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PREFACE

This Report for the year ended 31 March 2011 has been prepared for submission to the Governor under Article 151 (2) of the Constitution.

The audit of revenue receipts of the State Government is conducted under Section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. This Report presents the results of audit of receipts comprising taxes on sale, state excise, taxes on motor vehicles, land revenue, stamps and registration fees, other tax receipts and non-tax receipts of the State.

The cases mentioned in the Report are among those which came to notice in the course of test audit of records during the year 2010-11 as well as those which came to notice in earlier years but could not be included in previous years' Reports.

OVERVIEW

This Report contains 23 paragraphs including three Performance Audits relating to non/short levy of tax, interest etc involving ` 275.84 crore. Some of the major findings are mentioned below:

I General

Total revenue receipts of the State Government for the year 2010-11 were ` 58,206.23 crore against ` 49,155.70 crore for the previous year. 72 per cent of this was raised by State through tax revenue (` 38,473.12 crore) and non-tax revenue (` 3,358.29 crore). The balance 28 per cent was received from the Government of India as State's share of divisible Union taxes (` 9,506.32 crore) and grants-in-aid (` 6,868.51 crore).

(Paragraph 1.1.1)

3,738 inspection reports issued upto December 2010 containing 7,610 observations involving money value of ` 2,205.10 crore were pending settlement at the end of June 2011.

(Paragraph 1.2.1)

Records of 376 units of Commercial Taxes, State Excise, Taxes on Motor Vehicles, Land Revenue, Stamps and Registration Fees, Electricity Tax, Forest and other departmental offices were test checked during the year 2010-11. These revealed under-assessments, non/short levy of taxes, loss of revenue, failure to raise demands and other irregularities aggregating ` 905.66 crore in 1,057 cases. During the course of the year, the Departments concerned accepted under-assessments and other deficiencies of ` 122.62 crore in 259 cases, of which one case involving ` 22 lakh was pointed out in audit in earlier years. The Departments recovered ` 18.89 crore in 550 cases at the instance of audit

(Paragraph 1.5.1)

II Taxes on sales, trade, etc.

A Performance audit on '**Cross verification of Declaration Forms in Inter-State and Commerce**' revealed as under:

We found that the Department had not devised a proper and effective mechanism for printing/reviewing the existing stock of the Declaration Forms and the pace of issue of Declaration Forms before printing of new Forms. There were 3,150 'C' Forms in stock since 2008-09, and though 1,60,000 'H' forms were held in stock since 2005-06, additional 32,000 'H' forms were got printed during 2008-09 when only 8,000 forms were issued up to 2009-10, leaving a closing stock of 1,84,000 forms as at the end of 31 March 2011 and thus clearly printed forms were in excess of requirements.

(Paragraphs 2.9.5.1)

Very high percentage of error records (50 to 100 *per cent*) on the TINXSYS website, coupled with an incomplete database, defeated the purpose of the website for verification of the State's Inter-State transactions.

(Paragraphs 2.9.5.4)

We noticed that 79 *per cent* of the Central Sales Tax (CST) assessments were pending finalisation as on 31 March 2010, with only 21 *per cent* assessments being completed (1,55,682) as against 7,44,338 cases due for assessments, leaving a balance of 5,88,656 cases for the period 2005-06 to 2009-10. Incomplete assessments had a huge risk of tax escapement due to non-verification of claims of concessional tax on declaration forms.

(Paragraphs 2.9.5.6)

We noticed that the Dealer Ledger and Demand, Collection and Balance Register/G2 Register was not maintained either in manual form or in electronic mode. The CTD had not maintained position of arrears under CST separately.

We found that there were 2,462 cases of short/non-filing of declaration/statutory forms. Though tax together with interest aggregated to ` 147.40 crore was levied, these were not booked and taken as arrears of tax.

(Paragraphs 2.9.5.7)

We found that the Department had not put in place any mechanism for cross verification of the Declaration Forms furnished by the dealers of the State effecting Inter-State transactions with the concerned States.

(Paragraphs 2.9.5.8.1)

We noticed that in four LVOs, 36 'C' forms for a turnover of ` 68.19 lakh which had originated from Nagpur, Maharashtra were not issued by those Sales Tax authorities. Five State dealers had shown Inter-State sales turnover of ` 12.26 lakh for the year 2007-08 covered by 'C' forms which were not issued to the purchasers whose details were mentioned therein. The tax recoverable on such fake forms was ` 6.95 lakh besides penalty leviable. We found escapement of turnover of ` 8.17 crore involving a tax of ` 69.96 lakh in 20 'C' forms filed by 17 dealers in five LVOs.

(Paragraph 2.9.6)

We noticed that in four LVOs, Declarations Forms 'C', in support of Inter-State sale involving a turnover of ` 90.05 lakh though incomplete, were accepted in respect of eight dealers wherein the tax of ` 7.25 lakh was leviable by disallowing these forms.

(Paragraphs 2.9.7.1)

We noticed that Intra-State sales valued at ` 75.58 lakh were done by wrongful utilisation of 12 'C' forms resulting in escapement of tax of ` 6.97 lakh while Inter-State sales valued at ` 5.76 crore were not found supported by 'C' forms. Incorrect Grant of concessional rate of tax on the form 'C' covering transactions of more than one quarter resulted in short levy of tax of ` 18.19 lakh. Inter-State sales on Forms 'C' exceeded the turnover mentioned in their Monthly and Annual Returns of 11 dealers, with reference to the forms filed by them, by ` 1.20 crore resulting in escapement of tax of ` 4.46 lakh.

(Paragraphs 2.9.7.2 to 2.9.7.5)

In 10 LVOs we noticed exemption from payment of tax on stock transfer without verification of the Declaration Forms which were pertaining to more than one month. The tax leviable on these irregular forms was ` 61.36 crore. A tampered 'F' Form involving tax effect of ` 1.21 crore was incorrectly accepted. The matter needs investigation

(Paragraphs 2.9.8)

We found though three assessments of two dealers for the years 2005-06 to 2007-08 were concluded, the demand notices were not served on the dealers, resulting in non-demand of tax of ` 2.33 crore.

Further in one cases the assessing authority omitted to demand and levy interest and penalty thereon of ` 69.32 lakh.

(Paragraphs 2.9.9)

The 'Online Issue of Declaration Forms System' was deficient for want of adequate validation controls to prevent issue of more than one Form against an invoice, up-gradation to real time presentation system and cancellation of approved forms, for any reason.

(Paragraphs 2.9.11.1)

COMPLIANCE DEFICIENCIES

The audited accounts filed by a dealer in form VAT 240 revealed that the dealer had short declared output tax liability by ` 79.42 lakh and claimed input tax credit in excess of his actual eligibility by ` 5.52 lakh. The LVO concerned failed to demand these tax dues from the dealer along with interest and penalty aggregating to ` 1.05 crore.

(Paragraph 2.10.2)

In 94 returns filed by 21 dealers for tax periods between April 2005 and March 2009 there were understated output tax liability and overstated ITC aggregating ` 9.06 crore. The AAs concerned failed to levy and collect the penalty of ` 91.35 lakh leviable in these cases.

(Paragraph 2.10.3)

We noticed in five LVOs of Bangalore that exemptions from payment of tax were granted to 16 dealers on a turnover of ` 583.71 crore on exports without production of necessary documents, resulting in non-levy of tax of ` 72.26 crore.

(Paragraph 2.11)

III State Excise

A Performance audit on “**State Excise Receipts**” revealed as under:

Though the Rules and the licence condition provide for, sale of liquor in sealed bottles we observed that in many cases loose sale of liquor was made. We observed that sale of liquor was made in close proximity of religious and educational institutions, hospitals etc. in violation of the Rules.

(Paragraph 3.6.7.4, 3.6.7.5)

The State Government has not issued any fresh retail vending licences since December 1992, even though the population of the State has increased from 4.48 crore in 1991 to 5.27 crore in 2001 census despite demand for grant of licences. During this period though 238 retail shop licences (CL-2) and 225 bar licences (CL-9) were not renewed, no action was taken by the Department to issue an equal number of licences to new applicants, thereby Government revenue of not less than ` 48.43 crore was forgone. Further, considering the demand, there was no attempt to exploit the revenue resources through auction of licences.

(Paragraph 3.6.9)

Though the sales turnover of IML increased from 96.40 lakh carton boxes in 2003-04 to 408.60 lakh carton boxes in 2009-10, i.e., an increase of 323.85 *per cent*, the rate of licence fee for distilleries, breweries were not revised since July 2000.

(Paragraph 3.6.10)

The State Government did not take any action on recommendations of a Technical committee constituted by themselves to revise the norms for yield of rectified spirit from molasses. Even the lowest yield recommended by the Committee would have fetched additional revenue of ` 121.52 crore during 2008-09 and 2009-10.

(Paragraph 3.6.12)

We noticed licence of a Sugar Company Limited, Mandya was renewed for the year 2000-01 to 2008-09 without levying and collecting licence fee and additional licence fee resulting in non-levy/collection of licence fee of ` 2.76 crore.

(Paragraph 3.6.13)

We found that with increase in population and village areas coming under municipal limits, there was no suitable mechanism in place in the Department to keep track of new areas entering municipal limits, based on notification

passed by the Urban Development Department. Absence of the mechanism resulted in short recovery of license fee of ` 29.57 lakh in four cases.

(Paragraph 3.6.14)

Though consumption statement regarding the quantity of liquor lifted by the licensees (CL2 and CL9) was received by the Range offices from Karnataka State Beverages Corporation Limited (KSBCL) regularly, the Department failed to levy penalty leviable for short lifting of Indian Made Liquor (IML). The non-levy of penalty amounted to ` 9.04 crore.

(Paragraph 3.6.15)

IV Taxes on Motor Vehicles

A Performance audit on “**Computerisation in Transport Department**” revealed as under:

Smart cards for Registration of Vehicles (RCs) and Driving Licenses was introduced w.e.f. November 2009, with Computerisation through VAHAN and SARATHI, in all 54 RTOs/ARTOs of the State.

(Paragraph 4.7.6)

The Department has not evolved, documented and circulated policies relating to IT implementation. No clear demarcation of duties/responsibilities between the Department and the NIC, have been documented with reference to ensuring system reliability and integrity.

(Paragraph 4.7.8.1)

Even though the Computerisation has been implemented in all the RTOs as of November 2009, the activities of the Department with respect to transport vehicles were not routed through VAHAN. Smart Card RCs for transport vehicles were being issued only in 5 RTOs in Bangalore from 1 May 2010. Modules of the software such as Surrender, Demand, Collection and Balance, Departmental Statutory Authority Cases were not being utilised by the Department.

(Paragraph 4.7.8.3)

The Software application did not provide for mapping of certain business activities of the Department like jurisdiction of the RTOs, prompt for demand of tax on change of ownership of Government vehicle to individual owner, fee for advance registration mark, refund of tax etc.

(Paragraph 4.7.9)

Digitisation and porting of legacy data was not completed even as of November 2011 and work outside Bangalore was not given any priority; junk/redundant data had been ported into the present system as no clean up exercise was envisaged and done before porting the legacy data, thereby rendering the database incomplete and unreliable.

(Paragraph 4.7.10.1)

Analysis of database of VAHAN has revealed invalid/redundant data. For example, there were duplication of Permit Numbers in 80 cases in three RTOs, in 795 cases same engine numbers were found against different vehicle in the database of six RTOs, Insurance Details were not captured in 11,732 cases in database of eight RTOS, no sale value has been captured in 1,456 cases and in 1,342 case there is invalid sale amount for Non-Transport Vehicles. Invalid

data in fields related to determination of quarterly tax such as floor area, wheelbase was also noticed.

(Paragraph 4.7.11)

There was difference in the lifetime tax (LTT) payable as per Sale Value of vehicles and tax actually paid as per database as noticed in six RTOs and 3,632 vehicles, which was confirmed by us in physical check of records in 20 cases involving short levy of tax of ` 64,417.

(Paragraph 4.7.12.1)

We noticed on comparison of data of NOC/CC module with tax collection module data of three RTOs that in 147 instances, NOC/CC were issued even though there were arrears of tax from those vehicles.

(Paragraph 4.7.12.6)

The Department did not have a clearly documented and approved policy statement comprehensively covering all aspects of logical security. The system permitted the same user to be given permission for various processes in any activity.

(Paragraph 4.7.13.1)

We found from the database of issued licences of six RTOs that in 718 instances one person (identified by name, father's name and date of birth) has been issued with two or more licences (bearing different licence numbers).

(Paragraph 4.7.15)

In 22 RTOs, tax was either not paid or levied short. This resulted in non/short realisation of revenue of ` 64.32 lakh.

(Paragraphs 4.8.1 and 4.8.2)

V Stamps and Registration Fees

We noticed that five GPAs and corresponding Sale Agreement had come together for registration to the registering officer. These were not found to have been linked resulting in short levy of stamp duty of ` 3.31 crore and registration fee of ` 46.56 lakh on the differential market value of ` 46.56 crore. Further, a penalty of ` 16.56 crore could have been levied for suppression of facts.

(Paragraph 5.8.1)

In respect of two sale Agreements along with General Power of Attorney (GPAs) relating to sale of agriculture property, there was nothing on record to prove that subsequent Sale Deeds had been registered. The Stamp Duty and Registration fee of ` 6.63 lakh was leviable.

(Paragraph 5.8.1.4)

We noticed by cross verification with records of the Income Tax Department that two assesseees, who had furnished six lease agreements executed in Karnataka to the Income-tax Department as proof of sources of income, had not registered these documents with the Stamp Authorities resulting in stamp duty of ` 1.44 crore and registration fee of ` 21.94 lakh not being realised.

(Paragraph 5.8.2.2)

Short levy of Stamp duty and Registration fee due to undervaluation of properties in three cases was ` 11.07 lakh.

(Paragraph 5.8.4)

VI Land Revenue

We noticed that in respect of 12,719 applications received between 13 August 2008 and 9 January 2009, fee for pre-mutation sketches was levied at pre-revised rate. This resulted in short levy of fee of ` 25.06 lakh.

(Paragraph 6.5.1)

VII Non-Tax Receipts

Revenue Department failed to raise demand for water rate/penal water charges of ` 5.71 crore in seven taluks, for the period 2006-07 to 2009-10 though demand statements had been received from the Irrigation Department.

(Paragraph 7.2)

CHAPTER-I : GENERAL

1.1 Trend of revenue receipts

1.1.1 The tax and non-tax revenue raised by the Government of Karnataka during the year 2010-11, the State's share of divisible Union taxes and duties assigned to States and grants-in-aid received from the Government of India during the year and the corresponding figures for the preceding four years are mentioned below:

(` in crore)

Sl. No.	Particulars	2006-07	2007-08	2008-09	2009-10	2010-11
I.	Revenue raised by the State Government					
	• Tax revenue	23,301.03	25,986.76	27,645.66	30,578.60	38,473.12
	• Non-tax revenue	4,098.41	3,357.66	3,158.99	3,333.80	3,358.29
	Total	27,399.44	29,344.42	30,804.65	33,912.40	41,831.41
II.	Receipts from the Government of India					
	• State's share of divisible Union taxes	5,374.33	6,779.23	7,153.77	7,359.98	9,506.32 ¹
	• Grants-in-aid	4,813.17	5,027.49	5,332.25	7,883.32	6,868.51
	Total	10,187.50	11,806.72	12,486.02	15,243.30	16,374.83
III.	Total receipts of the State	37,586.94	41,151.14	43,290.67	49,155.70	58,206.23
IV.	Percentage of I to III	73	71	71	69	72

The above table indicates that during the year 2010-11, the revenue raised by the State Government (` 41,831.41 crore) was 72 *per cent* of the total revenue receipts against 69 *per cent* in the preceding year. The balance 28 *per cent* of receipts during 2010-11 were from the Government of India.

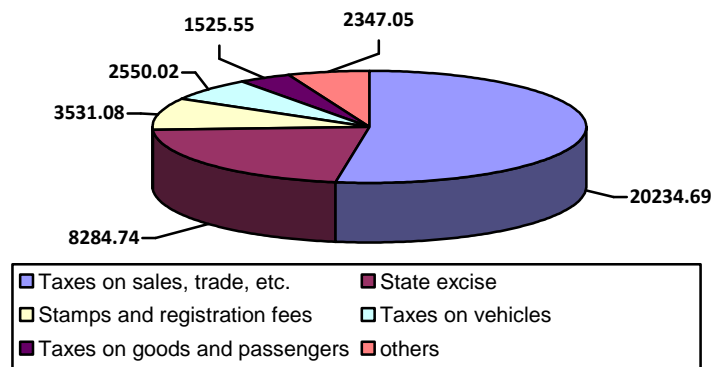
¹ Figures under the major heads of account 0020 Corporation Tax, 0021 Taxes on Income other than Corporation Tax, 0028 Other Taxes on Income and Expenditure, 0032 Taxes on Wealth, 0037 Customs, 0038 Union Excise Duties, 0044 Service Tax and 0045 Other Taxes and Duties on Commodities and Services – Minor head 901 – Share of net proceeds assigned to States booked in the Finance Accounts of the Government of Karnataka for 2010-11, under 'A-Tax Revenue' have been excluded from the revenue raised by the State Government and included in the State's share of divisible Union taxes.

1.1.2 The following table presents the details of tax revenue realised during the period from 2006-07 to 2010-11:

(` in crore)

Sl. No.	Head of revenue	2006-07	2007-08	2008-09	2009-10	2010-11	Percentage of increase (+)/ decrease (-) in 2010-11 over 2009-10
1.	Taxes on sales, trade, etc.	11,761.72	13,893.99	14,622.73	15,832.67	20,234.69	(+) 27.80
2.	State excise	4,495.48	4,766.57	5,749.57	6,946.32	8,284.74	(+) 19.27
3.	Stamps and registration fees	3,205.80	3,408.83	2,926.72	2,627.57	3,531.08	(+) 34.38
4.	Taxes on Vehicles	1,374.50	1,650.13	1,681.16	1,961.60	2,550.02	(+) 29.99
5.	Taxes on Goods and Passengers	1,147.20	837.34	1,085.02	1,291.13	1,525.55	(+) 18.15
6.	Taxes and duties on Electricity	388.57	449.50	370.59	678.69	663.49	(-) 2.23
7.	Other taxes on income and expenditure	392.58	451.37	538.79	527.21	549.74	(+) 4.27
8.	Other taxes and duties on commodities and services	425.05	380.68	406.15	576.83	946.95	(+) 64.16
9.	Land Revenue	108.76	145.31	255.65	127.88	177.53	(+) 38.82
10.	Taxes on agricultural income	1.37	3.04	9.28	8.70	9.33	(+) 7.24
Total		23,301.03	25,986.76	27,645.66	30,578.60	38,473.12	(+) 25.81

Graph 1: Tax Revenue 2010-11
(Rupees in crore)



The following reasons for variations were reported by the concerned Departments:

Taxes on Sales, Trade etc: The increase was attributed to increase in rate of tax and better compliance due to e-administration.

State Excise: The increase was attributed to increase in sales.

Stamps and Registration Fees: The increase was attributed to increase in registration of documents.

Taxes and Duties on Electricity: The tax payable in 2008-09 was paid during 2009-10. Hence the variation in 2010-11 is not due to actual decrease.

The other Departments did not inform (January 2012) the reasons for variation, although called for (June 2011).

1.1.3 The following table presents the details of major non-tax revenue realised during the period 2006-07 to 2010-11:

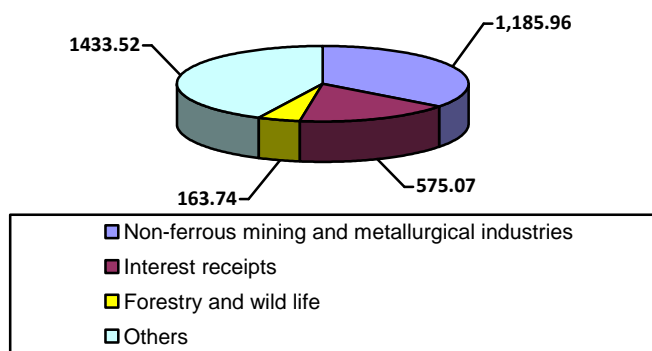
(` in crore)

Sl. No.	Head of revenue	2006-07	2007-08	2008-09	2009-10	2010-11	Percentage of increase(+)/ decrease (-) in 2010-11 over 2009-10
1.	Non-ferrous mining and metallurgical industries	366.29	472.35	556.07	859.50	1,185.96	(+) 37.98
2.	Interest receipts	376.19	375.24	337.17	383.86	575.07	(+) 49.81
3.	Forestry and wild life	127.97	131.84	126.92	212.48	163.74	(-) 22.93
4.	Contributions and recoveries towards pensions and other retirement benefits	27.47	29.08	76.20	69.07	54.74	(-) 20.74
5.	Other administrative services	101.34	79.60	94.37	99.29	104.20	(+) 4.94
6.	Education, sports, art and culture	65.00	74.93	73.56	95.85	127.83	(+) 33.36
7.	Medical and public health	39.54	52.77	40.52	54.67	121.29	(+) 121.85
8.	Police receipts	52.91	58.84	69.82	82.13	105.90	(+) 28.94
9.	Other general economic services	407.92	443.25	432.47	462.65	596.05	(+) 28.83
10.	Co-operation	30.13	33.14	37.30	46.62	51.47	(+) 10.40
11.	Village and small industries	39.46	35.30	36.65	50.41	86.19	(+) 70.97
12.	Public works	31.32	21.75	18.81	25.27	20.12	(-) 20.37
13.	Roads and bridges	24.18	14.05	36.71	32.46	61.07	(+) 88.13
14.	Major and medium irrigation	21.48	19.69	22.11	16.57	20.65	(+) 24.62
15.	Dividends and profits	19.48	23.40	40.14	29.48	43.44	(+) 47.35
16.	Housing	11.49	15.51	20.69	20.55	23.02	(+) 12.01
17.	Crop husbandry	12.92	14.04	15.69	9.96	13.03	(+) 30.82
18.	Miscellaneous general services	1,892.46	468.20	398.92	548.35	(-) 205.02 ²	(-) 137.38
19.	Others ³	450.86	994.68	724.87	234.63	209.54	(-) 10.69
Total		4,098.41	3,357.66	3,158.99	3,333.80	3,358.29	(+) 0.73

² Waiver of debt of ` 35,832.47 lakh granted to Government of Karnataka during 2008-09 has been withdrawn and the amount recovered during the year 2010-11. The recovery has been adjusted by debiting the Major Head "0075 – Miscellaneous General Services" per contra credit to "6004 Loans and Advances from the Central Government". Hence the minus figure.

