ink in the execution of such printing works. However, the AO, while finalising the assessments of the dealer for the years 2004-05 and

2005-06 in October 2006 and March 2007 respectively, failed to levy tax on the deemed sale value of printing ink involved in the execution of such works contract. The non-levy of tax on the deemed sale value of printing ink of Rs. 61.60 lakh in respect of the assessment years 2004-05 and 2005-06 worked out to Rs. 6.47 lakh.

After the case was pointed out in June 2007, the AO issued pre-revision notice and stated that revised order would be passed after expiry of notice time. Further report regarding the action taken on the pre-revision notice has not been received (November 2008).

The matter was reported to the Government in February 2008; their reply has not been received (November 2008).

2.10.1.4 It has been judicially held¹⁵ by the Madras High Court that goods purchased from outside the State of Tamil Nadu and utilised in the State of Tamil Nadu in the execution of works contract attract tax as deemed sale.

Test check of the records in Nungambakkam assessment circle revealed that the AO, while finalising the assessment of a dealer for the year 2004-05 in November 2006 had allowed deduction for Rs. 1.81 crore in respect of goods purchased from outside the State and utilised in the execution of works contract, instead of levying tax at the rates applicable to the deemed sale of such goods. The erroneous allowance of deduction resulted in short levy of tax of Rs. 22.76 lakh (inclusive of surcharge).

This was pointed out to the department and the Government in December 2007 and February 2008 respectively; their reply has not been received (November 2008).

2.10.1.5 Test check of the records in Sivakasi I and II assessment circles revealed that two dealers had received Rs. 8.26 crore as conversion charges for production of matches. Audit scrutiny further revealed that the dealers had used their own materials like chemicals, splints, slack wax, etc. in such conversion. The AOs, while finalising the assessments of the dealers for the years 2003-04 and 2004-05 between June 2006 and March 2007, however, omitted to levy tax on the deemed sale value of the materials which were utilised in the execution of the works. This resulted in non-levy of tax of Rs. 26.16 lakh.

After the cases were pointed out in November 2007, the AOs replied that revision of assessment would be considered after recheck of accounts. Further report has not been received (November 2008).

The matter was reported to the Government in March 2008; their reply has not been received (November 2008).

¹⁵ JDP Associates Vs. TNTST & Others – 2004-05 (10) TNCTJ P.165 (Mad)

2.11 Non-levy of purchase tax

Under the TNGST Act, every dealer who in the course of his business purchases from a registered dealer or from any other person any goods in the circumstances in which no tax is payable and despatches them to a place outside the State, except as a direct result of sale or purchase in the course of inter state trade or commerce, is liable to pay purchase tax at the prescribed rates.

As per entry 81 of the third schedule to the Act, turmeric for sale by any dealer whose total turnover does not exceed Rs. 300 crore in a year is exempted. The Tamil Nadu Taxation Special Tribunal (TNTST) had observed that the exemption was intended for dealers whose total turnover was below Rs. 300 crore and the goods could not be said to be non-taxable goods and had upheld¹⁶ the levy of purchase tax in respect of stock transfer of goods outside the State which had not suffered tax in the State.

Test check of the records in Nilakottai assessment circle revealed that a dealer whose total turnover was less than Rs. 300 crore had sent turmeric to places outside the State on consignment basis. As the turmeric had not suffered tax earlier in the State, purchase tax was leviable. However, the AO while finalising the assessments of the dealer for the years 2004-05 and 2005-06 in December 2005 and March 2007 respectively omitted to levy tax. This resulted in non-levy of purchase tax of Rs. 23.83 lakh.

After the case was pointed out in July 2007, the AO stated in September 2007 that as the commodity was exempted from the levy of tax upto Rs. 300 crore and the purchases were effected from registered dealers, purchase tax was not leviable. The reply is not tenable as the exemption is admissible only if the commodities are sold by a dealer. In this case, the goods have not been sold but have been sent outside the State on consignment basis and purchase tax is leviable. This view has also been upheld by the decision of the TNTST mentioned above.

The matter was reported to the Government in January 2008; their reply has not been received (November 2008).

2.12 Non-levy of resale tax

Section 3-H of the TNGST Act provides for the levy of resale tax at one *per cent* on the turnover of resale of goods specified in the first schedule in respect of every dealer liable to pay tax under Section 3(2) and whose total turnover is not less than Rs. 10 lakh for the year.