³ Public Service Commission, Jails, Stationery & Printing, Family Welfare, Water supply and sanitation, Housing, Urban development, Power, Labour & Employment, Civil Aviation, Food Storage and Warehousing, Social Security and Welfare, Stationary and Printing, Ports and Light Houses, Shipping, Minor Irrigation, Other Social Services, Fisheries, Animal Husbandry, Industries, Other Rural Development Programmes, Tourism, Information & Publicity, Inland Water Transport, Civil Supplies, Land Reforms, Family Welfare, Other Agricultural Programmes etc.

Graph 2: Non tax revenue 2010-11
(Rupees in crore)



The following reasons for variations were reported by the concerned Departments:

Co-operation: The increase was attributed to increase in the number of licences and renewals.

Police: The increase was attributed to increase in the NOC fees.

Mines and Geology: The increase was attributed to auction of seized iron ore and increase of royalty rates.

1.2 Response of the Departments/Government towards audit

The Accountant General (Works, Forests & Receipt Audit), Karnataka (AG) conducts periodical inspection of the Government Departments to test check the transactions and verify the maintenance of the important accounts and other records as prescribed in the rules and procedures. These inspections are followed up with the Inspection Reports (IRs) incorporating irregularities detected during the inspection and not settled on the spot, which are issued to the heads of the offices inspected with copies to the next higher authorities for taking prompt corrective action. The Heads of the offices/Government are required to promptly comply with observations contained in the IRs, rectify the defects and omissions and report compliance through initial reply to the AG within one month from the date of issue of the IRs. Serious financial irregularities are reported to the Heads of the Departments and the Government.

1.2.1 Outstanding IRs and audit observations

IRs issued upto December 2010 disclosed that 7610 paragraphs involving ` 2,205.10 crore relating to 3,738 IRs remained outstanding at the end of June 2011 as mentioned below along with the corresponding figures for the preceding two years:

	June 2009	June 2010	June 2011
Number of outstanding IRs	3,705	3,554	3,738
Number of outstanding audit observations	7,028	7,106	7,610
Amount involved (` in crore)	1,417.56	1,701.48	2,205.10

The Department-wise details of the IRs and audit observations outstanding as on 30 June 2011 and the amounts involved are mentioned below:

Sl. No.	Department	Nature of receipts	Number of outstanding IRs	Number of outstanding audit observations	Money Value (` in crore)
1.	Finance	(a) Taxes on sales, trade, etc., entry tax, entertainments tax, luxury tax, professions tax, betting tax and agricultural income tax	1,445	3,871	440.41
		(b) State excise	604	929	366.63
2.	Energy	Electricity duty	7	7	41.62
3.	Revenue	(a) Land revenue	463	720	146.58
		(b) Stamps and registration fees	470	765	385.74
4.	Home and Transport	Taxes on motor vehicles	362	592	123.70
5.	Forest, Ecology and Environment	Forest receipts	208	291	390.08
6.	Commerce and Industries	(a) Sericulture industries receipts	44	55	5.01
		(b) Mineral receipts	107	318	302.60
7.	Public Works	Public works receipts	28	62	2.73
Total			3,738	7,610	2,205.10

Even the first replies required to be received from the Heads of the offices within one month from the date of issue of the IRs were not received for 25 IRs issued upto December 2010. This large pendency of the IRs due to non-receipt of the replies is indicative of the fact that the Heads of the offices and Heads of the Departments failed to initiate action to rectify the defects, omissions and irregularities pointed out by the AG in the IRs.

We recommend the Government to take suitable steps to install an effective procedure for prompt and appropriate response to the audit observations and take action against officials/officers who fail to take action to recover loss/outstanding demand in a timebound manner.

1.2.2 Adhoc committee meetings

The Government set up 'Adhoc Committees' to expedite the clearance of audit observations contained in the IRs. As per Government instructions, these committees are required to meet periodically and in any case, at least once in a quarter. The details of the adhoc committee meetings held during the year 2010-11 and the paragraphs settled are mentioned in the following table:

Sl. No.	Department	Number of meetings held	Number of paragraphs settled	Amount
1.	Commercial Taxes	03	277	28.06

Sl. No.	Department	Number of meetings held	Number of paragraphs settled	Amount
2.	Land Revenue	04	162	4.66
3.	Transport	02	46	0.55
	Total	09	485	33.27

As seen from the above, only three Departments have convened Adhoc committee meetings. Further, only one Department, viz., Land Revenue has convened Adhoc committee meetings periodically. The Departments concerned have not held any Adhoc committee meetings to discuss the IRs on revenue receipts relating to taxes on electricity, mineral receipts, sericulture, forest receipts, stamps and registration, state excise and public works.

We recommend that the Government ensure convening of periodical adhoc committee meetings for effective and expeditious settlement of outstanding paragraphs.

1.2.3 Non-production of records to audit for scrutiny

We prepare the programme of local audit of all the offices planned for audit sufficiently in advance and issue intimations to the Department, usually one month before the commencement of audit, to enable them to keep the relevant records ready for audit scrutiny.

During 2010-11, 682 records relating to 39 offices of Commercial Taxes Department (CTD) were not made available to audit. Out of which, 113 re-assessment files pertaining to 12 Audit offices of the Department were not produced, since they were pending in appeals. In 560 cases, revenue involved was ` 423.13 crore and in the remaining 122 cases, the tax effect was not ascertainable. Further, Cash book (revenue), 13 A Receipts, Form FAC 33, records relating to selection of wood, DCB, repayment of deposits and Register of EMD were not produced by four Deputy Conservators of Forests in the Forest Department. Receipt book accounts, 'A' register, details of exemption of stamp duty relating to industrial policy, surcharge allocation details and remittance register were not produced by two Sub-Registrars in the Department of Stamps and Registration.

We recommend that the Government/Department issue suitable directions to all its offices for making available all these files as well as for production of all the records to audit at the time of audit itself.

1.2.4 Response of the Departments to draft audit paragraphs

We forward draft paragraphs/Performance Audits proposed for inclusion in the Audit Report to the Principal Secretaries of the concerned Departments through demi-official letters. According to the instructions issued (April 1952) by the Government, all Departments are required to furnish their remarks on the draft paragraphs/Performance Audits within six weeks of their receipt. We have indicated the fact of non-receipt of replies from the Government at the end of each such paragraph included in the Audit Report.

We forwarded 25 draft paragraphs (including three Performance Audits) proposed for inclusion in the Report of the Comptroller and Auditor General of India (Revenue Receipts) for the year ended 31 March 2011 to the

concerned Principal Secretaries to Government with copies endorsed to concerned heads of Departments during March-June 2011.

We received the replies of the Department to 22 draft paragraphs of which the Government endorsed 13 draft paragraphs and the same were considered while finalising the Report. We have not received any replies to three draft paragraphs (January 2012). We discussed the draft Performance Audit Reports in the Exit conference with the Principal Secretary/Secretary of the Department concerned.

1.2.5 Follow-up on Audit Reports – summarised position

According to the Rules of Procedure (Internal Working) of the Committee on Public Accounts (PAC) (as modified in September 1999), within four months (three months up to March 1994) of an Audit Report being laid on the table of the Legislature, the Departments of Government are to prepare and send to the Karnataka Legislative Assembly Secretariat detailed explanations (Departmental notes) on the audit paragraphs. The Rules further require that before such submission, the Departmental notes are to be got vetted by the Accountant General.

We reviewed the position in this regard, which revealed that as of January 2012, 10 Departments had not furnished the Departmental notes in respect of 93 paragraphs included in Audit Reports for the years 1992-93 to 2009-10 due between July 1994 and July 2011, for vetting. The delay ranged from three months to over 17 years, as detailed below:

Sl. No.	Department	Year of Audit Report	Dates of presentation to the Legislature	Last date by which Departmental Notes were due	Number of Paragraphs for which Departmental Notes were due	Delay ⁴ (months)
1.	Finance	1996-97, 2002-03 to 2004-05, 2008-09 and 2009-10	May 1998 to March 2011	September 1998 to July 2011	21	6 to 160
2.	Revenue	1992-93 to 1996-97, 2004-05 to 2009-10	March 1994 to March 2011	July 1994 to July 2011	48	6 to 210
3.	Forest	2002-03 and 2003-04	July 2004 and July 2005	November 2004 and November 2005	04	74 to 86
4.	Urban Development	1998-99, 2002-03 to 2004-05 and 2006-07	March 2000 to July 2008	July 2000 to November 2008	05	38 to 138
5.	Commerce and Industries	1996-97, 2002-03, 2007-08	May 1998 to March 2011	September 1998 to July 2011	08	6 to 160

⁴ Excluding the month in which these were due.

Sl. No.	Department	Year of Audit Report	Dates of presentation to the Legislature	Last date by which Departmental Notes were due	Number of Paragraphs for which Departmental Notes were due	Delay ⁴ (months)
		and 2009-10				
6.	Co-operation	2005-06 and 2007-08	July 2007 and February 2009	November 2007 and June 2009	02	31 to 50
7.	Health and Family Welfare	1997-98	March 1999	July 1999	1	150
8.	Public Works	2004-05 and 2008-09	March 2006 and March 2010	July 2006 and July 2010	02	18 to 66
9.	Minor Irrigation	2006-07 and 2007-08	July 2008 and February 2009	November 2008 and June 2009	02	31 to 38
Total					93	

This indicated that the executive failed to take prompt action on important issues highlighted in Audit Reports that involved large amount of unrealised revenue.

1.2.6 Compliance with earlier Audit Reports

In the Audit Reports 2005-06 to 2009-10, 31,163 cases of underassessments, non/short levy of taxes, loss of revenue, failure to raise demands, etc. were included involving ` 2,126.88 crore. Of these, to the end of December 2011, the Departments concerned have accepted 21,701 cases involving ` 697.84 crore and recovered ` 35.78 crore in 1,535 cases. Audit Report wise details of cases accepted and recovered are as under:

(` in crore)

Audit Report	Included in Audit Report		Accepted by the Department		Recovered	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
2005-06	1,314	694.48	773	117.22	255	4.57
2006-07	824	324.48	487	24.56	140	2.64
2007-08	5,080	331.77	2,410	166.51	386	9.24
2008-09	16,905	336.61	16,688	286.56	642	2.76
2009-10	7,040	439.54	1,343	102.99	112	16.57
Total	31,163	2,126.88	21,701	697.84	1,535	35.78

From the above, it is observed that only 5 per cent of the revenue involved in the cases accepted by the Department was recovered during the last five years.

We recommend that the Government take measures to ensure expeditious recovery of revenue in respect of the accepted cases.

1.3 Analysis of the mechanism for dealing with the issues raised by Audit

The succeeding paragraphs 1.3.1 and 1.3.2 discuss the performance of the Stamps and Registration Department in dealing with the cases detected in the course of local audit conducted during the last five years and also the cases included in the Audit Reports for the years 2006-07 to 2009-10.

1.3.1 Position of IRs

The summarised position of IRs issued during the last five years, paragraphs included in these reports and their status as on 31 March 2011 are tabulated below.

(` in crore)

Year	Opening balance		Additions during the year		Clearance during the year		Closing balance	
	IRs/ Paragraphs	Money value	IRs/ Paragraphs	Money value	IRs/ Paragraphs	Money value	IRs/ Paragraphs	Money value
2006-07	297/ 622	58.53	64/ 69	1.89	33/ 90	5.10	328/ 601	55.33
2007-08	328/ 601	55.33	31/ 47	1.51	12/ 27	0.49	347/ 621	56.35
2008-09	347/ 621	56.35	59/ 57	64.38	13/ 22	0.18	393/ 656	120.56
2009-10	393/ 656	120.56	108/ 135	141.19	04/ 30	0.14	497/ 761	261.61
2010-11	497/ 761	261.61	104/ 108	95.04	23/ 68	1.00	578/ 801	355.66
Total	1,862/ 3,261	552.38	366/ 416	304.01	85/ 237	6.91	2,143/ 3,440	849.51

During the five year period, we issued 366 IRs with 416 paragraphs involving ` 304.01 crore and cleared 237 paragraphs involving ` 6.91 crore included in 85 IRs.

1.3.2 Assurances given by the Department/Government on the issues highlighted in the Audit Reports

1.3.2.1 Recovery of accepted cases

The position of paragraphs included in the Audit Reports of the last five years, those accepted by the Department and the amount recovered are mentioned below:

(` in crore)

Year of AR	Number of paragraphs included	Money value of the paragraphs	Number of paragraphs accepted	Money value of accepted paragraphs	Position of recovery of accepted cases
2006-07	03	31.26	01	0.35	--
2007-08	02	2.44	01	0.03	0.03
2008-09	06	325.83	05	283.04	0.45
2009-10	07	16.49	05	12.03	0.08
2010-11	06	7.71	02	7.55	0.08
Total	24	383.73	13	303.00	0.64

From the above, it is observed that only 0.21 *per cent* of the revenue involved in the cases accepted by the Department was recovered during the last five years. The Department had with reference to the audit paras reported that action had been initiated under Section 45(A)(3), 46(A) and 67(B) of the Karnataka Stamp Act, 1957. However, we have not received final report on the outcome of the action initiated.

We recommend that the Department take measures to ensure expeditious recovery of revenue in respect of the accepted cases.

1.3.2.2 Action taken on the recommendations accepted by the Departments/Government

The Draft Performance Audits conducted by the AG are forwarded to the concerned Departments/Government for their information with a request to furnish their replies. These Performance Audits are also discussed in an Exit conference and the Department's/Government's views are included while finalising the Performance Audits for the Audit Reports.

We conducted a Performance Audit on the Stamps and Registration Department that was featured in the Audit Reports during the last five years. We had suggested four recommendations for improvement in the system for monitoring realisation of proper stamp duty and registration fee, framing rules for inspections to prevent leakage, mechanism for early disposal of appeal and setting up of an IAW to ensure timely detection and correction as given below:

Year of AR	Name of the review/ No. of recommendations included	Details of the recommendations
2008-09	Levy and collection of Stamp Duty and Registration Fee/ 4	<ol style="list-style-type: none"> 1. installing a system in the Department for co-ordination with various Departments/agencies to monitor realisation of proper stamp duty and registration fee on instruments presented before them. 2. framing rules prescribing the procedures for conducting inspections to prevent any leakage of revenue due to evasion of stamp duty on instruments not required to be presented for registration. 3. prescribing a mechanism for early disposal of appeal cases. 4. setting up of an IAW to ensure timely detection and correction of errors in levy and collection of stamp duty and registration fee.

The Government/Department has not reported initiation of any mechanism as recommended for realisation of revenue due to Government. The Department has reported that proposals for setting up of IAW were pending with Government since 2008.

1.4 Audit Planning

We categorised the unit offices under various Departments into high, medium and low risk units according to their revenue position, past trends of audit

observations and other parameters. We prepared the annual audit plan on the basis of risk analysis which inter-alia include critical issues in Government revenues and tax administration i.e. Budget speech, White paper on State Finances, Reports of the Finance Commission (State and Central), recommendations of the taxation reforms committee, statistical analysis of the revenue earnings during the past five years, features of the tax administration, audit coverage and its impact during past five years, etc.

During the year 2010-11, the audit universe comprised 1,188 auditable units, of which 376 units were planned and audited during the year, which is 31.65 per cent of the total auditable units.

We also conducted three performance reviews besides the compliance audit mentioned above to examine the efficacy of the tax administration of these receipts.

1.5 Results of audit

1.5.1 Position of local audit conducted during the year

We test checked records of 376 units of commercial taxes, state excise, taxes on motor vehicles, land revenue, stamps and registration fees, electricity tax, forest and other Departmental offices during the year 2010-11. Further, we conducted three performance audit reviews during the year 2010-11. These revealed underassessments, non/short levy of taxes, loss of revenue, failure to raise demands and other irregularities aggregating ` 905.66 crore in 1,057 cases. During the course of the year, the Departments concerned accepted underassessments and other deficiencies of ` 122.62 crore in 259 cases, of which one case involving ` 22 lakh was pointed out in audit in earlier years. The Departments recovered ` 18.89 crore in 550 cases at the instance of audit.

1.5.2 This Report

This Report contains 23 paragraphs (selected from the audit detections made during the local audit referred to above and during earlier years which could not be included in earlier reports) including three performance audits involving financial effect of ` 275.84 crore. The Departments accepted audit observations involving ` 18.35 crore, of which ` 1.06 crore had been recovered upto January 2012. These are discussed in the succeeding Chapters II to VII.

EXECUTIVE SUMMARY

Tax collection	In 2010-11, the collection of taxes on sales, trade, etc. which stood at ` 20,234.69 crore, had increased by 28 <i>per cent</i> over the previous year.
Absence of Internal Audit Wing	IAW in CTD was functioning up to 2004-05. On introduction of VAT, the IAW was abolished leaving it vulnerable to the risk of control failure. After we had recommended in 2009-10 to Government to expedite the setting up of an IAW, the same was re-established with effect from June 2011.
Insignificant recovery by the Department of observations pointed out by us in earlier years	During the last five years, through our Audit Reports, we had pointed out non/short levy, incorrect exemption, non/short levy of interest/penalty, etc with revenue implication of ` 202.97 crore in 61 paragraphs. Of these, the Government/ Department had accepted audit observations in 50 paragraphs involving ` 49.80 crore and had since then recovered only ` 13.54 crore which was 27 <i>per cent</i> of the recovery involved.
Results of audit conducted by us in 2010-11	We conducted a test check of the records of 64 VAT offices and 12 offices of commercial taxes covering Entry tax, Entertainment tax, Agricultural Income tax and Betting tax during the year 2010-11, which revealed under-assessments of tax and other irregularities involving ` 159.67 crore in 408 cases. Of these, the Department accepted 60 cases involving ` 3.41 crore and recovered ` 8.56 crore in 316 cases which were pointed out by us in earlier years.
What we have highlighted in this chapter	In this Chapter we present a Performance audit on ‘ Cross verification of Declaration Forms in Inter-State trade and Commerce ’ involving ` 3.96 crore and a few illustrative cases involving ` 75.30 crore selected from observations noticed during our test check of records conducted during 2010-11 relating to assessment, levy and collection of taxes on sale, trade, etc. in the CTD, where we found that the provisions of the Acts/Rules were not observed.
Our conclusion	<p>The Department needs to improve the internal control system including strengthening of internal audit so that weaknesses in the system are addressed and omissions of the nature detected by us are avoided in future.</p> <p>There was no system of regular Cross verification of Declaration Forms used in Inter-State Trade to ascertain the genuineness of the forms before allowing the concessional rates of taxes on Commodities traded/transferred. Cross verification through the TINXSYS website was ineffective as</p>

	<p>upto-date information was not available and most of the details were incorrect or incomplete.</p> <p>It also needs to initiate immediate action to act upon the recommendations on the Performance Audit on 'Cross verification of Declaration Forms in Inter-State trade and Commerce' and to recover the un-realised tax, undercharge of tax, etc pointed out by us, more so in those cases where the Department has accepted our contention.</p>
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CHAPTER-II: TAXES ON SALES, TRADE, ETC

2.1 Tax administration

The levy and collection of Value Added Tax (VAT) and Sales tax are governed by the Karnataka Value Added Tax Act, 2003 (KVAT Act), the Central Sales Tax Act, 1956 (CST Act), the Karnataka Sales Tax Act, 1957 (KST Act) and the rules made thereunder. The Commercial Taxes Department (CTD) is under the administrative control of the Finance Department and headed by the Commissioner of Commercial Taxes (CCT). The CCT is assisted by the 14 Additional Commissioners (Ad Com) and Joint Commissioners (JCCTs) Minor Acts, Enforcement, Vigilance and there are 13 Divisional VAT Offices (DVO) in the State each headed by JCCT and 13 JCCT (Appeals) and 148 Audit Offices headed by Deputy Commissioners (DCCT) and Assistant Commissioners (ACCT). At the field level, VAT is being administered through 95 Local VAT Offices (LVOs) and VAT Sub Offices (VSOs) headed by ACCTs and Commercial Tax Officers (CTOs) respectively. The computer cell of the CTD is headed by an Ad Com.

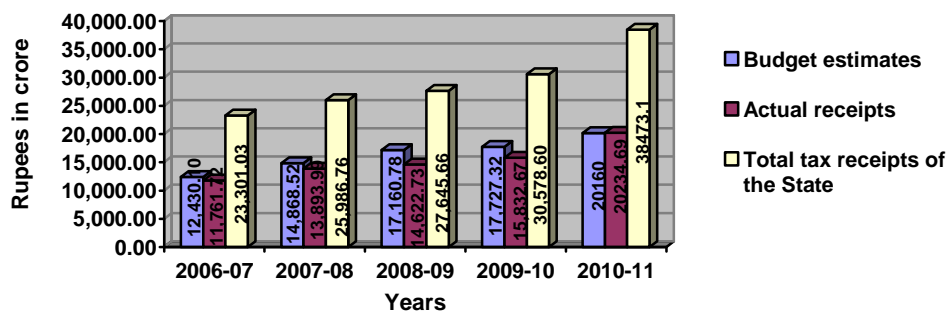
2.2 Trend of receipts

Budget Estimates (BEs) and actual receipts from taxes on sales, trade etc. during the years 2006-07 to 2010-11 along with the total tax receipts during the same period is exhibited in the following table and graphs.

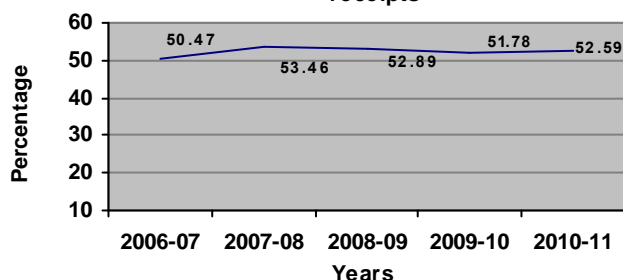
(` in crore)

Year	Budget estimates	Actual receipts	Variation excess(+)/shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
2006-07	12,430.10	11,761.72	(-) 668.38	(-) 5.38	23,301.03	50.47
2007-08	14,868.52	13,893.99	(-) 974.53	(-) 6.55	25,986.76	53.46
2008-09	17,160.78	14,622.73	(-) 2,538.05	(-) 14.79	27,645.66	52.89
2009-10	17,727.32	15,832.67	(-) 1,894.65	(-) 10.69	30,578.60	51.78
2010-11	20,160.00	20,234.69	(+) 74.69	(+) 0.37	38,473.12	52.59

Graph 1 : Budget estimates, Actual receipts and Total tax receipts



Graph 2: Percentage of Actual receipts vis-a-vis Total tax receipts



The percentage of actual receipts of VAT to the total tax receipts ranged between 50.47 and 53.46 *per cent* during five year period from 2006-07 to 2010-11.

2.3 Analysis of arrears of revenue

The arrears of revenue as on 31 March 2011 amounted to ` 3,193.21 crore. The following table depicts the position of arrears of revenue during the period 2006-07 to 2010-11, as furnished by the CTD.

(` in crore)

Year	Opening balance of arrears	Amount collected during the year	Percentage of collection to opening balance of arrears
2006-07	2,873.89	328.58	11.43
2007-08	4,297.18	358.33	8.34
2008-09	3,985.13	395.02	9.91
2009-10	4,164.96	316.76	7.61
2010-11	3,750.79	320.49	8.54

The CTD stated that the arrears include ` 1,024.73 crore pertaining to deferred tax amount. Of the remaining ` 2,168.48 crore, ` 393.34 crore were stayed by court orders, ` 108.05 crore is pending before Board of Industrial and Financial Reconstruction (BIFR), ` 176.35 crore under liquidation process, ` 82.54 crore covered by revenue recovery certificates, ` 184.07 crore covered by court recovery, ` 160.59 crore held under payment verification and ` 39.99 crore was under write off proposal. The balance ` 1,023.55 crore was under recovery by the Department.

The percentage of collection of arrears to the opening balance of arrears was less than 10 *per cent* for all the years except during the year 2006-07, when it was 11.43 *per cent*.

We recommend that the Department take effective measures for improving the collection of arrears of revenue.

2.4 Cost of VAT per assessee

The number of assessees, cost of collection, and the cost of VAT per assessee during 2006-07 to 2010-11 were as follows:

(Amount in `)

Year	Number of assessees	Cost of VAT collection	Cost of VAT collection per assessee
2006-07	3,42,458	60,60,46,000	1,770
2007-08	3,80,135	74,30,28,000	1,955
2008-09	4,01,817	81,61,95,000	2,031
2009-10	4,16,265	84,45,67,000	2,029
2010-11	4,03,639	92,86,95,000	2,301

2.5 Cost of collection

The gross collection in respect of taxes on sales, trade etc, expenditure incurred on collection and the percentage of such expenditure to gross

collection during the years 2008-09, 2009-10 and 2010-11 along with the relevant all India average percentage of expenditure on collection to gross collection for the respective preceding years were as follows:

Year	Gross collection	Expenditure on collection	Percentage of cost of collection to gross collection	All India average percentage for the preceding year
	(` in crore)			
2008-09	16,259.37	81.62	0.50	0.83
2009-10	16,546.34	84.46	0.51	0.88
2010-11	21,252.97	92.87	0.44	0.96

2.6 Impact of Audit Reports

During the last five years, through our Audit Reports, we had pointed out non/short levy, incorrect exemption, non/short levy of interest/penalty, etc., with revenue implication of ` 202.97 crore in 61 paragraphs. Of these, the Government/Department had accepted audit observations in 50 paragraphs involving ` 49.80 crore and had since recovered ` 13.54 crore. The details are shown in the following table:

(` in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ¹	Number	Amount
2006-07	14	23.47	14	11.12	03	2.30
2007-08	19	77.54	14	25.64	14	8.13
2008-09	09	7.41	07	1.72	06	1.36
2009-10	09	15.29	09	10.79	07	1.32
2010-11	10	79.26	06	0.53	06	0.43
Total	61	202.97	50	49.80	36	13.54

As seen from the above table, the recovery made by the Department was 27.19 per cent of the revenue involved in the total accepted cases.

We recommend that the Government may take measures to ensure expeditious recovery of revenue in respect of the accepted cases.

2.7 Working of Internal Audit Wing

Internal Audit Wing (IAW) is intended to examine and evaluate the level of compliance with the rules and procedures so as to provide a reasonable assurance on the adequacy of the internal control. Effective internal audit system both in the manual as well as computerised environment is a pre-requisite for the efficient functioning of any Department. However, consequent to introduction of VAT with effect from 01 April 2005, the Department abolished the Internal Audit Wing leaving it vulnerable to the risk of control failure.

After we pointed out, the Department replied (October 2011) that an IAW was re-established in the Department with effect from June 2011.

2.8 Results of Audit

¹ Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

We conducted a test check of the records of 64 VAT offices and 12 offices of commercial taxes covering Entry tax, Entertainment tax, Agricultural Income tax and Betting tax during the year 2010-11, which revealed under-assessments of tax and other irregularities involving ` 159.67 crore in 408 cases, which fall under the following categories.

(` in crore)

Sl. No.	Category	Number of cases	Amount
	Taxes on Sales, Trade, etc.		
1.	Cross verification of Declaration Forms in Inter-State trade and Commerce (A Performance Audit)	1	3.96
2.	Incorrect exemption as sale in the course of export/import	16	72.26
3.	Non/short levy of output tax	64	21.15
4.	Incorrect/excess allowance of input tax credit	63	8.88
5.	Incorrect/excess refund carried forward	27	3.85
6.	Non/short payment of tax	74	14.38
7.	Incorrect allowance of tax deducted at source	17	22.57
8.	Non/short levy of penalty	64	5.83
9.	Non/short levy of interest	44	2.58
10.	Non-forfeiture of tax collected in excess	3	0.92
11.	Other irregularities	5	1.97
	Total	378	158.35
	Entry Tax		
13.	Non/short realisation of entry tax/penalty	3	0.05
	Entertainment Tax		
13.	Non/short realisation of entertainment tax/penalty	7	0.73
	Agricultural Income Tax		
14.	Non/short levy of interest and penalty	14	0.34
	Luxury Tax		
15.	Non/short levy of tax, interest/penalty	3	0.06
	Betting Tax		
16.	Non/short levy of tax, interest/penalty	3	0.14
	Grand Total	408	159.67

During the course of the year 2010-11, the Department accepted 60 cases involving ` 3.41 crore and recovered ` 8.56 crore in 316 cases which were pointed out by us in earlier years.

A Performance Audit on ‘**Cross verification of Declaration Forms in Inter-State trade and Commerce**’ involving ` 3.96 crore and a few illustrative cases involving ` 75.30 crore are mentioned in the following paragraphs.

2.9 Performance Audit on “Cross verification of Declaration Forms in Inter-State trade and Commerce”

Highlights

We found that the Department had not devised a proper and effective mechanism for printing/reviewing the existing stock of the Declaration Forms and the pace of issue of Declaration Forms before printing of new Forms. There were 3,150 ‘C’ Forms in stock since 2008-09, and though 1,60,000 ‘H’ forms were held in stock since 2005-06, additional 32,000 ‘H’ forms were got printed during 2008-09 when only 8,000 forms were issued up to 2009-10, leaving a closing stock of 1,84,000 forms as at the end of 31 March 2011 and thus clearly printed forms were in excess of requirements.

(Paragraph 2.9.5.1)

Very high percentage of error records (50 to 100 *per cent*) on the TINXSYS website, coupled with an incomplete database, defeated the purpose of the website for verification of the State’s Inter-State transactions.

(Paragraph 2.9.5.4)

We noticed that 79 *per cent* of the Central Sales Tax (CST) assessments were pending finalisation as on 31 March 2010, with only 21 *per cent* assessments being completed (1,55,682) as against 7,44,338 cases due for assessments, leaving a balance of 5,88,656 cases for the period 2005-06 to 2009-10. Incomplete assessments had a huge risk of tax escapement due to non-verification of claims of concessional tax on declaration forms.

(Paragraph 2.9.5.6)

We noticed that the Dealer Ledger and Demand, Collection and Balance Register/G2 Register was not maintained either in manual form or in electronic mode. The CTD had not maintained position of arrears under CST separately.

We found that there were 2,462 cases of short/non-filing of declaration/statutory forms. Though tax together with interest aggregated to ` 147.40 crore was levied, these amounts were not booked and taken as arrears of tax .

(Paragraph 2.9.5.7)

We found that the Department had not put in place any mechanism for cross verification of the Declaration Forms furnished by the dealers of the State effecting Inter-State transactions with the concerned States.

(Paragraph 2.9.5.8.1)

We noticed that in four LVOs, 36 ‘C’ forms for a turnover of ` 68.19 lakh which had originated from Nagpur, Maharashtra were not issued by those Sales Tax authorities. Five State dealers had shown Inter-State sales turnover

of ` 12.26 lakh for the year 2007-08 covered by 'C' forms which were not issued to the purchasers whose details were mentioned therein. The tax recoverable on such fake forms was ` 6.95 lakh besides penalty leviable. We found escapement of turnover of ` 8.17 crore involving a tax of ` 69.96 lakh in 20 'C' forms filed by 17 dealers in five LVOs.

(Paragraph 2.9.6)

We noticed that in four LVOs, Declarations Forms 'C', in support of Inter-State sale involving a turnover of ` 90.05 lakh though incomplete, were accepted in respect of eight dealers wherein the tax of ` 7.25 lakh was leviable by disallowing these forms.

(Paragraph 2.9.7.1)

We noticed that Intra-State sales valued at ` 75.58 lakh were done by wrongful utilisation of 12 'C' forms resulting in escapement of tax of ` 6.97 lakh while Inter-State sales valued at ` 5.76 crore were not found supported by 'C' forms. Incorrect Grant of concessional rate of tax on the form 'C' covering transactions of more than one quarter resulted in short levy of tax of ` 18.19 lakh. Inter-State sales on Forms 'C' exceeded the turnover mentioned in their Monthly and Annual Returns of 11 dealers with reference to the forms filled by them by ` 1.20 crore resulting in escapement of tax of ` 4.46 lakh.

(Paragraphs 2.9.7.2 to 2.9.7.5)

In 10 LVOs we noticed exemption from payment of tax on stock transfer without verification of the Declaration Forms which were pertaining to more than one month. The tax leviable on these irregular forms was ` 61.36 crore. A tampered 'F' Form involving tax effect of ` 1.21 crore was incorrectly accepted. The matter needs investigation

(Paragraph 2.9.8)

We found that though three assessments of two dealers for the years 2005-06 to 2007-08 were concluded, the demand notices were not served on the dealers, resulting in non-demand of tax of ` 2.33 crore.

Further in one case the AA omitted to demand and levy interest and penalty thereon of ` 69.32 lakh.

(Paragraph 2.9.9)

The 'Online Issue of Declaration Forms System' was deficient for want of adequate validation controls to prevent issue of more than one Form against an invoice, upgradation to real time presentation system and cancellation of approved forms for any reason.

(Paragraph 2.9.11.1)

2.9.1

The Central Sales Tax Act, 1956 formulates principles for determining when a sale or purchase of goods takes place in the course of Inter-State trade or Commerce or outside a State or in the course of import into or export from India. It provides for the levy and collection of taxes on sale of goods in the course of Inter-State trade or Commerce. Though the rates are determined under the Central Law, the taxes are administered and collected by the State Government. Accordingly, every dealer, who in the course of Inter-State trade or Commerce, sells to a registered dealer, goods of the classes, specified in the registration certificate of the purchasing dealer, shall be liable to pay tax at the concessional rate of tax (four *per cent* upto 31-03-2007, three *per cent* w.e.f. 01-04-2007 and two *per cent* w.e.f. 01-06-2008) of such turnover, provided that the sales are supported by valid and complete declarations in Form 'C'. The tax payable by any dealer on his Inter-State sales turnover not supported by declaration in Form 'C' was at the rate of 10 *per cent* or at the rate of tax to sale or purchase of such goods inside the appropriate State under the Sales tax law of the State whichever was higher up to 31 March 2007. With effect from 1 April 2007, it shall be at the rate applicable to sale or purchase of such goods under the sales tax law of that State.

Exemption from levy of tax are also provided under the Act on production of specified Declaration Forms for deemed exports (Form 'H'), stock transfer to outside the State by a dealer to his any other business place or his agent or his principal (Form 'F').

Further, under the CST Act, no tax shall be leviable on a subsequent sale effected by transfer of documents of title to goods, during a movement of such goods from one State to another occasioned by an inter-State sale subject to the production of the prescribed certificates (Form 'E-I' or 'E-II') obtained from the selling dealer coupled with declarations in Form 'C' issued by the subsequent purchasing dealers.

2.9.2 Audit Objectives

We conducted the Performance Audit to assess whether:

- There exists a foolproof system for custody and issue of the declaration forms;
- Exemption/concession of tax granted by the assessing authorities (AAs) was supported by the original declaration forms;

- There was a system for ascertaining genuineness of the forms for preventing evasion of tax;
- There was a system of uploading the particulars in the TINXSYS website and the data available there is utilised for verifying the correctness of the forms;
- Appropriate steps were taken on receipt and detection of fake, invalid and defective (without proper or insufficient details) forms; and
- There exists an effective and adequate internal control mechanism.

2.9.2.1 Audit Criteria

We adopted the following criteria in the Performance Audit:

1. The Central Sales Tax Act, 1956
2. The Central Sales Tax (Registration and Turnover) Rules, 1957
3. Karnataka Value Added Tax (KVAT) Act, 2003
4. Notifications issued by Government of India from time to time
5. Notification issued by Government of Karnataka

2.9.3 Scope and methodology of audit

We conducted the Performance Audit on Cross verification of Declaration Forms (C&F) in Inter-State trade and Commerce during the period November 2010 to August 2011 with a view to assess the correctness in accounting, printing, receipt, issue and utilisation of the Declaration Forms by 12 offices of the CTD (Eight LVOs and Four AOs) during the years 2007-08 to 2009-10. We collected 10,783 Declaration Forms and verified these forms with the records of CTD of 13 States through our Accountants General/Pr. Accountants General of the concerned States. The details are mentioned in the following table.

Forms	C	F	Total
Number of Forms	42,690	1,121	43,811
Number of form on which verification report received	10,415	368	10,783

We received 7,452 Declaration forms for cross verification from other States:

Forms	C	F	Total
Number of Forms	5,706	1,746	7,452
Discrepancies found	Nil	Nil	Nil

We also test checked the assessments concluded under the CST Act, the results of the test check are also included in the Performance Audit.

2.9.4 Acknowledgement

We acknowledge the co-operation of the CTD in providing necessary information and records for audit including access to Information systems. Our findings as a result of test check of the records and system were reported to the CTD during the period December 2010 to August 2011. We held an Entry conference in December 2010 with the Principal Secretary, Finance

Department (FD), wherein the scope of audit, methodology and audit objectives were explained to the Department. Exit conference was held in December 2011 and our findings were discussed with the Principal Secretary, Finance Department and the CCT. The replies received during the exit conference and at other points of time have been appropriately commented in the relevant paragraphs of the Audit Report.

Audit findings

System deficiencies

2.9.5.1 Maintenance of accounts of receipts and use of declaration forms Printing, custody and issue of declaration forms

The CTD introduced on-line issue of Form 'C' with effect from 25 April 2009 and on-line filing of monthly return with effect from 01-04-2010. Consequent to this, the stock and issue registers lost its relevance as the same need not be maintained manually by the issuing authority.

Prior to introduction of on-line issue of Form 'C', all forms i.e., 'C', 'F' and 'H' were being obtained by the CCT from the State Government press and supplied to the divisions for distribution amongst the circle offices under their jurisdiction. Declaration forms are issued to the registered dealers by circle offices to enable them to issue prescribed declaration forms to other registered dealers for purposes specified in their registration certificate in order to avail exemption from levy of tax or to pay concessional rate of tax. Dealers had to submit periodical utilisation certificate to the circle office concerned for the declaration forms received and utilised by them, and the same is to be properly recorded by the Assessing Officer. No declaration form was to be issued by the circle office to the dealers till accounts of the utilisation of forms issued earlier to the dealer was submitted.

The details of opening stock of declaration forms, got printed during the year, issues and closing balance, as furnished by the CTD during the period 2005-06 to 2009-10 are mentioned in the following table:

Year Form	Opening stock			New forms printed			Issued during the year			Closing stock		
	C	F	H	C	F	H	C	F	H	C	F	H
2005-06	4937	25	160000	0	0	0	3370	8	0	1567	17	160000
2006-07	1567	17	160000	16563	5000	0	17150	2447	0	980	2570	160000
2007-08	980	2570	160000	15000	0	0	3440	840	0	12540	1730	160000
2008-09	12540	1730	160000	0	0	32000	9390	150	0	3150	1580	192000
2009-10	3150	1580	192000	0	0	0	0	0	8000	3150	1580	184000
2010-11	3150	1580	184000	0	0	0	0	390	0	3150	1190	184000

It can be seen from the above table that:

- i. The Department had 3,150 'C' Forms held in the closing stock since 2008-09, for which the CTD had not issued any directions for disposal of these forms.
- ii. Though 1,60,000 'H' forms were held in stock since 2005-06, additional 32,000 'H' forms were got printed during 2008-09 and only

8,000 forms were issued up to 2009-10 leaving closing stock of 1,84,000 forms as at the end of 31 March 2011 indicating therein that the forms were printed in excess of the requirement.

This indicates that the Department had not devised a proper and effective mechanism for printing/reviewing the existing stock of the Declaration Forms and the pace of issue of Declaration Forms before proceeding for printing of additional forms.

After this being pointed out by us, the Department in the Exit conference accepted the fact that Declaration Forms were got printed in excess, which are now redundant.

2.9.5.2 Receipts and Issue

The receipt and issue of the aforesaid Declaration Forms are accounted for in separate stock registers by the division and circle offices indicating receipt and issue of various declaration forms. When the forms are issued to the dealer, the signature of the dealer as a token of receipt is to be obtained in the register. Every registered dealer to whom any declaration form is issued by the appropriate authority shall maintain complete account of every such form. The dealer has to furnish utilisation certificate to the competent authority showing the name of dealer to whom the form is issued, bill number and date and description of goods with value.

We noticed that the physical verification of statutory forms held at Head office, Divisions and assessment circles were not conducted by the CTD during our audit period.

After we pointed out, the CTD had issued instruction to the newly established internal audit wing to conduct regular physical verification of statutory forms.

2.9.5.3 Computerisation of the CTD- On-line issue of Declaration Forms

The CTD was computerised on introduction of VAT with effect from 1 April 2005. The VATSoft developed by National Informatics Centre (NIC) was made operational initially for registration of dealers and generating TIN, receipt and acknowledgement of returns and payments, capturing and analysing the contents of return for their correctness, accounting for payments, etc. On-line issue of C forms was made operational with effect from 25 April 2009. Currently the CTD is functioning in computerised environment which includes on-line filing, e-payment, on-line updation and issue of declaration forms, etc.

2.9.5.4 Tax Information Exchange System

2.9.5.4.1 TINXSYS is a centralised exchange of all Inter-State dealers spread across the various States and Union territories of India. TINXSYS will help the CTDs of various States and Union Territories to effectively monitor Inter-State trade and Commerce.

2.9.5.4.2 TINXSYS could be used by any dealer to verify the counterpart dealer in any other State. Apart from dealer verification, CTDs could use TINXSYS for verification of the Statutory Forms issued by other State CTDs

and submitted to them by the dealers in support of claim for concessions or exemptions. TINXSYS would also provide MIS and Business Intelligence Reports to the CTDs to monitor interstate trade movements and enable Empowered Committee (EC) of State Finance Ministers to monitor the trends in Inter-State trade. TINXSYS would be used as an effective centralised tool for verification and monitoring of interstate trade in post VAT scenario.

2.9.5.4.3 Ineffective TINXSYS

As and when the Commercial Tax Department uploads the data of the statutory forms to the TINXSYS, the website provides the details of information of Data Extracted by the Department and the error data details in the form of messages (included in the details). As could be seen from the TINXSYS, the detailed information of data extracted, the number of error records are very high on each and every occasion of uploading of forms.

We downloaded (7-06-2011) the data relating to the 'C' & 'F' forms uploaded for the month of November 2010 on 31-05-2011 by CTD from the TINXSYS website and found that the percentage of error records ranged from 50 per cent to 100 per cent as mentioned in the following table:

Sl. No.	Type of Data	Extracted records	Correct records	Error Records	Percentage of error records
1	Dealer Business Information	8870	4435	4435	50
2	C forms issued	178138	88091	90047	51
3	C forms utilisation	357360	87010	270350	76
4	C form Invoice details	1816125	443169	1372956	76
5	C forms received	1074	NIL	1074	100
6	F forms issued	1810	892	918	51
7	F form invoice details	7253	NIL	7258	100
8	F forms received	108	NIL	108	100

We noticed that, on every occasion of uploading of information of statutory forms, the percentage of error records varied from 50 to 100 per cent. The existence of large number of error records in the TINXSYS, and non-availability of latest information of statutory forms, the cross verification of the data by the other States virtually would not fetch the required results and purpose of cross verification by the CTDs of other States would become ineffective thereby defeating the intended purposes of the web site. The CTD of Karnataka had not taken any action to correct the error records right from the inception of the TINXSYS website to till date.

The TINXSYS was, thus, totally ineffective as large number of error records/data exist, which hampers the cross verification and defeated the very purpose for which it was established.

2.9.5.4.4 Deficiencies noticed in updating/non-availability of Declaration Form details in TINXSYS

We found the following deficiencies in the updation of TINXSYS system:

- Even though the data availability statistics at the TINXSYS website shows the last updated date as 31-05-11 for the State of Karnataka, forms issued

after 01-12-2010 were not traceable on the website. This indicates a data updation lagging behind by more than 6 months.

- Ten declaration forms drawn from ISSUE TABLE of VATSoft Database issued during the financial year 2009-10 (prior to 31-11-2010) were also not traceable in the TINXSYS site. These are given below:

Sl. No.	TIN to whom issued	Type	Series	Form No.	Date of issue
1	29790077420	C	KA-C/01	951932	4/28/2009
2	29500247960	E1	E	137132	11/11/2009
3	29390146122	F	3	602000	2/16/2010
4	29960061467	C	TCK-R	2616304	5/14/2010
5	29910034189	C	G-21	695603	5/15/2010
6	29170128104	H	F1	150501	5/27/2010
7	29060085533	F	KA-F/01	312031	6/18/2010
8	29290787056	F	KA-F/01	97195	6/30/2010
9	29560075364	F	KA-F/01	97222	7/1/2010
10	29310117066	F	H	706605	9/17/2010

The reasons for non-updating or uploading of these forms to TINXSYS are not forthcoming.

2.9.5.4.5 The following lack of controls and related issues were also noticed in connection with the updating of data on TINXSYS.

- It was observed that no input controls are available in the system to ensure that serial numbers of the declaration forms are entered in the standard/uniform format in the statutory form issue database. Several entries in incorrect/non-uniform format (“0012393-97”, “hI” instead of “H1”, “ka-c/01” instead of “KA-C/01”) are noticed in the statutory form issue database. Since this table gets directly uploaded to TINXSYS, the site will fail to respond to queries based on entry of serial numbers and show the forms as untraced. This undermines the utility of the site and makes it ineffective in achieving its intended purpose.
- It is also observed in many cases that the selling dealer information available in the database of statutory form utilisation, had failed to upload into TINXSYS.
- The belated and delayed uploading of the details of statutory forms to the TINXSYS defeats the very purpose for which the web site was established.