Test check of the records in Annasalai-II and Villupuram-I assessment circles revealed that the AOs while finalising/revising the assessments of two dealers

¹⁶ Ruchi Soya Industries Ltd. Vs. CTO Harbour III and another – 139 STC P.294

for the years 2003-04 and 2004-05 in June 2006 and February 2007, omitted to levy resale tax on the turnover of resale of toner cartridges and ink cartridges and readymade garments for Rs. 10.58 crore. This resulted in non-levy of resale tax of Rs. 10.58 lakh.

After the cases were pointed out in August 2007 and October 2007, the department revised the assessments and raised an additional demand of Rs. 10.58 lakh; of which an amount of Rs. 2.48 lakh has been collected. Report on recovery of the balance amount has not been received (November 2008).

Government to whom the matter was reported in October/November 2007 accepted the audit observation in one case. Reply in respect of the other case has not been received (November 2008).

2.13 Affording of excess credit

According to the Commercial Taxes Manual, assessment registers, also called 'D2' ledgers are to be maintained for each year in the assessment circles to show the tax paid by the assessee. The ledger shows the details of the taxable turnover, tax due thereon, tax paid, etc.

Test check of the records in five¹⁷ assessment circles revealed that six dealers had paid tax of Rs. 1.49 crore for the years 2003-04, 2004-05 and 2005-06. The AOs finalised the assessments for Rs. 1.49 crore between July 2005 and December 2007 but erroneously adopted the tax paid as Rs. 1.70 crore and issued notices to the assessee indicating excess payment of tax. This resulted in affording of excess credit of Rs. 20.65 lakh.

After the cases were pointed out between April 2006 and December 2007, the AOs accepted the audit observation and revised the assessments in five cases by withdrawing the excess credit of Rs. 19.15 lakh erroneously afforded to the assessee. Reply in respect of the remaining case has not been received (November 2008).

The matter was reported to the Government in July 2007 and January 2008. Government accepted the audit observation in two cases. Reply in respect of the remaining cases has not been received (November 2008).

2.14 Non/short levy of interest

According to sub section 2 of Section 13 of the TNGST Act, the tax shall become due without issue of any notice of demand to the dealer on the date of receipt of the return or on the last due date prescribed, whichever is later. According to Section 24(3) of the Act, on any amount remaining unpaid after the due date, the dealer shall pay, in addition to the tax amount due, interest at two *per cent* per month for the entire period of default. With effect from

¹⁷ Egmore-II, Koyambedu, Madurantakam, Nandanam & Tiruchendur

1 September 2004, the rate of interest is one and a half *per cent* per month for the first three months of default and two *per cent* per month for the remaining period of default. The provisions relating to levy of interest for belated payment of tax under the TNGST Act also apply in respect of the tax payable under the Central Sales Tax Act.

Test check of the records in 13 assessment circles¹⁸ revealed that tax of Rs. 4.08 crore relating to the assessment years 1991-92 to 1997-98 and 2002-03 to 2005-06 was paid belatedly by 17 dealers between December 2002 and April 2007. The delays ranged from three days to 81 months and 26 days. The AOs failed to levy interest of Rs. 58.13 lakh for the belated payment of tax.

After the cases were pointed out between March 2007 and February 2008, the AOs levied interest of Rs. 54.43 lakh in 14 cases; of which Rs. 18.31 lakh was collected. Report on realisation of the balance amount and reply in respect of the remaining cases has not been received (November 2008).

The matter was reported to the Government between December 2007 and February 2008. The Government accepted the audit observations in 11 cases in July/August 2008. Reply in respect of the remaining cases has not been received (November 2008).

2.15 Non-levy of penalty

Section 12(3)(b) of the TNGST Act provides for levy of penalty at 150 *per cent* of the difference of the tax assessed and the tax paid, if the tax paid as per the return submitted by the assessee falls short of the tax assessed by more than 75 *per cent*.

Test check of the records in Vadapalani-II assessment circle revealed that the AO while finalising the assessment of a dealer for the year 2004-05 in November 2006 omitted to levy penalty, though the dealer had paid Rs.80,000 only as against the assessed tax of Rs. 6.29 lakh. The amount of penalty leviable worked out to Rs. 8.24 lakh, calculated at 150 *per cent* of the balance tax of Rs. 5.49 lakh.

After the case was pointed out, the Government accepted the audit observation in July 2008 and stated that the concerned AO had revised the assessment and levied penalty of Rs. 8.24 lakh. However, the dealer has preferred an appeal against the order before the Appellate Assistant Commissioner.

¹⁸ Ambattur, Ashok Nagar, Avinashi Road, Koyambedu, Kothawalchavadi, Nagercoil, Royapettah-II, Sankarankoil, Shencottah, Tambaram-I, T.Nagar (North), Tiruvanmiyur and Vellore (North).