2.9.5.5 ‘Copy’ function in statutory forms issued on-line not disabled

Under on-line issue of statutory forms, the dealers submit requests for Declaration Forms on-line on the basis of inter-State purchases effected. After verification and approval by the CTD, the forms are issued online, which the dealers can take print outs and submit to their respective inter-State sellers. It was observed that as the online format of the statutory forms are not in the ‘pdf’ format and the ‘copy’ function in the format of form provided on-line was not disabled, the system permits the dealer to copy the form on to any word processing application and take unlimited number of copies with suitable alterations in form number, date, dealer name, purchase invoice/bill particulars, amount, etc. Deficiency of this control may lead to a proliferation of bogus

forms in the absence of automatic online mechanisms for authentication of forms between all participating States.

2.9.5.6 Non-finalisation of VAT and CST Assessments

The Government of Karnataka implemented the KVAT Act with effect from 1 April 2005. Under the KVAT Act, every dealer shall be deemed to have been assessed to tax based on the return filed by him.

In this scenario, we are of the opinion that there is a potential risk of dealers claiming concessional rate of tax or exemption from levy of tax in their CST returns without filing the mandatory declaration forms. The potential risk of misclassifying local sale as Inter-State sale to claim exemption/concessional rate of CST against the liability to pay tax at higher rates under the KVAT Act cannot be ruled out. These kind of evasions could not be detected and corrected unless scrutiny assessments are concluded by the Department or the mechanism prescribed for filing utilisation details of declaration forms are duly monitored.

Under the CST Act, scrutiny assessments were to be taken up and completed for every year. As per the information furnished by the CTD, total number of 1,55,682 assessments (about 21 *per cent*) only were concluded as against 7,44,338 cases due for assessments, leaving a balance of 5,88,656 cases (about 79 *per cent*) for the years 2005-06 to 2009-10. The year wise pendency position is mentioned in the following table:

Year	Number of cases due for assessments	Assessments concluded	Percentage of completion of assessments	Pending assessment cases	Percentage of pending assessments
2005-06	1,08,736	40,951	37.66	67,785	62.34
2006-07	1,18,405	68,522	57.87	49,883	42.13
2007-08	1,10,844	17,223	15.53	93,621	84.47
2008-09	1,68,178	16,303	09.69	1,51,875	90.31
2009-10	2,38,175	12,683	05.32	2,25,492	94.68
Total	7,44,338	1,55,682	21	5,88,656	79

The above table would reveal that the percentage of assessments concluded each year from 2006-07 to 2009-10 was declining despite the increase in number of dealers under CST each year.

The details of additional revenue generated and collected from the CST assessment concluded from 2005-06 to 2009-10 were as mentioned in the following table:

(` in lakh)				
Year	Assessments completed	Additional demand for revenue raised in the assessment orders	Additional revenue collected	Percentage of collection
2005-06	40,951	2,713.58	746.27	27.50
2006-07	68,522	14,131.11	10,286.85	72.79
2007-08	17,223	8,449.33	6,056.93	71.68
2008-09	16,303	32,217.73	5,317.27	16.50
2009-10	12,683	12,229.07	4,827.35	39.47
Total	1,55,682	69,740.82	27,234.67	39

From the above table it is obvious that substantial additional revenue was raised by the Department on conclusion of assessments. Hence, timely

conclusion of the remaining 5,88,656 cases pending for assessment would result in substantial tax revenue to the Government.

After we pointed out, the CTD issued circular instructions to all the Divisional VAT Officers (DVOs) to take out the pendency of CST assessments from 2005-06 to 2009-10 through Comprehensive Audit System (CAS) for early completion of assessments.

In the Exit conference CCT mentioned that separate action is being taken to reduce the pendency in assessments.

2.9.5.7 Correctness of the arrears of revenue under CST and KVAT – Non-maintenance of records

The Karnataka Commercial Taxes Manual (KCT Manual) prescribed maintenance of various demand registers to watch recovery of arrears of tax.

We noticed that the internal control mechanism of the Department is very weak as the Department had not devised a mechanism or system to watch the assessments, collection, remittances and refunds under CST or VAT as evidenced by the absence of maintenance of the Dealer Ledger and Demand, Collection and Balance Register/G2 Register either in manual as prescribed in the KCT Manual or in electronic mode. The CTD had not maintained position of arrears under CST separately.

We also noticed in seven² LVOs that as per the assessments concluded there were 2,462 cases of short/non-filing of declaration/statutory forms. In respect of these cases differential tax together with interest aggregated to ` 147.40 crore were levied and demand notices were served to the concerned dealers. However, these amounts were not booked and taken as arrears of tax under CST. This includes demand notices issued under CST for ` 52.19 crore for the assessment years 2005-06 and 2006-07 to M/s. Hindustan Aeronautics Limited.

Though the demand notices were issued in these cases between January 2009 and March 2010, follow up actions for recovery of these demands were not forthcoming from the records. As a result the position of arrears of revenue stated by the CTD being not only inaccurate, but also there was no effective action for recovery of these amounts from the dealers concerned, which is a matter of serious concern.

After we pointed out, the CTD stated in October 2011 that circular instructions were issued in June 2011 to update arrears position within three months and submit the same to Commissionerate for follow-up action.

2.9.5.8 Absence of a system of cross verification of declaration forms

² LVO: 010, 090, 110, 120, 130, 140 and 045.

As the declaration forms filed by the dealers provide them with concession/exemption from levy of tax, filing of fake or inflated value in declarations by the dealers is a potential risk. Therefore, cross verification of the declaration forms by the State/s in which the forms were received with the originating State of those forms is an effective internal control to check this risk.

2.9.5.8.1 During the course of the Performance Audit we found that the Department had not put up any mechanism to cross verify the declaration forms furnished by the dealers of the State effecting inter-State transactions with the concerned States. No statistical information indicating the details for cross verification of Declaration Forms filed by the dealers in the LVOs with the concerned originating State was made available to us.

2.9.5.8.2 We noticed that in cases of loss of forms due to theft, fire mishaps, etc. the Department issues gazette notifications to invalidate such forms and news paper advertisement are also given. However, the gazette notification alone would not serve the purpose as the invalidated forms if issued by any dealer would be getting the benefit of tax exemption/concession in the State to which they were issued. Hence it is important to communicate to all the other States regarding the cancellation of those forms. Effective measures taken if any, by the Department to prevent the misuse of such cancelled declarations though called for has not been received (January 2012).

2.9.5.8.3 The CTD received requests from various other States for the cross verification of “suspected” declaration forms. We noticed that in such cases, except for forwarding the letter to the concerned LVOs, the Department had not watched the progress of verifications of such forms. We also noticed from some of the correspondence between the office of the AdCom (I&C) and LVOs that the AdCom (I&C) fixed the time frame to furnish the detail by the LVOs. However the details were not furnished by the LVOs promptly and thus did not adhere to the time frame.

Compliance deficiencies

2.9.6 Irregularities based on cross verification of details of Declaration Forms

We noticed the following types of irregularities from the cross verification of details of Declaration Forms received from CTD of other States through our State Accountants General/Pr. Accountants General.

2.9.6.1 In four³ LVOs, nine State dealers filed 36 ‘C’ forms for a turnover of ` 68.19 lakh for the period 2005-06 and 2006-07, which had originated from Nagpur, Maharashtra. Our cross verification with the concerned authorities in Nagpur revealed that these Forms were not issued by those Sales Tax

³ LVOs 120, 090, 130, 110.

authorities. These transactions involving tax effect of ` 5.79 lakh required verification.

In the Exit conference the CCT stated that these cases would be verified and details would be furnished by the end of December 2011.

2.9.6.2 Five State dealers had shown Inter-State sales turnover of ` 12.26 lakh for the year 2007-08 covered by 'C' forms. Our cross verification of these forms with the concerned States revealed that those 'C' forms were not issued to the purchasers whose details were mentioned therein. As such, the transactions required verification for escapement of tax of ` 1.16 lakh.

2.9.6.3 In seven cases 'C' forms were filed by the dealers in support of their claim of Inter-State sales of various commodities for ` 28.75 lakh effected to purchasers in Uttarakhand and Jammu & Kashmir during the year 2007-08. Accordingly tax at a concession rate of 4 *per cent* was paid by the dealer which was accepted by the AAs. However, our cross verification revealed that the registration certificate of the dealers in the respective States to whom the goods were stated to have been sold did not cover the goods sold. Thus the inter-State transactions involving tax effect of ` 2.73 lakh required verification.

2.9.6.4 In one case, 'C' forms filed by a dealer in support of his claim of Inter-State sales of parts and accessories of motor vehicles for ` 29.23 lakh effected during the year 2006-07 to a purchaser in Uttar Pradesh dealing with beverages and soft drinks. Accordingly tax at a concession rate of 4 *per cent* was paid by the dealer and was accepted by the LVO-130. However, our cross verification revealed that the registration certificate of the dealer in respective State to whom the goods were stated to have been sold did not cover those goods. The transaction required verification for escapement of tax of ` 2.49 lakh.

2.9.6.5 In 20 'C' forms filed by 17 dealers in five⁴ LVOs in support of their Inter-State sales turnover of ` 8.87 crore, our cross verification with the concerned States revealed that the respective purchasers declared purchase turnover of ` 70.02 lakh only. Thus, escapement of turnover of ` 8.17 crore involving a tax of ` 69.96 lakh required verification.

2.9.7 Deficiencies noticed in the Assessments

2.9.7.1 Acceptance of incomplete declaration forms

⁴ LVOs 90, 110, 120, 130 and 10.

CST Act, 1956 provides that concessional rate of tax under the Act shall not be applicable unless a dealer claiming such concession furnishes to the prescribed authority a declaration duly filled and signed by the Registered dealer in support of the inter-State transaction made by him. Thus incomplete Declaration Forms are liable to be rejected for the purpose of concessional rate of tax.

We noticed that four⁵ LVOs, accepted Declarations Forms 'C' in support of inter-State sale involving a turnover of ` 90.05 lakh for the years 2005-06 to 2007-08, in respect of eight dealers. Our scrutiny of the Declaration Forms revealed that the forms did not contain prescribed particulars such as date of issue, to whom issued, registration numbers, etc. These forms were liable to be rejected and concessional rate of tax

claimed by the dealer was not admissible but the LVO failed to detect the omissions resulting in short levy of tax of ` 7.25 lakh.

2.9.7.2 Misuse of 'C' Form

Under the CST Act, a dealer shall not be entitled to a concessional rate of tax unless he produces the Declaration forms in support of his inter-State sale.

In case a dealer furnishes a false Declaration for claiming concessional rate of tax, he shall after being heard, be liable to simple imprisonment or with a daily fine which may extend to ` 50 for every day during which the omission continues under section 10 of the CST Act 1956

We noticed from the Monthly Returns and Annual Returns filed by two dealers in two⁶ LVOs that the dealers had made intra-State sales valued at ` 75.58 lakh by utilising 12 'C' forms for the year 2006-07 and 2007-08. This was evident from the fact that these 'C' forms were issued to the dealers

in Karnataka by the dealers registered in Karnataka. However the LVOs while accepting the returns submitted by the dealers and raising the demands (March and August 2009) did not detect the omissions. The issue of the Declaration Forms involving tax of ` 6.97 lakh needs investigation as detailed in the following table:

⁵ LVOs 10, 90, 120 and 130.

⁶ LVOs 110 and 130.

(` in lakh)

Sl. No.	C Form No.	Assessing authority	Authority by whom issued	Year	Turnover	Differential rate of tax	Short levy of tax
1.	TCK R 4301654	LVO 110	LVO 035	2006-07	4.19	8.5	0.36
2.	TCK R 4961935	LVO 110	LVO 110	2006-07	8.04	8.5	0.68
3.	TCK R 4959415	LVO 110	LVO 120	2007-08	5.91	9.5	0.56
4.	TCK R 4959416	LVO 110	LVO 120	2007-08	4.82	9.5	0.46
5.	TCK R 4301655	LVO 110	LVO 035	2007-08	3.19	9.5	0.30
6.	KAC/01 236498	LVO 110	LVO 120	2007-08	18.96	9.5	1.80
7.	4704602	LVO 130	LVO 140	2006-07	3.74	8.5	0.32
8.	4704603	LVO 130	LVO 140	2006-07	5.08	8.5	0.43
9.	4704499	LVO 130	LVO 140	2007-08	13.99	9.5	1.33
10.	4704498	LVO 130	LVO 140	2007-08	5.65	9.5	0.54
11.	4717768	LVO 130	LVO 060	2007-08	0.77	9.5	0.07
12.	4704497	LVO 130	LVO 140	2007-08	1.24	9.5	0.12
Grand total					75.58		6.97

Further, the penalty for misuse of Form 'C' was also leviable under the Act.

2.9.7.3 Non- production of 'C' Forms

In five⁷ LVOs we noticed from Monthly Returns and Annual Returns filed by 19 dealers made inter-State sales valued at ` 5.76 crore during the period 2005-06 to 2007-08. We found that neither these sales were supported by 'C' forms nor was the production of forms mentioned anywhere in the returns filed by the dealer. As such these sales were liable to be rejected for concessional rate of tax. However, we noticed that the LVOs did not notice the omission while issuing demand notices between December 2008 and September 2009 on the basis of the returns filed by the dealers.

Thus, grant of concessional rate of tax without production of C forms was incorrect resulting in short levy of tax of ` 49.36 lakh as detailed in the following table:

(` in lakh)

Sl No.	Year	Turnover involved	Rate of tax (percentage)			Short levy of tax
			Leviable	Levied	Differential	
1	2005-06 and 2006-07	325.33	12.5	4	8.5	27.65
2	2007-08	197.93	12.5	3	9.5	18.80
3	2005-06 and 2006-07	47.44	10	4	6	2.85
4	2007-08	5.60	4	3	1	0.06
Total		576.30				49.36

2.9.7.4 Incorrect Grant of concessional rate of tax on the form 'C' covered transactions of more than one quarter

Rule 12 of the CST (Registration and Turnover) Rules, 1957, provide that a Declaration Forms 'C' furnished by a dealer should not cover transactions of more than *one quarter* of a financial year between same dealers.

We noticed from the Declaration Forms and Monthly Returns submitted by the five dealers in support of their inter-State sale valued at ` 2.42 crore in four⁸

⁷ LVOs 010, 030, 110, 120 and 130.

⁸ LVOs 120, 110, 130 and 010.

LVOs that the Declaration Forms ‘C’ furnished by them during the period 2005-06 to 2007-08 covered transactions of more than *one quarter*. Hence the same were liable to be rejected. However, the LVOs while raising the demand (May to August 2009) for the unpaid amount on the basis of the returns filed by the dealers failed to detect the omission. This has resulted in short levy of tax of ` 18.19 lakh at the differential rates of tax as detailed below.

(` in lakh)

Sl No.	Year	Turnover involved	Rate of tax (percentage)			Short levy of tax
			Leviable	Levied	Differential	
1	2005-06 and 2006-07	96.46	12.5	4	8.5	8.20
2	2007-08	62.07	12.5	3	9.5	5.90
3	2005-06 and 2006-07	65.21	10	4	6	3.91
4	2007-08	18.27	4	3	1	0.18
	Total	242.01				18.19

2.9.7.5 Suppression of sales turnover

In five⁹ LVOs we noticed from the returns that the inter-State sales mentioned by 11 dealers in the Declaration Forms ‘C’ filed by them in support of their inter-State sale was in excess of the turnover declared by them in their Monthly and Annual Returns for the years 2005-06 to 2007-08 by ` 1.20 crore.

This indicates that the concerned LVOs while accepting and raising the demands on the basis of returns between 2008-09 and 2009-10 did not reconcile the figures mentioned in the Declaration Forms with the returns filed by the dealer. Thus sales valued ` 1.20 crore involving tax of ` 4.46 lakh for the periods from 2005-06 and 2007-08 escaped assessment. Besides, the dealers had suppressed the sales in their returns; interest and penalty was also leviable.

2.9.8 Incorrect grant of exemption of stock transfer turnover

Under the CST Act 1956 read with Rule 12(5) of the CST (Registration and Turnover) Rules, 1957, transfer of goods from one state to another “*other than by way of sale*” are exempted from levy of tax provided the turnover is covered by declaration in Form ‘F’. A single declaration Form ‘F’ requires to cover stock transfers pertaining to *one calendar month* of the year only.

2.9.8.1 In 10¹⁰ LVOs we noticed that while finalising the assessments under the CST Act for the assessment years 2005-06 to 2007-08, the AAs had accepted Declaration Forms ‘F’ for a turnover of ` 545.06 crore covering transactions for more than *one calendar month* in violation of the

⁹ LVOs 110, 090, 010, 130 and 120.

¹⁰ LVOs 140, 120, 10, 20, 71, 61, 45, 110, 35 and 90.

provisions of the Act. Thus, the allowance of exemption without verification of the Declaration Forms resulted in non-levy of tax of ` 61.36 crore.

2.9.8.2 We noticed in ACCT, LVO-061, Bangalore that the AA granted exemption of turnover on the basis of the Declaration Form 'F'. However, it was observed that in one Form filed for ` 12.06 crore during year 2005-06, though the validity of the form was for the month¹¹ of January 2005, it was tampered and the validity¹² was mentioned as January 2006. Acceptance of the tampered Form involving tax effect of ` 1.21 crore was incorrect. The matter needs investigation.

2.9.8.3 We noticed in four¹³ LVOs of Bangalore that six dealers had not filed Form 'F' for a turnover of ` 1.46 crore during 2005-06 to 2007-08. As such the dealers were liable to tax. But the LVO did not notice the omission and accepted the returns filed by the dealers. LVOs incorrectly raised demand (December 2008 and November 2009) by allowing exemption on stock transfers. The non-levy of tax at the rate of 12.5 per cent amounted to ` 18.26 lakh.

2.9.9 Non-issue of demand notices to the dealers

A demand notice indicating the amount payable and the date by which it should be paid is required to be issued in Form VAT 210 once the assessment is finalised by AA. In case of non-payment of the tax demanded, interest and penalty are leviable.

(i) Our test check of the CST assessment records ACCT, LVO-035, Bangalore revealed that in three assessments of two dealers for the years 2005-06 to 2007-08, the AA concluded the assessment (30 June 2011) and assessed tax, interest and penalty aggregating ` 2.33 crore but

the demand notices though prepared in Form VAT 210, were not served to the dealers. This has resulted in non-demand of tax of ` 2.33 crore.

(ii) We noticed during the test check of CST assessments in ACCT, LVO-035, Bangalore that while concluding the scrutiny assessment of a dealer for the years 2005-06 and 2006-07 the AA levied a tax of ` 1.24 crore for non-filing of 'C' forms and the demand notice issued in Form VAT 180. However, the AA omitted to demand and levy interest and penalty thereon. This has resulted in non-levy of interest and penalty of ` 69.32 lakh.

After we pointed out the above omissions the CCT stated that the concerned DVO has been instructed to finalise the issue and to personally supervise the compliance. A report on further action taken has not been received.

¹¹ from 1 January 2005 to 31 January 2005.

¹² from 1 January 2006 to 31 January 2006.

¹³ LVOs 10, 90, 110 and 120.

2.9.10 Defective system of information sharing

In the erstwhile KST regime, there was a system of forwarding the documents/information gathered at check post to the respective AAs for ensuring the correctness and proper accounting of such transaction by correlating with the returns and related records furnished by the dealers.

2.9.10.1 Further, it was also noticed that the reports of the Intelligence or Vigilance wing of the Department on random check of dealers conducted by them were also not made available to the AAs/LVOs in all the cases.

2.9.10.2 In one case it was noticed that a dealer transferred the goods to his factory situated in Tamil Nadu that the scrap materials were sent for conversion into HSD/TMT rods and claimed exemption from filing Forms 'F'. The contention of the dealer was accepted by the ACCT, LVO-090, Bangalore and "endorsement" was accorded exempting the dealer from filing the declaration forms. There was an intelligence report on this case insisting the need for filing the Declaration Forms 'F'. Further, while concluding the re-assessment under the CST Act, the dealer filed the declarations in Form 'F' in the office of the DCCT, AUDIT-33, Bangalore and the re-assessment concluded accordingly. The check post documents were not available to the LVO concerned as well as to the re-assessment authority. In the absence of information sharing between different wings of the Department, the LVO was not aware that the dealer filed Declaration Forms in the Audit Office and, the Audit Officer was not aware that the LVO had furnished such an "endorsement" granting exemption of turnover without declaration forms.

Thus, due to defect in the system of information sharing between Check Posts, intelligence wing and AAs, the assessment were finalised without considering the intelligence reports and Check Post documents/declaration. Better co-ordination among different wings of the Department is very essential to avoid such kind of mistakes/omissions.

2.9.11 Inadequate Controls

As mentioned earlier, on-line issue of 'C' forms was made operational in the State w.e.f. 25 April 2009. The following lack of Application, Input and Output controls in respect of on-line issue of 'C' forms was noticed during the course of the Performance audit.

2.9.11.1 A test check of the back end data tables of on-line issue of forms revealed that in 9969 instances the Department issued 'C' forms against the same purchase invoice, date and amount. This proves that the application system lacks necessary controls to prevent the dealer from obtaining more than "one" declaration form against a single inter-State purchase. This deficiency would also result in the module being unfit for both integration with other modules and upgraded into real time system in view of the following:

- The Statutory Form Issue Module represented an inflated figure in respect of Inter-State purchases effected by the dealers and failed to integrate with the Online Returns Module in case the dealer had presented a single transaction in his return.

- The System is unfit to be upgraded to real-time online statutory form presentation system that obviates the necessity of printing and physical submission of forms and does not detect any exaggerated Inter-State sales on part of the selling dealer.
- In case the dealer inadvertently represented an invoice in more than one form, under the manual system, there was facility of cancelling the form. Under the online system the dealer was deprived the opportunity of cancelling a form after its approval by the CTD. The system at present fails to distinctly establish the difference in status of a form that had been printed and actually been issued to the selling dealer as evidence of inter-State sale at concessional rate. Thus, it was construed that the present system may be unfit to be upgraded to a real-time presentation system.

2. 9.12 Conclusion

The Performance Audit revealed a number of deficiencies in the system of finalisation of assessments under the CST Act. Due to defect in the system of information sharing among check posts, intelligence wing, LVOs and AAs/Audit Officer, in many cases assessments were finalised without considering and cross verifying the facts and documents. There was no system of regular Cross verification of Declaration Forms by the assessing officers to ascertain the genuineness of the forms. Cross verification through TINXSYS is ineffective as up-to-date information is not available and most of the details were incorrect, incomplete and erroneous; and some of the States had not subscribed to the web site also. Internal control mechanism of the Department is very weak as evidenced by the absence of non-maintenance of various registers and records. In the absence of Internal Audit Wing, the Department remained unaware of the deficiencies. The prevailing mechanism to conduct and monitor the main areas of verification and scrutiny of returns, non-filing of returns, verification of declaration forms, collection of tax, re-assessment or audit of cases etc., are not adequate to ensure proper administration of tax under the CST Act and to prevent leakage of revenue.

2. 9.13 Recommendations

The Government may consider implementing the following recommendations for rectifying the system and compliance deficiencies:

- **Prescribe a system of carrying out regular cross verification of Declaration Forms and issuing guidelines of checks to be exercised before accepting the Declaration Forms for allowing concessional rate of tax or granting exemptions;**
- **Constituting an Inter-State Intelligence wing for cross verification of transactions;**
- **Cancellation of Declaration Forms due to loss in transit, theft, fire mishaps, etc. may be notified on the Departmental website also;**

- **Defects in on-line issue of forms may be corrected immediately,**
- **Errors in the TINXSYS data may be set right promptly and make the website effective for utilisation by all interested parties;**
- **Make the Internal Audit Wing functional and effective; and**
- **Strengthen internal control mechanism by maintaining the Dealer Ledger and DCB registers either manually or in electronic form.**

2.10 Non-observance of provisions of the Act/Rules

The KVAT Act provides as under:

- *Section 4 for levy of output tax at prescribed rates;*
- *Section 10(2), 11, 14 and 17 for deduction of ITC subject to certain restrictions;*
- *Section 10(3) for net tax liability which shall be the amount of output tax less the input tax deductible;*
- *Section 10(5) for adjustment/refund of excess ITC for any other tax period;*
- *Section 9-A for tax deduction at source in respect of works contractors;*
- *Section 15 for composition of tax in lieu of net tax payable;*
- *Sections 35 and 36 for levy of interest for omission to pay tax;*

- Section 35(4) for furnishing of revised returns within six months after the end of the relevant tax period; and
- Section 72(2) for levy of penalty for understatement of output tax/overstatement of ITC.

Under the KVAT Act, every registered dealer is required to furnish returns in the prescribed form and pay the tax due on such return within 20 days after the end of the preceding month or any other tax period. Every dealer shall be deemed to have been assessed to tax based on such return filed by him. Where any prescribed authority has grounds to believe that any return furnished, which is deemed as assessed, understates the correct tax liability, it may re-assess such cases.

We noticed in test check of the records of 29 VAT offices that the above provisions were not fully followed by the concerned Assessing Authorities (AAs). The omissions and irregularities in 221 cases involve non/short realisation of Government revenue amounting to ` 75.30 crore. The Department has accepted audit observations in 84 cases involving ` 53.08 lakh and intimated recovery of ` 43.32 lakh in 38 cases. In respect of the remaining cases final reply has not been received (January 2012).

2.10.1 Excess adjustment of credit/refund amount

Eight LVOs and one Audit Office in Bangalore

Any dealer in whose case, on the basis of return filed for any tax period, the input tax deductible exceeds the output tax payable by him, such dealer may adjust the excess amount towards the tax payable by him for any other tax period.

We noticed between January 2010 and November 2010 that 12 assesseees in their 13 returns filed for tax periods between April 2007 and April 2009, adjusted credit/refund amount of ` 50.98 lakh as brought forward from earlier tax periods as against ` 19.51 lakh only due to them as credit/refund. This resulted in excess adjustment of credit/refund amount of ` 31.47 lakh.

After we pointed out the cases, the Government/Department accepted audit observations in respect of six cases involving ` 13.25 lakh and recovered ` 11.26 lakh in four cases. We have not received final reply in the remaining cases (January 2012).

2.10.2 Failure to demand tax

One VAT office in one¹⁴ district

¹⁴ Bangalore.

Under the Karnataka Value Added Tax Act 2003 (KVAT), every dealer whose total turnover in a year exceeds ` 40 lakh shall have his accounts audited by a Chartered Accountant or a Cost Accountant or a Tax Practitioner (Auditor) and shall submit to the prescribed authority a copy of the audited statement of accounts in Form VAT-240 and prescribed documents in the prescribed manner.

Form VAT-240 provides for the Auditor to fill a comparative statement of dealer's liability to tax and his entitlements for input tax/refund as declared in the tax returns and corresponding correct amount determined on audit. In case of difference between them, the Auditor may advise the dealer either to pay the differential tax together with the interest and penalty if any, or to claim refund due to him as the case may be.

We noticed in the office of the ACCT (LVO-035), Bangalore in May 2010 that in an audited statement of accounts filed by a dealer¹⁵ for the year 2008-09 in December 2009, the Auditor had brought out the following differences:

(` in lakh)

Particulars	Amount as per return in Form VAT 100	Amount determined on audit in Form VAT 240	Difference
Output tax payable under the KVAT Act 2003	1,239.55	1,318.97	79.42
Input tax deduction claimed under Section 10	594.47	588.95	5.52
		Total	84.94

However, neither the Auditor advised the dealer to pay the differential tax of ` 84.94 lakh together with interest and penalty as applicable nor was the differential tax paid by the dealer. The LVO concerned also failed to demand and collect the same on receipt of the Audited Statement of Accounts on 31 December 2009. The short levy of tax worked out to ` 1.05 crore as per details below:

(` in lakh)

Tax amount short declared and paid	84.94
Interest leviable under Section 36(2) of the KVAT Act, 2003 at 1.25 per cent per month (considering that the payment was due latest by 20.4.2009) for 11 months and 10 days upto 31 March 2010.	12.03
Penalty leviable at 10 per cent of output tax declared short by the dealer in the returns as the difference was more than 5 per cent of the actual liability to tax (5% of ` 13,18,97,109 = ` 65,94,855)	7.94
Total	104.91

We reported the case to the CCT in June 2010 and to the Government in June 2011; we have not received their reply (January 2012).

¹⁵

M/s Subhash Projects & Marketing Limited (TIN: 29270327190).

We recommend that the Department issue instructions to all Assessing officers to take action under VAT Rules on receipt of audited accounts and auditor's reports reconciling taxes paid as per Returns for short fall in payment of taxes.

2.10.3 Non/short levy of penalty on Shortfall in payment of taxes as per returns

Nine VAT offices in Bangalore and Hassan districts

Section 72(2) of KVAT Act provides that a dealer who for any prescribed tax period furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five *per cent* of his actual liability to tax or his actual tax credit, as the case may be, shall after being given the opportunity of showing cause in writing against the imposition of a penalty, be liable to a penalty equal to ten *per cent* (20 *per cent* up to 31 March 2006) of the amount of such tax under or overstated.

We noticed between February and December 2010 that in 94 returns filed by 21 dealers for tax periods between April 2005 and March 2009 output tax liability was understated and ITC aggregating ` 9.06 crore was overstated. Of these in 49 cases revised returns were filed by the dealers rectifying the errors in the original returns. In the remaining 45 cases errors were rectified by the

AAs through reassessments. However, in none of these cases the penalty due was demanded by the concerned AAs. This resulted in non-levy of penalty of ` 91.35 lakh.

After we pointed out the cases, the Government/Department accepted audit observations in respect of 37 returns of eight dealers involving ` 10.41 lakh and recovered ` 9.26 lakh in seven of them.

In respect of one case involving penalty of ` 8.82 lakh, the AA concerned stated that the dealer had filed the revised return within one month of filing the original return and paid the tax alongwith interest and hence penal provision under Section 72(2) cannot be applied as provided under Section 35(4) of the KVAT Act. The reply is not tenable as the dealer has furnished revised return under Section 35(4) of the KVAT Act and had understated his tax liability by more than 5 *per cent* as such he is liable to a penalty equal to 20 *per cent* of the amount for such tax understated.

In another case the AA concerned had levied and collected penalty of ` 1.79 lakh as against ` 4.79 lakh pointed out by us. We noticed that the AA had worked out the penalty incorrectly on the understated net tax liability of the dealer instead of on understated actual output tax liability.

We have not received final reply in the remaining cases (January 2012).

2.10.4 Excess/ Incorrect allowance of input tax

Four VAT offices in Bangalore district

Input tax in relation to a registered dealer means the tax paid or payable on the purchase of any goods for use in his business.

We noticed between April and August 2010 that six dealers had claimed ITC of ` 6.74 crore in 24 (deemed assessments) returns for tax periods between April 2008 and

March 2009. The input tax admissible as per the provisions of the Act in these cases was ` 6.50 crore, which resulted in excess/ incorrect allowance of input tax of ` 23.95 lakh as detailed below. This was due to arithmetical errors, allowance of ITC on labour charges/ITC restricted goods, allowance of ITC without purchases, etc.

Sl. No.	LVOs	Observation in brief	Excess credit availed (` in lakh)
1.	3 LVOs	The dealers had declared purchase turnover of ` 5.17 crore on which the ITC at 12.5 percent VAT paid worked out to ` 64.56 lakhs. However, the dealers concerned claimed ITC of ` 73.10 lakh in their returns due to arithmetical errors which were accepted by the LVOs resulting in excess claim of ITC.	8.53
2.	2 LVOs	The dealers had declared purchase turnover of ` 144.74 crore on which the ITC at 12.5 percent VAT paid worked out to ` 5.79 crore. However, the dealers concerned claimed ITC of ` 5.93 crore in their returns due to arithmetical errors which were accepted by the LVOs, resulting in excess claim of ITC.	14.50
3.	1 LVO	The dealers had declared purchase turnover of ` 1.10 crore and ` 27.80 lakh on which the ITC at 12.5 percent VAT paid worked out to ` 4.38 lakh and ` 3.47 lakh respectively. However, we noticed that the dealer had filed purchase statement only for ` 96.37 lakh (at 4 per cent) and ` 24.71 lakh (at 12.5 per cent). Hence the admissible ITC was only ` 6.94 lakh.	0.92
Total			23.95

After we pointed out the cases, the Government/Department accepted audit observations in respect of two returns of a dealer involving ` 4.34 lakh and recovered the entire amount. We have not received final reply in the remaining cases (January 2012).

2.10.5 Non-levy of interest

Seven VAT offices in three districts

Every dealer is liable to pay simple interest at the rate of 1.25 *per cent* per month on any amount of tax omitted to have been declared in a return and also for default in payment of tax wrongly collected. Further, interest shall also be demanded on additional tax liability determined on re-assessment.

We noticed between January and December 2010 that while finalising 33 assessments (all reassessments) of 11 assesees for the tax periods between April 2005 and March 2009, an additional demand of ` 1.31 crore was raised.

However, interest of ` 18.67 lakh was not levied as detailed below:

(` in lakh)

Sl. No.	District (number of assesees)	Amount of tax involved	Non-levy of interest
1.	Bangalore (4)	86.84	7.73
2.	Dakshina Kannada (4)	24.96	8.50
3.	Raichur (3)	19.34	2.44
Total (11)		131.14	18.67

After we pointed out the cases, the Department accepted audit observations in respect of 32 assessments of 10 dealers involving ` 15.06 lakh and recovered ` 8.44 lakh in 18 assessments of eight dealers. We have not received final reply in the remaining case (January 2012).

2.10.6 Underassessment of output tax

Seven VAT offices and one Audit Office in Bangalore and Hassan districts

Every registered dealer shall be liable to pay tax on his taxable turnover (output tax) at the rates specified in the relevant schedules to the Act. In respect of goods not specified in any of the schedules, tax is payable at the rate of 12.5 *per cent*.

We noticed between February and August 2010 that the taxable turnover of nine dealers for the tax periods between April 2007 and March 2009 amounted to ` 1,319.36 crore. The assesees declared output tax liability of

only ` 164.52 crore in their 35 monthly returns/annual statements whereas the tax liability worked out to ` 164.69 crore. This was due to application of incorrect rate of tax, error in computation of the tax liability, error in declaring of taxable turnover, etc. This resulted in underassessment of output tax of ` 17.47 lakh as detailed in the following table:

Sl. No.	No. of returns	Observation in brief	Excess credit availed (` in lakh)
1.	3	In the re-assessment order concluded in May 2009 the AA omitted to levy output tax at 4 <i>per cent</i> on turnover relating to sale of REP licences of ` 97.14 lakh.	3.89
2.	15	Three dealers in their 15 returns declared tax liability at 4 <i>per</i>	7.17

Sl. No.	No. of returns	Observation in brief	Excess credit availed (` in lakh)
		cent on turnover of ` 84.36 lakh relating to sale of jelly, size stone and granite instead of at 12.5 per cent.	
3.	10	Three dealers in their 10 returns declared and paid output tax of ` 164.44 crore at 12.5 per cent on sale turnover of ` 1,315.86 crore instead of ` 164.48 crore due to arithmetical error.	4.11
4.	4	A dealer omitted to pay tax at the rate of 4 per cent on his purchases from un-registered dealers amounting to ` 33.76 lakh.	1.35
5.	3	A dealer in his three returns declared and paid output tax of ` 4.42 lakh at 4 per cent on sale turnover of ` 1.34 crore instead of ` 5.38 lakh due to arithmetical error.	0.95
	35	Total	17.47

After we pointed out the cases, the Government/Department accepted audit observations in four assessments of two dealers and recovered ` 5.19 lakh. We have not received final reply in the remaining cases (January 2012).

2.10.7 Short payment of tax

Four VAT offices in two¹⁶ districts

Every registered dealer shall be liable to pay tax in respect of any taxable sale of goods made by him after deducting the tax on the purchase of goods made by him, for use in the course of business.

We noticed between January and May 2010 that four assesseees in their returns filed between April 2008 and March 2009, had short paid the net taxes amounting to ` 9.95 lakh.

After we pointed out the cases, the Government/Department accepted audit observations in respect of three cases involving ` 4.83 lakh and recovered the entire amount. We have not received final reply in the remaining case (January 2012).

2.10.8 Incorrect acceptance of belated returns

A VAT office in Bangalore district

If any dealer, having furnished a return under the Act, discovers any omission or incorrect statement therein, he shall furnish a revised return within six months from the end of the relevant tax period.

We in July 2010 noticed that a dealer filed revised returns for tax period July 2008 in February 2009 and claimed reduction in tax liability amounting to ` 6.38 lakh. As per the provisions the dealer was eligible to file revised return only upto 31 January 2009 and hence the revised return was liable for rejection. However, it was accepted by

¹⁶ Bangalore, Raichur.

the LVO-075. Thus, acceptance of belated revised return resulted in irregular reduction of tax liability of ` 6.38 lakh which needs to be recovered.

We reported the case to the Department in August 2010 and to Government in June 2011; we have not received their reply (January 2012).

2.11 Incorrect exemption as sale in the course of export/import

Under the provisions of CST Act, the assesses are eligible to claim certain exemptions of turnovers such as Direct Export, High sea sales or In Bond sales, etc. on the basis of the documentary evidence or proof such as Bill of lading, customs invoices, high sea sales agreement copies, etc.

We noticed in five¹⁷ LVOs of Bangalore that exemptions claimed by 16 dealers on a turnover of ` 583.71 crore as Direct exports, Sale in the course of import or High sea sales, etc., during the years 2005-06 to 2007-08 were allowed. However the dealers had not filed the documentary

evidences in support of their claim for exemptions. The irregular/incorrect grant of exemption resulted in non-levy of tax at the rate of 12.5 *per cent* on turnover of ` 575.46 crore and at four *per cent* on ` 8.25 crore amounted to ` 72.26 crore.

¹⁷ LVOs 35, 130, 110, 90 and 120.

EXECUTIVE SUMMARY

Tax collection	In 2010-11, the collection of taxes under State Excise, which stood at ` 8284.74 crore, increased by 19 <i>per cent</i> over the previous year which was attributed by the Department to increase in rate of tax and better compliance due to e-administration.
Internal Audit Wing	The Internal Audit Wing (IAW) is functioning in the State Excise Department with working strength of one Senior Audit Officer and two Assistant Audit Officers. There are 311 offices in the Department out of which 104 offices were planned for audit during 2009-10 and 108 offices were audited. During 2005-06 to 2009-10 IAW raised 506 observations involving ` 33.79 crore, of which 39 observations involving ` 31.18 lakh were settled which was only eight <i>per cent</i> of the total objections raised.
Insignificant recovery by the Department of observations pointed out by us in earlier years	<p>During the last five years, through our Audit Reports, we had pointed out non/short levy, non/short realisation, and loss of revenue, etc., with revenue implication of ` 183.54 crore in three paragraphs. Of these, the Government/Department had accepted audit observation in two paragraphs involving ` 10.44 crore and had since recovered ` 23.95 lakh.</p> <p>The Government needs to take concerted actions on the audit paragraphs in interest of revenue and for better tax compliance.</p>
Results of audit conducted by us in 2010-11	We conducted a test check of records of 29 offices of the State Excise Department (SED). We found non/short levy of penalty, non/short levy of licence fee, non/short levy of excise duty, non/short levy of interest, amounting to ` 443.31 crore in 57 cases.
What we have highlighted in this Chapter	In this Chapter we present a Performance audit on ' State Excise receipts '. Wherein we have pointed out faulty licensing policies of the Government for retail vending of liquor which have resulted in revenue forgone of ` 48.43 crore. License fees for distilleries/breweries were not revised since July 2000 despite increasing sales turnovers of IML. Norms for yield of rectified spirit from molasses were not revised, which could have fetched additional revenue of ` 121.52 crore to the Government. In absence of any mechanism to keep track of new areas entering municipal limits, Government lost revenue on account license fee of ` 29.57 lakh. Penalty was not levied on shortlifting of Indian Made Liquor (IML) by licensees.
Our conclusion	The Department may like to take action on the recommendations made by us on the deficiencies both

	systemic and compliance related based on the Performance Audit.
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CHAPTER-III: STATE EXCISE

3.1 Tax administration

The State Excise duty is levied on any liquor, any intoxicating drug, opium or other narcotics and non-narcotic drugs which the State Government may, by notification declares to be an excisable article. The Karnataka Excise (KE) Act, 1965 and Rules made thereunder govern the law relating to the production, manufacture, possession, import, export, transport, purchase and sale of liquor and intoxicating drugs and levy of duties of excise thereon. The State Excise Department (SED) is under the administrative control of the Finance Department and is headed by the Excise Commissioner, who is assisted by Joint Commissioners of Excise. The excise duty is administered by the Deputy Commissioners of Excise at the district level and the Superintendents of Excise, Deputy Superintendents of Excise, Inspectors of Excise and other sub-ordinate officers at the distilleries and range offices.

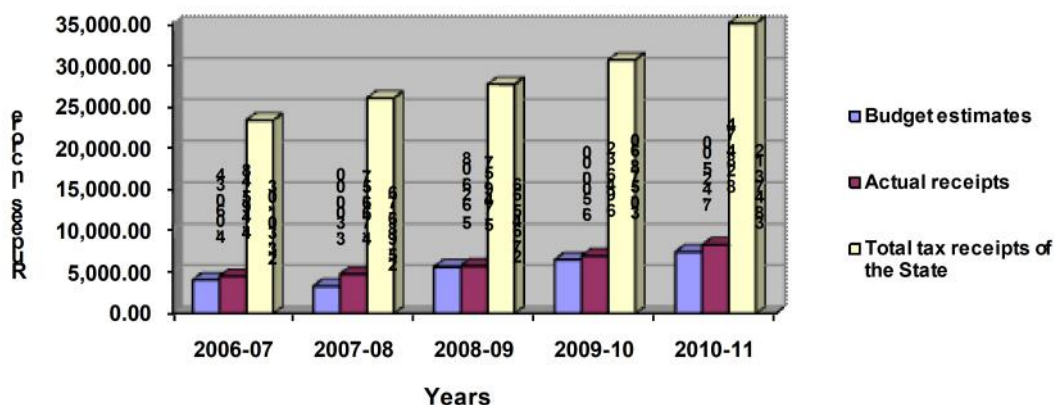
3.2 Trend of receipts

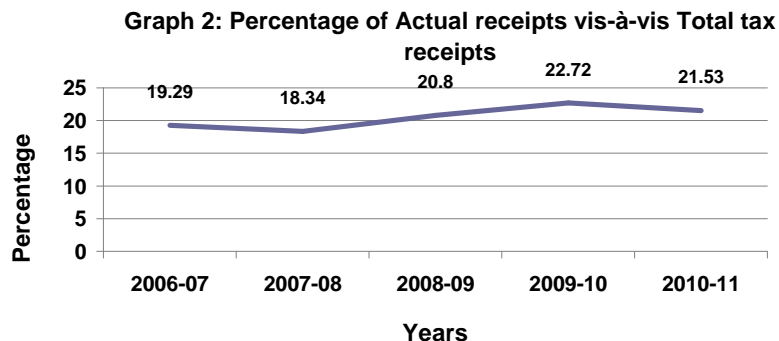
Budget Estimates (BEs) and actual receipts from State Excise along with the total tax receipts during the years 2006-07 to 2010-11 are exhibited in the following table and graphs:

(` in crore)

Year	Budget estimates	Actual receipts	Variation excess(+)/shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
2006-07	4,060.34	4,495.48	(+) 435.14	(+) 10.72	23,301.03	19.29
2007-08	3,300.00	4,766.57	(+)1,466.57	(+) 44.44	25,986.76	18.34
2008-09	5,626.08	5,749.57	(+) 123.49	(+) 2.19	27,645.66	20.80
2009-10	6,500.00	6,946.32	(+) 446.32	(+) 6.87	30,578.60	22.72
2010-11	7,425.00	8,284.74	(+) 859.74	(+) 11.58	38,473.12	21.53

Graph 1: Budget estimates, Actual receipts and Total tax receipts





3.3 Cost of collection

The gross collection in respect of state excise, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2008-09, 2009-10 and 2010-11 along with the relevant all India average percentage of expenditure on collection to gross collection for the respective preceding years were as follows:

Year	Gross collection	Expenditure on collection	Percentage of cost of collection to gross collection	All India average percentage for the preceding year
	(` in crore)			
2008-09	5,754.42	55.78	0.97	3.27
2009-10	6,948.72	60.55	0.87	3.66
2010-11	8,286.83	68.35	0.82	3.64

3.4 Impact of Audit Reports

During the last five years, through our audit reports, we had pointed out non/short levy, non/short realisation, and loss of revenue, etc., with revenue implication of ` 183.54 crore in three paragraphs. Of these, the Government/ Department had accepted audit observation in two paragraphs involving ` 10.44 crore and had since recovered ` 23.95 lakh. The details are given in the following table:

(` in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ¹	Number	Amount ¹
2006-07	--	--	--	--	--	--
2007-08	01	0.23	01	0.23	01	0.09
2008-09	--	0	--	0	--	--
2009-10	01	1.02	01	1.02	--	--
2010-11	01	182.29	0	9.19	0	0.15

¹ Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

(` in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ¹	Number	Amount ¹
Total	03	183.54	02	10.44	01	0.24

As seen from the above table, the recovery made by the Department is only 0.9 per cent of the amount involved in the total accepted cases.

The State Government may take more concerted action on the Audit Reports in interest of revenue and better tax compliance.

3.5 Results of audit

We conducted a test check of records of 29 offices of the State Excise Department during the year 2010-11 and found non/short levy of penalty, non/short levy of licence fee, non/short levy of excise duty, non/short levy of interest, amounting to ` 443.31 crore in 57 cases. The observations broadly fall under the following categories:

(` in crore)

Sl. No.	Category	Number of cases	Amount
	State Excise		
1	State Excise Receipts (A Performance audit)	1	182.29
2	Non/short levy of licence fee, additional licence fee and shifting fee	5	248.17
3	Non/short levy of excise duty and additional excise duty	4	0.17
4	Non-levy of interest on outstanding arrack shop rentals	1	10.25
5	Irregular acceptance of lapsed EVC	1	0.74
6	Non-levy of fee on rectified spirit	1	1.65
7	Other irregularities	44	0.04
	Total	57	443.31

During the course of the year 2010-11, the Department accepted under assessments and other deficiencies of ` 8.58 lakh in four cases pointed out during the year. Further, the Department also recovered ` 26.20 lakh in eight cases pointed out in earlier years.

A Performance Audit on 'State Excise Receipts' involving system and compliance deficiencies besides revenue forgone of ` 182.29 crore is mentioned in the following paragraphs. Of this, the Department accepted our observation involving ` 9.19 crore and recovered ` 14.95 lakh.

3.6 Performance Audit on 'State Excise Receipts'

Highlights

Though the Rules and the licence condition provide for, sale of liquor in sealed bottles we observed that in many cases loose sale of liquor was made. We observed that retail liquor outlets were in close proximity of religious and educational institutions, hospital etc. in violation of the Rules.

(Paragraph 3.6.7.4, 3.6.7.5)

The State Government has not issued any fresh retail vending licences since December 1992, even though the population of the State has increased from 4.48 crore in 1991 to 5.27 crore in (2001 census) despite demand for grant of licences. During this period though 238 retail shop licences (CL-2) and 225 bar licences (CL-9) were not renewed, no action was taken by the Department to issue an equal number of licences to new applicants, thereby Government revenue of not less than ` 48.43 crore was forgone. Further, considering the demand, there was no attempt to exploit the revenue resources through auction of licences.

(Paragraph 3.6.9)

Though the sales turnover of IML increased from 96.40 lakh carton boxes in 2003-04 to 408.60 lakh carton boxes in 2009-10, i.e., an increase of 323.85 *per cent*, the rate of licence fee for distilleries, breweries were not revised since July 2000.

(Paragraph 3.6.10)

The State Government did not take any action on recommendations of a Technical committee constituted by themselves to revise the norms for yield of rectified spirit from molasses. Even the lowest yield recommended by the Committee would have fetched additional revenue of ` 121.52 crore during 2008-09 and 2009-10.

(Paragraph 3.6.12)

We noticed that the licence of a Sugar Company Limited, Mandya was renewed for the year 2000-01 to 2008-09 without levying and collecting licence fee and additional licence fee resulting in non-levy/collection of licence fee of ` 2.76 crore.

(Paragraph 3.6.13)

We found that with increase in population and village areas coming under municipal limits, there was no suitable mechanism in place in the Department to keep track of new areas entering municipal limits, based on notification passed by the Urban Development Department. Absence of the mechanism resulted in short recovery of license fee of ` 29.57 lakh in four cases.

(Paragraph 3.6.14)

Though consumption statement regarding the quantity of liquor lifted by the licensees (CL2 and CL9) was received by the Range offices from Karnataka State Beverages Corporation Limited (KSBCL) regularly, the Department

failed to levy penalty leviable for short lifting of Indian Made Liquor (IML). The non-levy of penalty amounted to ` 9.04 crore.

(Paragraph 3.6.15)

3.6.1 Introduction

The Karnataka Excise Act 1965, and rules made thereunder govern the licensing of manufacture, possession, transportation, sale or purchase, import and export of any liquor or opium or any intoxicating drug called 'excisable articles' in the State. The state excise receipts mainly comprise levy and collection of licence fee on manufacture of 'excisable articles' in distilleries, breweries, wineries, etc., on dealers in such articles viz., distributors, bar and restaurants, hotels, retail shops, etc., and excise duty (ED) and additional excise duty (AED) on such articles besides levy of penalty for offenses and levy interest on belated payment of excise revenues.

KSBCL was established as a private Limited company under the Companies act, 1956 for the Sourcing and Distribution of Indian made Liquor and Foreign Liquor. For this purpose, Government of Karnataka has issued a Distributors license to KSBCL under Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968. All manufacturers/suppliers who want to sell liquor or beer in Karnataka, whether produced in Karnataka or outside have to channelise it through KSBCL only (Liquor includes Indian made Liquor and Foreign Liquor, beer and wine).

3.6.2 Organisational Setup

At the Government level, the general superintendence of the State Excise Department (SED) is vested with the Principal Secretary to Government in the Finance Department. The Excise Commissioner (EC) is the Head of the Department and is responsible for administration of excise matters in the State. Joint Commissioners of Excise at State level and 32 Deputy Commissioners of Excise (DCOE) at district level, 63 Superintendents of Excise (SOE), 406 Inspector of Excise (IOE) and other staff at field level assist the EC.

3.6.3 Audit objectives

We conducted the Performance Audit to ascertain whether

- i) Proper levy and realisation of excise receipts;
- ii) System existed for monitoring the arrears of revenue;
- iii) The norms prescribed regarding yield of Rectified Spirit and IML are adequate;
- iv) Intelligence and Enforcement measures adopted by the Department are adequate to check violation of the Excise provisions; and
- v) Internal control mechanism provide for effective functioning of the Department.

3.6.4 Scope and methodology of audit

We conducted audit during the period from February 2011 to September 2011 and examined levy and collection of excise duty for the period 2005-06 to 2009-10. We selected 10 Districts out of 29 Districts and also selected 20 Distilleries/Breweries out of 42 Distilleries/Breweries coming under 10 Districts selected for detailed check.

3.6.5 Acknowledgement

We acknowledge the Co-operation of the State Excise Department in providing necessary information and records for audit. We held an Entry conference with the Commissioner of Excise, State Excise Department during February 2011 wherein the scope of audit, methodology and audit objectives including sampling were explained. We requested the Government/Department for an exit conference to discuss the findings of the Performance Audit but despite several requests, the Department have not responded.

Audit Findings

3.6.6 Arrears of revenue

The arrears of revenue as on 31st March 2010 amounted to ` 737.78 crore. The year wise position of arrears of revenue is mentioned in the following table:

(` in crore)

Year	Opening Balance of Arrears	Amount collected during the year	Closing balance of arrears	Percentage of amount collected to opening balance of arrears
2005-06	781.24	1.03	780.21	0.13
2006-07	780.21	36.74	743.47	4.71
2007-08	743.47	2.33	741.14	0.31
2008-09	741.14	1.64	739.50	0.22
2009-10	739.50	1.72	737.78	0.23

The arrears of revenue as on 31 March 2010 was ` 737.78 crore. The arrears comprised of Principal amount of ` 250.35 crore and interest of ` 487.43 crore. Of this, ` 6.26 crore were stayed by courts, ` 245.39 crore were referred to Revenue Department pertaining to 166 cases to recover as arrears of land revenue and balance ` 486.13 crore were with the SED. During the year 2010-11, the Department collected only ` 6.21 crore from the defaulters.

The age wise pendency of arrears furnished by the Department is as mentioned below:

Age	Arrears amount (` in crore)
Above 25 years	118.28
From 15 years to 25 years	363.37
From 10 years to 15 years	23.79
From 5 years to 10 years	232.34
Total	737.78

The above table indicates that 68.5 per cent (₹ 505.42 crore) of the arrears are pending for more than 10 years.

The total Principal amount due of ₹ 250.35 crore includes about ₹ 100.05 crore from the ten defaulters and pertains to the period from 1993-94 to 2001-02 as mentioned in the following table:

(₹ in crore)

Sl. No.	Name of the Defaulters	Period	Principal amount due	Follow-up action by the Department
1	Krishnappa N.V	2001-02	21.35	Department stated that the defaulter did not own any property for recovery of the arrears.
2	Narayanaswamy D.P	1995-96	12.57	It was reported by the Department during 2000-01 to the Public Accounts Committee that ₹ 6 lakh was recovered by auctioning two houses held in the name of the defaulter except this he had no other properties in his name.
3	Somashekar H.V	2001-02	11.37	The Department stated that the defaulter did not own any property for recovery of the arrears.
4	Eshwaraswamy .G	1993-94	11.79	It was reported that though the case was covered by RRC, the Deputy Commissioners of Bangalore and Mysore stated that there was no property in the name of the defaulter.
5	Lokesh	2001-02	8.35	The Department stated that the defaulter did not own any property for recovery of the arrears
6	Krishna T	1999-00	7.57	-do-
7	Srinivas .M.V	2001-02	6.86	-do-
8	Babu Bheemesh Mugali	2001-02	5.61	-do-
9	Ragavendra T	2001-02	9.63	22 properties held by the defaulter have been identified. However, it was stated that the contractor approached the Hon'ble High Court requesting to adjust the forfeited earnest money deposit amount against his arrears. The case is pending before Hon'ble High Court of Karnataka.
10	M/s. Torgal Groups	2001-02	4.95	Department stated that the defaulter did not own any property for recovery of the arrears.
Total			100.05	

From the year 2005-06 onwards the Department obtained bank guarantee from the Nationalised banks as a result of which there was no accumulation of arrears from that year.

Mention of huge arrears was reported in the Audit Report for the year ended 31 March 1995 and the same was discussed by PAC during the year 2000. However recommendations are awaited.

The Department stated that the Government introduced 'Karasamadhana Scheme' on 29.5.2010 and was able to collect principal amount of ` 16.56 lakh from the defaulters. It is also stated that, arrears amount outstanding from the defaulters would be recovered by identifying their property particulars and suitable action would be taken to forfeit the same to Government. The Department's reply is not convincing looking at the very old arrears for whose recovery; no action was taken all these years.

3.6.7 Enforcement Activity

The KE Act empowers the Excise officer not below the rank of a Sub-Inspector of Excise to exercise powers conferred on an Officer-in-charge of a Police station by the provisions of the Code of Criminal Procedure, 1973 with regards to offences under the Act. These powers include power to enter and inspect places of manufacture and sale at any time, by day or by night, to examine the accounts and registers, examine, test, measure or weigh any materials, stills, utensils, implements apparatus or intoxicant found in such place.

3.6.7.1 The Department was conducting surprise inspection of the licensed premises to ensure that licensees are adhering to the excise rules and licence conditions and also raids were being made based on the information received regarding illegal activities involving excisable articles.

Sl. No.	Excise Year	No. of Raids Conducted	Cases booked	No. of persons arrested	No. of Vehicle Seized	LIQUOR SEIZED IN LITRES			
						IML	Beer/ fenny	RS/NS/ DS	Arrack
1	2005-06	63029	7488	4706	882	134912	89764	157036	241898
2	2006-07	62093	5455	3037	663	80796	25216	274263	33864
3	2007-08	69787	7454	3720	810	143890	51859	300423	623731
4	2008-09	64025	9994	4521	999	369963	57292	199835	14726
5	2009-10	64583	11086	4345	841	196006	116828	134555	6456
	Total	323517	41477	20329	4195	925567	340959	1066112	920675

We noticed from the crime statistics maintained by the Department that there was increase in crime from the year 2007-08 onwards.

It would be seen from the above that in 13 per cent of the raids conducted by the Department, cases were booked against the offenders but for the balance 87 per cent of the cases, the outcome is not known.

3.6.7.2 Fixation of targets: We noticed that the Department has not fixed any target for the Enforcement wing with regard to number of inspections to be conducted by them. The district wise inspections/raids conducted, cases booked and their success rate in terms of percentage of cases booked to the number of raids conducted during the years 2008-09 and 2009-10 were as mentioned in the following table:

Sl.	District	2008-09	2009-10	Total
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No.		No. of raids conducted	No. of cases booked	Percentage of cases booked to No. of raids	No. of raids conducted	No. of cases booked	Percentage of cases booked to No. of raids	No. of raids conducted	No. of cases booked	Percentage of cases booked to No. of raids
1	Bangalore (U)	8719	802	9.20	6276	1315	20.95	14995	2117	14.12
2	Bangalore (R)	2165	140	6.47	1204	197	16.36	3369	337	10.00
3	Bagalkot	1916	387	20.20	2531	437	17.27	4447	824	18.53
4	Belgaum	2744	611	22.27	2501	739	29.55	5245	1350	25.74
5	Bellary	2274	380	16.71	2214	412	18.61	4488	792	17.65
6	Bidar	1650	425	25.76	1163	260	22.36	2813	685	24.35
7	Bijapura	2202	265	12.03	1378	289	20.97	3580	554	15.47
8	Chamarajanagar	1916	119	6.21	1733	128	7.39	3649	247	6.77
9	Chickmagalur	4090	385	9.41	2757	524	19.01	6847	909	13.28
10	Chikkaballapura	1151	208	18.07	1313	330	25.13	2464	538	21.83
11	Chithradurga	1160	244	21.03	960	245	25.52	2120	489	23.07
12	D' Kannada	2369	334	14.10	3293	211	6.41	5662	545	9.63
13	Davangere	2332	296	12.69	3141	206	6.56	5473	502	9.17
14	Dharawad	1679	295	17.57	1967	335	17.03	3646	630	17.28
15	Gadag	1080	269	24.91	1402	372	26.53	2482	641	25.83
16	Gulbarga	2242	606	27.03	3385	458	13.53	5627	1064	18.91
17	Hassan	3453	616	17.84	4461	663	14.86	7914	1279	16.16
18	Haveri	1452	286	19.70	2302	296	12.86	3754	582	15.50
19	Kodagu	637	97	15.23	1339	183	13.67	1976	280	14.17
20	Kolar	1942	598	30.79	2399	569	23.72	4341	1167	26.88
21	Koppal	371	30	8.09	395	82	20.76	766	112	14.62
22	Mandya	2697	345	12.79	3497	488	13.95	6194	833	13.45
23	Mysore	2719	571	21.00	1350	416	30.81	4069	987	24.26
24	Raichur	2205	262	11.88	2095	143	6.83	4300	405	9.42
25	Ramanagara	523	110	21.03	767	327	42.63	1290	437	33.88
26	Shimoga	1563	521	33.33	1574	480	30.50	3137	1001	31.91
27	Tumkur	2074	382	18.42	3085	555	17.99	5159	937	18.16
28	Udupi	1071	259	24.18	844	225	26.66	1915	484	25.27
29	U' Kannada	3629	151	4.16	3257	201	6.17	6886	352	5.11
	Total	64025	9994	15.61	64583	11086	17.17	128608	21080	16.39

The above table would show that in respect of Chamarajanagar, Dakshina Kannada, Davanagere, Raichur and Uttara Kannada Districts percentage of cases booked to number of raids conducted were less than 10 per cent.

3.6.7.3 Leniency in dealing with crime

The Chief Minister, who was functioning as State Finance Minister, in his budget speech for the year 2008-09, stated that the Excise Act would be amended to provide for cancellation of licences in proven cases of liquor shops charging higher prices than the maximum retail price (MRP) prescribed by the Excise Commissioner. Accordingly, the conditions for allotment of CL-2 licence were amended with effect from 15 January 2009 to include a condition stipulating that the licensee shall sell or permit to sell liquor at prices not exceeding the MRP indicated on the labels of the bottles as declared under the provisions of the Karnataka Excise (Excise duties and fees) Rules, 1968. Therefore, sale of liquor at prices exceeding the MRP after the said amendment constitutes violation of conditions of licence.

In this regard we noticed that, the offence which is in the nature of violation of conditions of licence could be dealt by the authorities under the different sections of the KE Act having different scope and consequences as detailed below:

Sl. No.	Section of the KE Act	Provision
1.	29 (1) (b)	Subject to such restrictions as the State Government may prescribe, the authority granting any licence or permit under this Act shall cancel it in the event of any breach by the holder thereof, or by any of his servants or by any one acting on his behalf with his express or implied permission, of any of the terms and conditions thereof.
2.	36 (1) (b)	Whoever, being the holder of a licence or permit granted under this Act, or being in the employ of such holder and acting on his behalf willfully does or omits to do, anything in breach of any of the conditions of his licence, or permit, not otherwise provided for in this Act shall, on conviction, be punished with imprisonment which may extend to three months or with fine which may extend to five hundred rupees or with both.
3.	45(1)	The EC, the DCOE or any Excise Officer specifically empowered in this behalf may accept from the licensee a sum of money not less than five thousand rupees but which may extend to fifty thousand rupees by way of compensation for the offence which may be committed.

We noticed from the scrutiny of 'Crime Register' maintained in Bangalore (Rural), Bangalore (Urban) and Mandya districts in respect of 12 cases booked during 2009-10 to 2011-12 for violation of licence conditions, that the cases were later compounded by levying compounding fee between ` 12,000 and ` 15,000 only.

Sl. No.	District	Name of the licensee (M/s)	Nature of offences noticed	Period of offence Date of compounding order	Amount levied on compounding
1.	Bangalore (Rural)	Sujatha Wines, Hosakote taluk	1. Selling price exceeding MRP 2. Accounts not upto date. 3. Loose sale of liquor 4. Non-production of blue print	2009-10 (25.5.2010) 16.6.2010	15,000
2.		J.R.D Wines, Hosakote	1. Selling price exceeding MRP 2. Loose sale of liquor 3. Cash receipt not issued	2009-10 (1.3.2010) 4.6.2010	15,000
3.		Venkateshwara wines, Hosakote	1. Selling price exceeding MRP 2. Loose sale of liquor 3. Bill book not produced 4. Allowing consumption at premises	2009-10 4.6.2010	15,000
4.		Highway Wines, Hosakote	1. Selling price exceeding MRP 2. Loose sale of liquor	2009-10 4.6.2010	15,000
5.		Manjunatha Wines, Hosakote	1. Selling price exceeding MRP 2. Bill book not produced 3. Allowing consumption at premises	2009-10 4.6.2010	15,000
6.		J.R.D Wines, Hosakote	1. Selling price exceeding MRP 2. Loose sale of liquor	2009-10 (19.2.2010) 4.6.2010	15,000
7.		Honnu Wines, Hosakote	1. Selling price exceeding MRP 2. Loose sale of liquor 3. Cash receipt not issued	2009-10 4.6.2010	15,000
8.		Sujatha Wines, Hosakote taluk	1. Selling price exceeding MRP 2. Bill book not produced 3. Allowing consumption at premises	2009-10 (15.2.2010) 14.6.2010	15,000
9.		Honnu Wines, Hosakote	1. Raja whisky sold for `42 which is more than MRP	2009-10 16.1.2010	15,000
10.	Bangalore	Balaji Wine,	1. Selling price exceeding MRP	2009-10	15,000

Sl. No.	District	Name of the licensee (M/s)	Nature of offences noticed	Period of offence Date of compounding order	Amount levied on compounding
	(Urban)	Lingarajapura	2. Allowing consumption at premises	24.11.2009	
11.	Mandya	Renuka Wines, Maddur	1. Selling price exceeding MRP	2011-12 14.10.2011	12,000
12.	Mandya	Gururaja Wines, Maddur	1. Selling price exceeding MRP 2. Loose sale of liquor	2011-12 14.10.2011	15,000

It may be seen from the above illustrative cases that the Department has taken a lenient view in dealing with the cases booked for violation of licence conditions. Even in respect of licensees who appear to be habitual offenders, i.e., who repeated the same offences within a span of three months (sl.no. 1 and 8 and sl.no. 2 and 6 of the above table), each time compounding amount of ` 15,000 only was levied. Besides, other stringent provisions of cancellation of licences, imprisonment etc available under the law were not invoked.

3.6.7.4 Violation of excise rules by retail shop

Under the KE (SI and FL) Rules, the retail shop licences are issued in the Form CL-2, for sale of liquor in sealed bottles to any person in a quantity not less than 0.180 litres at a time is prohibited. Further, the licence condition also stipulates that no liquor shall be allowed to be consumed on the premises. However, we observed that in many cases loose sale of liquor continued to be made and consumption of liquor by public in the premises itself were allowed as shown below.



Picture No. 1-Loose sale and consumption of liquor at one of the outlets in Bangalore

3.6.7.5 Sales outlets irregularly operating in the vicinity of religious institutions and educational institutions

The Karnataka Licenses (General Conditions) Rules, 1967 stipulates maintenance of a distance of 100 meters between the licensed sale outlets and educational institutions, religious institution, hospital, any office of the State Government or Central Government of local authorities or in any residential locality. However, we observed that sale of liquor near religious and educational institutions in violation of the restrictions imposed, as shown below:



Picture No. 2- A wine store situated at a distance within 50 metres from a Church, in Bangalore.



Picture No. 3- A Bar and Restaurant located at a distance of 50 metres from a temple in Bangalore.



Picture No. 4 - A Bar and Restaurant located within 50 metres distance from an Education Institution in Bangalore.

3.6.8 Social obligation of Government in mitigating the effects of alcoholism

Social responsibility is an ethical ideology or theory by which an entity, be it an individual, organisation or Government has an obligation to act for the

benefit of society at large. A socially responsible approach would involve attention to social and environmental concerns in addition to financial goals. The SED which is earning second highest tax revenue to the State Government may discharge their social obligation by promoting responsible use of excisable articles which means moderate consumption, enforcing legal age of drinking, promoting zero tolerance for drinking while driving or performing sports activities, etc.

Government of Karnataka constituted an autonomous body in October 1984, the Karnataka State Temperance Board, which is entrusted with task of eradicating alcoholism and hazardous drug addiction through public awareness and educational programmes involving Governmental and non-Governmental agencies. During the period 2005-06 to 2009-10 grants released to the board is detailed in the following table:

Year	Grant released (` in lakh)
2005-06	33.20
2006-07	32.78
2007-08	39.48
2008-09	40.88
2009-10	42.50

As per the information furnished by the Karnataka Temperance Board, 50 *per cent* grant goes to the Pay and allowance of the Staff of the Board and the balance of 50 *per cent* incurred towards production of documentary movies, handouts and advertisements through media.

In Kerala State, the Temperance commission is spreading awareness among the public on the ill-effects of consuming liquor. In addition, it also treats addicts of Alcohol and Drugs improving the personality of the addicts to bring them to a new life. This includes medical treatment, psychological helps, spiritual encouragement and social support. The commission also gives anti-alcohol treatment free of cost.

Andhra Pradesh State Government earmarked ` 50 crore to educate general public about the ill effects of consuming liquor.

We recommend that Government may consider widening the scope and activities of temperance board similar to that of neighbouring States with adequate budgetary support and also to disseminate information about MRP, introduction of barcodes affixing by wholesale distributors, and also propaganda material to persuade safe and healthy drinking methods.

3.6.9 Non-issue of licences in CL-2 (Retail sale) and CL-9 (Bar Licence)

In Karnataka, various types of licences for retail sale of Indian and Foreign liquor are issued on payment of fee under the provisions of the Karnataka Excise (Sale of Indian and Foreign liquors) Rules, 1968. These licences are required to be renewed annually on payment of prescribed fee. The sale/transfer of licences is also permissible in the event of death of the licensee to the legal heirs of the deceased under the provisions of the Karnataka Excise Licences (General Conditions) Rules, 1967.

The maximum number of licences to be granted in an area shall be determined from time to time by the Department with reference to population and probable demand. The State Government has stopped issue of fresh licences with effect from 5 December 1992. No further licences were issued even though the population of the State has increased from 4.48 crore in 1991 to 5.27 crore in 2001 census and several applications were received for grant of licence. As a result the licences which existed prior to 1992 were being renewed annually and being transferred on sale/inheritance basis.

We noticed from the statistical information maintained by the Department that due to various reasons 238 retail shop licences (CL-2) and 225 bar licences (CL-9) were not renewed. No action was taken by the Department to issue an equal number of licences to new applicants. Non-issue of these licences deprived the Government a revenue not less than ` 48.43 crore at the lowest rate of licence fee payable as applicable to 'other areas' for the period from 2005-06 to 2009-10 as mentioned in the following table:

(` in crore)

Year	Licence fee for 238 CL2 licences			Licence fee for 225 CL9 licences			Total revenue foregone
	Licence fee (fee per licence)	Additional licence fee (@ 15%)	Total	Licence fee (fee per licence)	Additional licence fee (@ 15%)	Total	
2005-06	2.38 (0.01)	0.36	2.74	2.25 (0.01)	0.34	2.59	5.32
2006-07	2.38 (0.01)	0.36	2.74	2.25 (0.01)	0.34	2.59	5.32
2007-08	4.76 (0.02)	0.71	5.47	4.50 (0.02)	0.68	5.18	10.65
2008-09	4.76 (0.02)	0.71	5.47	4.50 (0.02)	0.68	5.18	10.65
2009-10	7.14 (0.03)	1.07	8.21	7.20 (0.032)	1.08	8.28	16.49
Total	21.42	3.21	24.63	20.70	3.12	23.82	48.43

Further as per the statistical information maintained by the Department there were 3835 CL-2 and 3447 CL-9 licences in operation during the year 2009-10. Many writ petitions were filed before the Honourable High Court of Karnataka by the applicants for grant of new licences and the High Court disposed of these petitions by directing the respondents to fix the quota based on the population. The Excise Commissioner has worked the quota of CL-2 and CL-9 licences based on population. As per the quota worked by the Excise Commissioner in 2003, additional 489 CL-2 and 618 CL-9 licences were to be issued, however no fresh licences were issued as of November 2011.

Under these circumstances, it was necessary for the Government to have a re-look in the existing procedure of issue of such licences to cater to the needs of the increase in population as well as to prevent unauthorised sale of liquor.

In this regard, it is pertinent to mention that in the State of Andhra Pradesh, there is a system of auctioning of the licences with a validity period of two years. It was seen that during the year 2010-11, the Government of Andhra

Pradesh had received ` 6,904 crore from auction of 6,505 licences. In Karnataka, the revenue realised from issue of all types of licences including additional licences fee was only ` 1,134.74 crore during the year 2009-10. Since no new licences are being issued in the State, auctioning of the existing licences each year would have yielded additional revenue to the Government apart from providing level playing field for new entrants and discouraging monopoly and cartelisation. This was pointed out to the Department in November/December 2011 and their reply is awaited (January 2012).

We also noticed that M/s Mysore Sales International Limited (MSIL), a Government of Karnataka undertaking was sanctioned 463 retail licences in form CL 11(c) on 3 July 2009. As there was demand for quality liquor in all the districts, Government may consider increasing the outlets operated by Government agencies to prevent unhealthy crimes of charging of rates beyond MRP by other retailers and sale of unauthorised and unsafe liquor, as well as for augmenting government revenue.

3.6.10 Non-revision of licence fee

The Karnataka Excise (Distillery and Warehouse) Rules 1967 and Karnataka Excise (Brewery) Rules, 1967 stipulates the fee payable for grant or renewal of Distilleries and Breweries. With effect from 1.7.2000, the Government fixed the rate of licence fee for the Distilleries/Breweries at the following rates.

Type distillery/brewery	Licence fee per annum (` in lakh)
Distilleries Which distill spirit out of molasses	22.50
Distilleries Which use spirit for manufacture of Indian liquor	30.00
Distilleries Which distill spirit out of tapioca/sweet potato	17.50
Breweries	18.00

There was no provision of revision of licence fee based on production capacity of Distillery/Brewery.

Time limit was not prescribed in the Act/Rules for periodical revision of the rate of licence fee. As per Basic Excise Statistics Report published by the State Excise Department, Government of Karnataka, the sales turnover of IML increased from 96.40 lakh carton boxes in 2003-04 to 408.60 lakh carton boxes in 2009-10, i.e., an increase of 323.85 *per cent*, the rate of license fee remained unchanged/unrevised since July 2000.

The trend of revenue from licence fee on distilleries/breweries during 2005-06 to 2009-10 is given in the following table:

Year	Number of licensees	Licence fee/Additional licence fee (` in crore)
2005-06	31	17.68
2006-07	31	18.47
2007-08	44	23.71
2008-09	44	23.71
2009-10	39	22.51

We noticed that Government increased (double) the licence fee in respect of retail vending of IML with effect from 1 July 2007 in the State and lowered

the profit margin of retail sales from 20 to 10 *per cent* with effect from 28 February 2009 due to increase in sale of IML on abolition of sale of arrack. This was done along with increase in excise duty/additional excise duty and increased repatriation of privilege fee from sole distributor. The production of IML increased from 1509.65 lakh BLs in 2006-07 to 2981.26 lakh BLs in 2007-08. However, the licence fee of distilleries was not revised upwards, commensurate with increase in excise duty/additional excise duty and increased sales.

It was stated that the Department in consultation with Government is examining the proposal of revising the distillery licence fee.

3.6.11 Comparative price of liquor in the neighbouring States

As per Article 47 of the Constitution of India, the State shall endeavour to bring about prohibition of consumption of liquor. Being a demerit commodity, it was expected that the tax on liquor should be high enough to discourage its consumption and at the same time result in augmentation of revenue. However, it was seen that the cost of liquor for the consumers at MRP is less when compared with the neighbouring States, as per the information collected by us from websites are mentioned in the following table:

(Amount in `)

Sl. No.	Brand (750 ML)	Karnataka	Andhra Pradesh	Kerala	Maharashtra	Tamil Nadu
1	Whyte and Mackay	1000	1266	NA	1260	NA
2	Black Dog Delux Aged 12years	1700	1976	NA	1900	1790
3	Mc Dowells No.1 Reserve	328	368	370	NA	400
4	Black and White	1049	NA	1538	NA	1240

It would be seen from the above that the MRP of the liquor is less in the State compared to neighboring States. Government may consider revision of rates of Excise Duty/Margins of state wholesale distributors to maintain MRP at par with neighboring States. This would boost the excise revenues of the Government.

3.6.12 Need for revision of norms in respect of Minimum yield of spirit from molasses

The Karnataka Excise (Regulation of Yield etc.,) Rules, 1998, lays down the norms for minimum quantity of yield of spirit/liquor from the raw materials used. According to these norms, one ton of grade - I molasses should yield 220 BLs of rectified spirit with 166 degree proof strength. For manufacture of IML, such spirit has been reduced to a strength of 75° proof.

Though the rule came into force from 4-8-1998, these norms were fixed by the Government as early as 1980. We pointed out a need for revision of norms in the Audit Report (Revenue Receipts)

for the year 2004-05. A technical committee constituted by Government on 22 December 2005 in this regard submitted their report to the Department on 5 October 2007. The technical committee observed that the reason for varying

yield of RS within the grade of molasses was the Total Reducible Sugar (TRS) percentage in the molasses. Based on the TRS factor the Committee recommended revised norms for yield of RS as mentioned in the following table:

Yield of Rectified Spirit (under Grade 'A')

No	Type of process	TRS	Existing requirement	Modification proposed
1	Batch process	(i) > 52	220	255
		(ii) 51-51.9	220	250
		(iii) 50-50.9	220	245
2	Continuous process	(i) > 52	220	270
		(ii) 51-51.9	220	265
		(iii) 50-50.9	220	260

However, the Government did not take any action on the recommendations of the Technical committee.

We noticed that the average yield of RS obtained per ton of grade - I molasses during the period 2005-06 to 2009-10 by 20 distilleries were between 222 BLs and 272 BLs as mentioned in the following table:-

Sl. No.	Name of the Distillery	Sector	Molasses used (MT)	RS produced (BLs)	Average production of RS(BLs)
	Yield obtained more than 250 Bls per tonne				
1	M/s HSSKN, Sankeshwara	Co-operative	163924	44589929	272
2	M/s United Spirits, Hospet	Private	142212	28455313	270
3	M/s Godavari Bio-refinery, Sameerwadi	Private	265394	71688945	270
4	M/s Renuka Sugars, Soundatti	Co-operative	313048	84219718	269
5	M/s Samson. Distillery, Duggavathi	Private	218358	57858687	265
6	M/s Doodhganga KSSKN, Chikodi	Co-operative	101452	26413039	260
7	M/s Siddapura Distillery, Siddapura	Private	184022	47143603	256
8	M/s Chamundeswari Sugars, KM Doddi	Private	243563	61853358	254
9	M/s Sovereign Distillery, Singapura	Private	322572	81594358	253
	Yield obtained less than 250 Bls per tonne				
1	M/s Ugar Sugars, Ugar Khurd	Private	220882	53949687	244
2	M/s Bannariamman, Nanjungud	Private	136527	33013507	242
3	M/s Malaprabha SSKN, MK Hubli	Co-operative	44105	10624373	241
4	M/s Venkateshwara Distillery, Balki	Private	69168	16495498	238
5	M/s Vishwanatha sugars, Hukkeri	Private	96941	22694215	229
6	M/s Ravindra Distillery, Mallik Mirjapura	Private	28709	6572483	228
7	M/s Gemini, Nanjungud	Private	72757	16616914	223
8	M/s SPR Groups, Chamundeswari, TN Pura	Private	101678	22628147	223
9	M/s SLN Distillery, Garag	Private	146960	32826872	223

Sl. No.	Name of the Distillery	Sector	Molasses used (MT)	RS produced (BLs)	Average production of RS(BLs)
10	M/s JP Distilleries, Heggadathihalli	Private	184743	42576293	223
11	Mysore Sugar Co. Ltd, Mandya	GoK undertaking	67150	14881271	222

Taking the minimum yield of 245 BLs recommended by the Committee as basis, short yield of RS by 18 distilleries works out to 49.57 lakh BLs during the excise years 2008-09 and 2009-10. The consequent revenue implication on account of excise duty and additional excise duty forgone worked out to ` 121.52 crore as under:

Year	Molasses distilled in MT	Expected yield of RS in BL (at 245 BL per MT of molasses)	Actual yield of RS In BL	Shortfall in BLs	Estimated IML at 75° proof.	ED at 45 per BL of IML	AED on IML
						(` in lakh)	
2008-09	157209	38516205	35938411	2577794	5705517	2567.48	3423.31 (@ ` 60 per BL)
2009-10	223277	54702865	52323614	2379251	5266076	2369.73	3791.57 (@ ` 72 per BL)
Total	380486	93219070	88262025	4957045	10971593	4937.21	7214.88
Grand Total (ED+AED)						12152.09	

When we pointed out this, the Government stated that the term of the Committee had expired on 15 April 2011 and they have constituted a new standing technical committee and the issue would be examined. They have not furnished their comments for their inaction all these years on the Committee's recommendation.

We recommend that the Government may revise the norms in respect of minimum yield of spirit from molasses at the earliest based on the available Report.

3.6.13 Non-levy of licence fee and Additional licence fee

According to Rule 6 of the Karnataka Excise (Distillery and Warehouse) Rules, 1967, a distillery licence may be renewed on application submitted to the Commissioner at least one month before the expiry of the licence already granted along with licence fee prescribed under Rule 7 of the said rules.

We noticed from the records of the EC during December 2010 that the distillery licence of M/s. Mysore Sugar Company Limited, Mandya was renewed for the year 2000-01 to 2008-09 without levying and collecting licence fee and additional licence fee as prescribed under Rule 7 of Karnataka Excise (Distillery and Warehouse) Rules, 1967. This resulted in non-levy/ collection of licence fee of ` 2.76

crore as mentioned in the following table:

(` in lakh)			
Year	Licence fee and Addl. licence fee payable	Fee Paid	Balance

	Current year	Arrears		
2005-06	34.50	172.50 (2000-01 to 2004-05)	Nil	207.00
2006-07	34.50	207.00	Nil	241.50
2007-08	34.50	241.50	Nil	276.00
2008-09	34.50	276.00	34.50	276.00
2009-10	34.50	276.00	34.50	276.00

The Department replied that the company had approached the Government, for waiver of license fees. The reply is not tenable as the licence was to be renewed on payment of licence fee.

3.6.14 Short levy of licence fee and Additional licence fee

Karnataka Excise (Sale of Indian and foreign liquors) Rules 1968, prescribes the rate at which the licence fee is leviable in respect of different kinds of licences issued for sale of Indian and foreign liquor in the State. In respect of each kind of licence, different amount of fee was prescribed depending on the area or population of the area where such liquor vending units are situated.

3.6.14.1 License fee payable for retail sale of liquor licenses is based on the population of the place/ town/area where the license is to be operated. We found that with increase in population and village areas coming under municipal limits, there was

no suitable mechanism in place in the Department to keep track of new areas entering municipal limits, based notification passed by the Urban Development Department. Some such instances resulting in short recovery of license fee of ` 29.57 lakh are mentioned in the following table:

Sl No	Name of the lessee	Year	Type of licence	Licence/Additional licence fee (` in lakh)		
				Payable	Paid	Short
A	As per urban Development Departments notification dated 16.01.2007, where in Doddathoguru was included in the area Bangalore Mahanagar Palike. But license fee as applicable to "other areas" were collected.					
1.	M/s. Lemon Tree Hotels,	2009-10	CL 7	7.59	3.22	4.37
		2010-11	CL 7	7.59	3.22	4.37
2.	M/s. Oasis Hotels	2010-11	CL 9	6.90	3.68	3.22
3.	M/s. Fairmount Hotels	2008-09	CL 7	7.59	3.22	4.37
		2009-10	CL 7	7.59	3.22	4.37
		2010-11	CL 7	7.59	3.22	4.37
B	As per Urban Department Notification dated 27.7.2007, Gopasandra Cross comes under Chinthamani CMC. But license fee as applicable to "other areas" was collected.					
4.	M/s. M/s. Vinayaka	2007-08	CL 2	3.80	2.30	1.50
		2008-09	CL 2	3.80	2.30	1.50
		2009-10	CL 2	3.80	2.30	1.50
				Total	29.57	

The above cases are only illustrative ones; there could be many more such instances. The Government may consider issuing directions to the Department to consider the notifications issued by the UDD from time to time before levying the license fee in accordance with the Act.

Under the Karnataka Excise (General Condition) Rules any licensee who wishes to transfer the license held by him in favour of any other person shall pay the transfer fee equivalent to the annual licence prescribed for such license. In case, the constitution of a firm changes, the new firm shall be treated a fresh licensee.

3.6.14.2 We noticed from the records of the DCOE, Bangalore (south) that from M/s. Nexus Enterprises, a partnership firm which had CL-9 licence for the excise year 2007-08. Subsequently, one of the partner retired with effect from 1 April 2008 and remaining two partners continued the business. Thereafter, the partnership deed was dissolved and a new partnership deed was executed

on 1 April 2008 among the existing partners. Since the constitution of the firm was changed, the licence also should have been transferred to the newly executed firm after the payment of transfer fee equivalent to an annual licence fee. The same was not demanded by the Department which has resulted in non-realisation of transfer fee of ` 6.90 lakh.

Under the Karnataka Excise (General Condition) Rules DCOE may permit any licensee to shift the location of his shop from one place to another within the limits of Grama Panchayat or Municipal area or City Municipal Corporation on payment of fee equivalent to 25 per cent of licence fee charged on the licence in respect of such shop.

3.6.14.3 We noticed from the records of two DCOEs in July/September 2010 that five licensees were permitted to shift their shops in Bagalkot and Bangalore Urban (South) districts without levying and collecting the prescribed fee. The non-

levy of the fee amounted to ` 2.78 lakh as mentioned in the following table:

Name of the lessee current location	Previous location	Kind of licensee	Licence/Additional licence fee		
			Payable	Paid	Short (in `)
M/s. Vijayalakshmi Association, Jamkhandi (CMC)	Savalgi Village, Jamkhandi (others)	CL 2	94875	57500	37375
Sro M.J. Thoragal, Jamkhandi	Mudhol Jamkhandi Taluk (others)	CL 2	94875	57500	37375
Sro M.J. Thoragal, Jamkhandi (CMC)	Heppargi, Village, Jamkhandi (others)	CL 2	94875	57500	37375
Sri. Manoj Janpanna, Thoragal, Rabakasi, Jamkandi (CMC)	Hebbal Village, Jamkhandi Taluk (others)	CL 2	94875	57500	37375
Total					149500
Classic Wine Mall, No.20,21,22 Northern Portion, Ground Floor, Hosur Road, Bangalore	Classic Wine Mall, No.20,21,22 Southern Portion, Ground Floor, Hosur Road, Bangalore	CL2	128225	0	128225
Grand Total					277725

Under the Karnataka Excise (Sale of Indian and Foreign liquors) Rules 1968, a licence in form CL 6-A shall be issued by the DCOE to Star Hotels for possession and sale of liquor.

3.6.14.4 As per Ministry of Tourism, Government of India, M/s. Ananth Residency, Hubli, Dharwad District and M/s. Grand Pevilian,

K.H. Road, Bangalore were classified as Star hotels with effect from 24 January 2006 and 17 July 2007 respectively. We noticed from the records of DCOE, Dharwad and DCOE Bangalore (South) Division, these star hotels obtained licence in Form CL 7 applicable to Hotels and Boarding houses instead of in Form CL 6-A resulting in short levy of licence fee and additional licence fee of ` 14.95 lakh as mentioned in the following table:

Star hotel	Year	Licence fee/Additional licence fee (` in lakh).		
		Leviabale as per CL 6-A	Levied as per CL 7	Short levy
M/s. Ananth Residency, Hubli, Dharwad District	2005-06	4.60	3.34	1.26
	2006-07	4.60	3.33	1.27
	*2007-08	*9.20	6.67	2.53
	2008-09	9.20	6.67	2.53
	2009-10	9.20	6.67	2.53
M/s. Grand Pevilian, K.H. Road, Bangalore	2007-08	9.20	7.59	1.61
	2008-09	9.20	7.59	1.61
	2009-10	9.20	7.59	1.61
Total		64.40	46.45	14.95

* Licence fee enhanced during the year 2007-08.

After we pointed out, the Department collected the entire differential amount of ` 14.95 lakh.

3.6.15 Non-levy of penalty for short lifting of IML

Under the Karnataka Excise (Sale of Indian and Foreign liquors) Rules, 1968, licensees holding retail shop licences in Form CL-2 and bar licences in Form CL-9 shall lift for sale from a wholesale licensee, the minimum quantity of liquor fixed per month. In case, the licensees fail to lift the prescribed minimum quantity of IML so fixed per month, they shall be liable to pay a penalty at the rate of ` 100 for every bulk litre on the quantity short lifted.

Consumption register maintained by the Inspector of Excise at Range level and statements furnished to DCOEs shows the actual quantity of IML lifted every month by the CL-2 and CL-9 licensees. We noticed during test check of records of nine DCOEs between December 2010 and April 2011 that 245 licensees had short lifted IML to the tune of 889123 BLs for the period 2005-06 to 2009-10. Though consumption statement regarding the quantity of liquor lifted by the licensees holding CL-2 and CL-9 licenses is being sent to the Range offices from KSBCL regularly, the Department failed to levy penalty for short lifting of IML. The non-levy of penalty amounted to ` 9.04 crore.

After we pointed out this between January 2011 and April 2011, the Department accepted the objection and stated that action would be taken to recover the amount after verification.

3.6.16 Working of Internal Audit Wing

The Internal Audit Wing (IAW) is functioning in the State Excise Department with working strength of one Senior Audit Officer and two Assistant Audit Officers. There are 311 offices in the Department out of which 104 offices were planned for audit during 2009-10 and 108 offices were audited. Year wise details of the number of objection raised and settled with duty effect and recoveries effected during the preceding five years are as under:

(` in lakh)

Year	Objection raised		Objection settled		Objection pending	
	No. of objection	Amount	No. of cases	Amount	No. of cases	Amount
2005-06	419	2,989.40	32	23.48	387	2,965.92
2006-07	56	358.20	01	0.11	55	358.09
2007-08	02	1.40	01	0.12	01	1.28
2008-09	19	19.28	03	0.19	16	19.09
2009-10	10	10.74	02	7.28	08	3.46
Total	506	3,379.02	39	31.18	467	3,347.84

From the above, it was observed that only Eight *per cent* of the total objection raised have been settled and a huge number of objections are pending settlement for over five years.

We recommend that the Department take appropriate steps for speedy clearance of outstanding objections, particularly those pending for more than five years.

3.6.17 Conclusion

The review on receipts from State excise revealed a number of policy shortcomings. The Enforcement Activities of the Department showed leniency in dealing with excise crimes as evidenced from the low rate of offences booked after conducting raids and meagre penalty levied on offenders. There were instances of sale of loose liquor in licensed premises violating license conditions. We came across instances of liquor outlets operating in proximity of religious/educational institutions. Old arrears of excise revenue were not tackled in time, making their recovery doubtful. There were instances of short realisation of licence fee due to application of wrong rates. The State Government had stopped issue of fresh retail vending licenses with effect from 5 December 1992. No further licenses were issued even though the population of the State had increased from 4.48 crore in 1991 to 5.27 crore in 2001 census and several applications were received for grant of license. During this period through 238 retail shop licenses (CL-2) and 225 bar licenses (CL-9) were not renewed, no action was taken by the Department to issue an equal number of licenses to new applicants, thereby Government revenue of not less than ` 48.43 crore was forgone. Further, considering the demand, there was no attempt to exploit the revenue resources through auction of licenses.

The State Government did not take any action on recommendation of a Technical committee constituted by them to revise the norms for yield of rectified spirit from molasses. Even the lowest yield recommended by the committee would have fetched additional revenue of ` 121.52 crore during 2008-09 and 2009-10. We noticed license of a Sugar Company was renewed for the year 2000-01 to 2008-09 without levying and collecting licence fee and additional license fee. There was no suitable mechanism in place in the Department to keep track of new areas entering municipal limits, based on notifications passed by the Urban Development Department resulting in short levy of licence fee for retail sale of liquor. Though consumption statement regarding the quantity of liquor lifted by the licensees holding CL2 and CL9 licences were received by the Range offices from Karnataka State Beverages Corporation limited (KSBCL) regularly, the Department failed to levy penalty leviable for short lifting of Indian Made Liquor (IML).

3.6.18 Summary of recommendations

The Government may consider the following recommendations for improving the system and compliance:

- **To review their policy regarding issue of fresh retail vending licenses considering the increased population and demands for fresh licenses.**
- **Consider widening the scope and activities of temperance board similar to that of neighboring States with adequate budgetary support and also to disseminate information about MRP, introduction of barcodes affixing by wholesale distributors, and also propaganda material to persuade safe and healthy drinking methods.**
- **Take action on recommendation of a Technical committee constituted by them to revise the norms for yield of rectified spirit from molasses to save the Government from further losses.**
- **Renew the license of a Sugar Company(ies) regularly after levying and collecting license fee and additional license.**
- **A suitable mechanism need to be put in place by the Department to keep track of new areas entering municipal limits, based on notifications of the Urban Development Department, for license fee purposes.**

EXECUTIVE SUMMARY

Tax collection	In 2010-11, the collection of taxes on Motor vehicles which stood at ` 2,550.02 crore, had increased by 30 <i>per cent</i> over the previous year which was attributed by the Department to increase in registration of vehicles by about 10 <i>per cent</i> .
Cost of collection	We noticed that the percentage of Cost of collection to the Gross collection was lower than the all India average percentage for the years 2008-09 to 2010-11.
Internal Audit Wing	<p>The Internal Audit Wing is functioning in the Department. Internal audit was completed for about 82 <i>per cent</i> of the Offices selected. As per the information furnished by the Department, we noticed that the statistics of number of observations raised, settled and pending with money value thereof looked incorrect.</p> <p>We recommend the Department initiate remedial action for reconciliation of figures and follow up on pending Internal Audit objections.</p>
Insignificant recovery by the Department of observations pointed out by us in earlier years	During the period 2006-07 to 2010-11, we had, through our Audit Reports pointed out non/short levy, non/short realisation of revenue amounting to ` 5.59 crore. Of these, the Government/Department had accepted audit observations involving ` 4.97 crore and had since recovered only ` 94.25 lakh. The recovery made by the Department is only 18 <i>per cent</i> of the amount involved in the total accepted cases.
Results of audit conducted by us in 2010-11	<p>We conducted a test check of the records of 53 offices of the Transport Department during the year 2010-11, which revealed under-assessments of tax and other irregularities involving ` 9.66 crore in 194 cases. Of these, the Department accepted 72 cases involving ` 1.45 crore.</p> <p>We also conducted a Performance Audit on “Computerisation in Transport Department” the findings of which are featured in this chapter.</p>
What we have highlighted in this Chapter	We noticed that Smart cards for Registration of Vehicles (RCs) and Driving Licenses was introduced w.e.f November 2009 with ‘VAHAN’ and ‘SARATHI’ being implemented in all 54 RTOs/ARTOs of the State. The Department has not evolved, documented and circulated policies relating to IT implementation. No clear demarcation of duties/responsibilities between the

	<p>Department and the NIC, have been documented with reference to ensuring system reliability and integrity. Even though the Computerisation has been implemented in all the RTOs as of November 2009, registration of transport vehicles except for Bangalore City was not routed through VAHAN. Software modules such as Surrender, Demand, Collection and Balance, Departmental Statutory Authority Cases were not being utilised by the Department. The Software application did not provide for mapping of certain business activities of the Department like jurisdiction of the RTOs, prompt for demand of tax on change of ownership of Government vehicle to individual owner, fee for advance registration mark, refund of tax etc. Digitisation and porting of legacy data was not completed even as of November 2011 and work outside Bangalore was not given any priority; junk/redundant data had been ported into the present system as no clean up exercise was envisaged and done before porting the legacy data, thereby rendering the database incomplete and unreliable.</p> <p>We noticed on comparison of data of NOC/CC module with tax collection module data of three RTOs that in 147 instances NOC/CC were issued even though there were arrears of tax from those vehicles. The Department did not have a clearly documented and approved policy statement comprehensively covering all aspects of logical security. The system permitted the same user to be given permission for various processes in any activity.</p> <p>We found from the SARATHI database of issued licenses of six RTOs that in 718 instances one person (identified by name, father's name and date of birth) has been issued with two or more licenses (bearing different license numbers).</p>
<p>Our conclusion</p>	<p>The Department needs to gear up its activities and implement the computerisation in all the RTOs in respect of all its activities to meet its e-governance objectives. The Department should improve the Internal control systems including strengthening of Internal audit so that weaknesses in the system are addressed and omissions of the nature detected by us are avoided in future.</p> <p>It also needs to initiate immediate action to recover the non-realisation, undercharge of tax, etc pointed out by us, more so in those cases where it has accepted our contention.</p>

CHAPTER-IV: TAXES ON MOTOR VEHICLES

4.1 Tax administration

The provisions of the Karnataka Motor Vehicle Taxation (KMVT) Act, 1957 and rules made thereunder govern the levy and collection of taxes on motor vehicles. The levy of taxes on motor vehicles is administered by the Transport Department headed by the Commissioner for Transport who is assisted by Joint Commissioners of Transport. There are 55 Regional Transport Offices (RTOs)/Assistant Regional Transport Offices (ARTOs) and 15 check posts in the State.

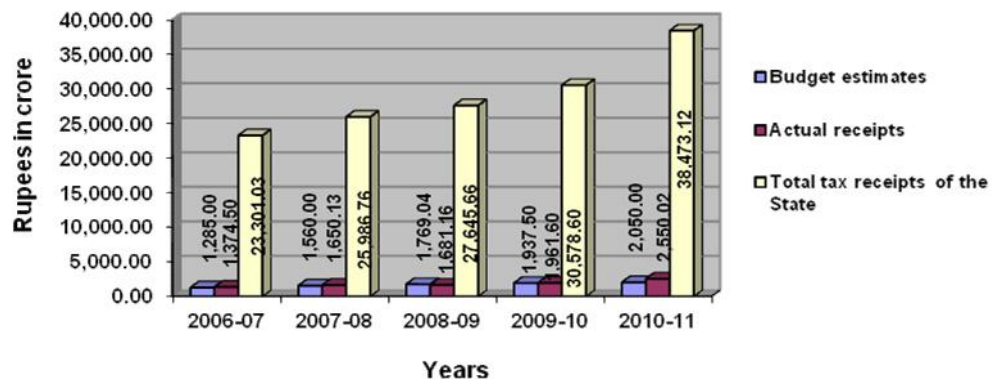
4.2 Trend of receipts

Budget Estimates (BEs) and actual receipts from taxes on motor vehicles during the years 2006-07 to 2010-11 along with the total tax receipts during the same period is exhibited in the following table and graphs.

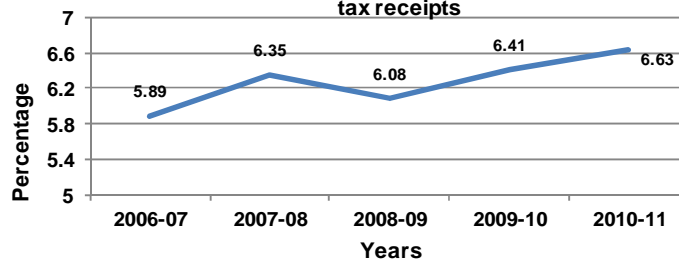
(in crore)

Year	Budget estimates	Actual receipts	Variation excess(+)/shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
2006-07	1,285.00	1,374.50	(+) 89.50	(+) 6.96	23,301.03	5.89
2007-08	1,560.00	1,650.13	(+) 90.13	(+) 5.78	25,986.76	6.35
2008-09	1,769.04	1,681.16	(-) 87.88	(-) 4.97	27,645.66	6.08
2009-10	1,937.50	1,961.60	(+) 24.10	(+) 1.24	30,578.60	6.41
2010-11	2,050.00	2,550.02	(+) 500.02	(+) 24.39	38,473.12	6.63

Graph 1 : Budget estimates, Actual receipts and Total tax receipts



Graph 2: Percentage of Actual receipts vis-à-vis Total tax receipts



It is seen from the table that the revenue realisation in 2010-11 was 24 per cent more than the BEs and 30 per cent more than the previous year. The Department reported (November 2011) that the increase in revenue was due to increase in registration of vehicles by about 9 to 10 per cent.

4.3 Cost of collection

The gross collection of taxes on motor vehicles, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2008-09, 2009-10 and 2010-11 along with the relevant all India average percentage of expenditure on collection to gross collection for the respective preceding years were as follows:

Year	Gross collection	Expenditure on collection	Percentage of cost of collection to gross collection	All India average percentage for the preceding year
	(` in crore)			
2008-09	1,682.90	34.84	2.04	2.58
2009-10	1,962.62	36.35 ¹	1.85	2.93
2010-11	2,551.40	41.45	1.62	3.07

As seen from the above, the percentage of Cost of collection to the Gross collection was lower than the all India average percentage for all the three years.

4.4 Impact of Audit Reports

During the last five years, through our Audit Reports, we had pointed out non/short levy of tax with revenue implication of ` 5.59 crore in 16 paragraphs. Of these, the Government/Department had accepted audit observations involving ` 4.97 crore in 15 paragraphs and had since recovered ` 94.25 lakh. The details are shown in the following table:

(` in lakh)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ²	Number	Amount ²
2006-07	03	199.82	03	191.81	02	0.24
2007-08	04	139.61	04	138.51	02	15.90
2008-09	04	135.39	04	135.39	04	57.65
2009-10	02	19.54	02	4.58	02	4.30
2010-11	03	64.32	02	26.60	02	16.16
Total	16	558.68	15	496.89	12	94.25

As seen from the above table, the recovery made by the Department is only 18.47 per cent of the amount involved in the total accepted cases.

We recommend that the Government take measures to ensure expeditious recovery of revenue in respect of the accepted cases.

¹ Indicates non-plan expenditure only. Plan expenditure for 2009-10 was ` 0.46 crore.

² Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

4.5 Working of Internal Audit Wing

The Internal Audit Wing (IAW) is functioning in the Transport Department since 1960. As against the sanctioned post of eight First Division Assistants and one Accounts Superintendent for Internal audit, two posts of First Division Assistants were vacant.

As per the information furnished by the Department, out of 72 offices due for audit during 2010-11, 59 (82 *per cent*) were audited. Year-wise details of the number of objections raised, settled and pending along with tax effect, as furnished by the Department are as under:

(` in lakh)

Year	Observations raised		Observations settled		Objections pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
Upto 2006-07	183	104.56	658	105.69	-	-
2007-08	352	154.85	564	108.51	-	46.34
2008-09	9	7.17	2	576.00	7	7.16
2009-10	15	9.18	-	-	15	9.18
2010-11	75	29.45	75	13.64	1,217	256.96

As seen from the above, the number of paragraphs and amount do not tally. We had recommended earlier in 2009-10 that remedial action may be taken for reconciliation of figures and for speedy clearance of old objections. However, the discrepancy in figures continued during 2010-11 also.

We recommend that the Department accord due importance for follow up on internal audit.

4.6 Results of audit

Test check of records of 53 offices of the Transport Department, conducted during the year 2010-11, disclosed underassessment of tax and other irregularities amounting to ` 9.66 crore in 195 cases, which fall under the following categories:

(` in crore)

Sl. No.	Category	Number of cases	Amount
1.	Computerisation of Transport Department (A Performance audit)	01	-
2.	Short levy of tax on fleet owners	02	3.81
3.	Non-levy of tax on grant of special permits	16	2.66
4.	Non/short levy of quarterly tax	48	1.76
5.	Non-levy of part 'B' tax	04	0.51
6.	Non/short levy of lifetime tax	11	0.19
7.	Non/short levy of tax on violation of condition of surrender	05	0.08
8.	Non-levy of fee on registration with fancy numbers	11	0.07
9.	Other irregularities	97	0.58
	Total	195	9.66

During the year 2010-11, the Department accepted under-assessments of tax of ` 1.45 crore in 72 cases pointed out during the year. The Department also recovered ` 5.26 crore in 110 cases pointed out in earlier years.

After the issue of a draft paragraph, the Department reported (June 2011) recovery of the entire amount of ` 21.64 lakh revenue due.

A Performance audit on **Computerisation of Transport Department** and few illustrative cases involving ` 64.32 lakh are mentioned in the succeeding paragraphs.

4.7 A Performance Audit on “Computerisation of Transport Department”

Highlights

Smart cards for Registration of Vehicles (RCs) and Driving Licenses was introduced w.e.f. November 2009 with Computerisation through VAHAN and SARATHI, in all 54 RTOs/ARTOs of the State.

(Paragraph 4.7.6)

The Department has not evolved, documented and circulated policies relating to IT implementation. No clear demarcation of duties/responsibilities between the Department and the National Informatics Centre (NIC), have been documented with reference to ensuring system reliability and integrity.

(Paragraphs 4.7.8.1 & 4.7.8.2)

Even though the Computerisation has been implemented in all the RTOs as of November 2009, the activities of the Department with respect to transport vehicles were not routed through VAHAN. Smart Card RCs for transport vehicles were being issued only in 5 RTOs in Bangalore from 1 May 2010. Modules of the software such as Surrender, Demand, Collection and Balance, Departmental Statutory Authority Cases were not being utilised by the Department.

(Paragraph 4.7.8.3)

The Software application did not provide for mapping of certain business activities of the Department like jurisdiction of the RTOs, prompt for demand of tax on change of ownership of Government vehicle to individual owner, fee for advance registration mark, refund of tax etc.

(Paragraph 4.7.9)

Digitisation and porting of legacy data was not completed even as of November 2011 and work outside Bangalore was not given any priority; junk/redundant data had been ported into the present system as no clean up exercise was envisaged and done before porting the legacy data, thereby rendering the database incomplete and unreliable.

(Paragraph 4.7.10.1)

Analysis of database of VAHAN has revealed invalid/redundant data. For example, there were duplication of Permit Numbers in 80 cases in three RTOs, in 795 cases same engine numbers were found against different vehicle in the database of six RTOs, Insurance Details were not captured in 11,732 cases in database of eight RTOS, no sale value has been captured in 1,456 cases and in

1,342 cases there is invalid sale amount for Non-Transport Vehicles. Invalid data in fields related to determination of quarterly tax such as floor area, wheelbase was also noticed.

(Paragraph 4.7.11)

There was difference in the lifetime tax (LTT) payable as per Sale Value of vehicles and tax actually paid as per database as noticed in six RTOs and 3,632 vehicles, which was confirmed by us in physical check of records in 20 cases involving short levy of tax of ` 64,417.

(Paragraph 4.7.12.1)

We noticed on comparison of data of NOC/CC module with tax collection module data of three RTOs that in 147 instances, NOC/CC were issued even though there were arrears of tax from those vehicles.

(Paragraph 4.7.12.6)

The Department did not have a clearly documented and approved policy statement comprehensively covering all aspects of logical security. The system permitted the same user to be given permission for various processes in any activity.

(Paragraph 4.7.13.1)

We found from the database of issued licences of six RTOs that in 718 instances one person (identified by name, father's name and date of birth) has been issued with two or more licences (bearing different licence numbers).

(Paragraph 4.7.15)

4.7.1 Introduction

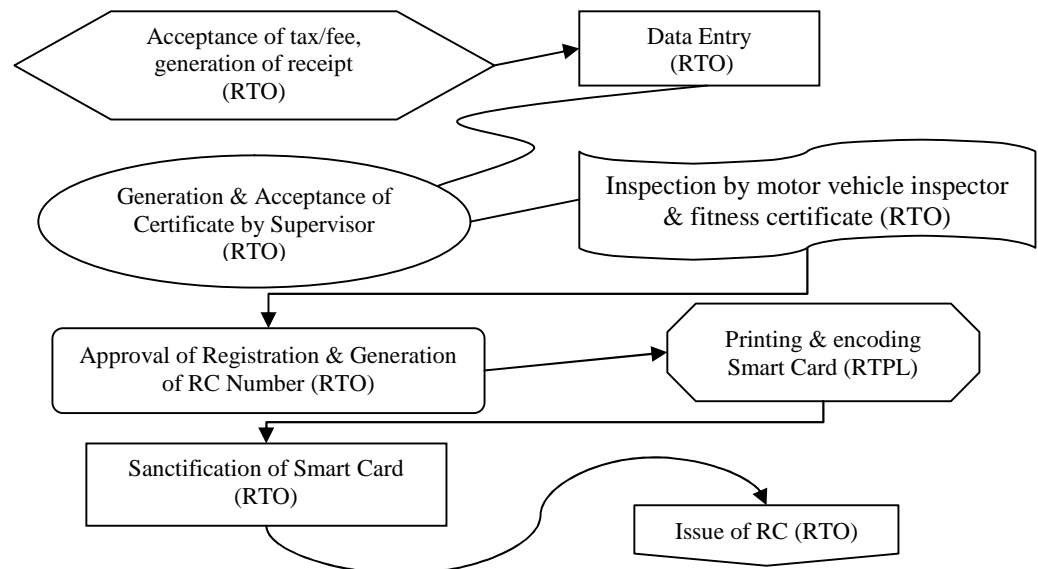
Road Transport is a concurrent subject under Indian Constitution. Legislation and coordination of road transport among States is done by the Central Government and the implementation of the various provisions of the Motor Vehicles Act is done by the States. With a view to creating a National database of registration, driving licenses, national permits etc to serve as a reliable planning tool both for the Central and State Governments and as part of National e-governance programme, the Ministry of Road Transport and Highways (MoRTH) entrusted the development of standardised software to the National Informatics Centre (NIC) in 2002. Accordingly, the following softwares were developed by NIC:

VAHAN: An application for registration of vehicles and road tax clearance by the RTA/RTO. It helps the Department to register vehicle, collect tax, issue various certificate and permits and record fitness of vehicles.

SARATHI: An application for issue of learners licence, permanent driving licence, conductor's licence and driving school licence.

These softwares also provided for issue of Registration Certificates (RC) and Driving Licenses (DL) in electronic form – SMART Cards. Besides, a Data Transformation Service (DTS) was developed by NIC State unit for transferring VAHAN and SARATHI from Transport Commissioner's office to a Central database and ensuring data security. M/s Rosemerta Technologies Pvt. Ltd. (RTPL) is entrusted with the work of printing and encoding of smart cards.

The processes involved in the system are summarised below



4.7.2 Audit Objectives

We undertook the present review with a view to examine whether:

- The implementation of the system followed a planned programme and customisation of the modules was in accordance with specific requirements of the Department;

- Proper application controls existed in the system to ensure the integrity of data;
- All third party issues are administered to ensure adequate delivery of services;
- Authorisation procedures, access control and privileges established in the applications were adequate;
- Adequate security controls and disaster recovery plan existed; and
- Adequacy of system established for mapping of business rules with provisions in the application.

4.7.3 Audit scope and methodology

The Performance Audit covered the working of the Department after the implementation of computerisation in June 2009. We analysed records and data in respect of eight³ RTOs relating to the period from June 2009 to August 2011 using Computer Aided Audit Techniques (CAAT) during the period from July 2011 to November 2011. Controls were also evaluated by feeding test data through application windows. Results of analysis were cross verified with physical records available in the field offices.

4.7.4 Audit criteria

The provisions of the following Acts and Rules were used as criteria:

- Motor Vehicles Act, 1988 (MV Act),
- Central Motor Vehicles Rules, 1989 (CMV Rules),
- Karnataka Motor Vehicles Taxation Act, 1957 (KMVT Act),
- Karnataka Motor Vehicles Taxation Rules, 1959 (KMVT Rules),
- Concession agreement dated 25 February 2009 between Government of Karnataka and M/s RTPL, Mumbai, and
- Best practices followed for IT implementation.

4.7.5 Acknowledgement

We acknowledge the co-operation of the Transport Department, the State NIC team engaged in the implementation of the Systems and the staff of RTOs visited, in providing necessary information and records for audit including access to Systems. We held an Entry conference with the Principal Secretary, Transport Department in August 2011, wherein the Scope of audit, Methodology and Audit objectives were explained. We also discussed the audit findings with the State NIC in December 2011. The Exit Conference was held with the Principal Secretary, Transport Department in January 2012 and views of the Government/Department and NIC are incorporated in the relevant paragraphs.

³ RTO Indiranagar, RTO Koramangala, RTO Yashwantpur, RTO Tumkur, RTO Chamarajnagar, RTO Ramanagara, RTO Mangalore and RTO Dharwad.

4.7.6 Status of VAHAN, SARATHI and RTA application software

The Government of Karnataka (GoK) computerised the operations in the Office of the Commissioner and five Regional Transport Offices (RTOs) in Bangalore as early as in 2000-01 and eight⁴ other RTOs in the State during the period 2002-05 along with a central vehicle database established in the Office of the Commissioner of Transport. The software was developed by the NIC and the hardware was being maintained by the Department. The areas computerised covered vehicle registration, issue of DLs and permits and tax collection.

The State Level Empowered Committee on e-Governance projects in November 2006 approved the proposal of the Transport Department (TD) to computerise all the 54 RTOs/ARTOs and nine supervisory offices (Deputy Commissioner's offices) in the State by implementing the VAHAN and SARATHI applications. For issue of permits and for check-post operations, the Department also got developed from NIC a separate software application called 'RTA software'.

Accordingly, GoK issued order (GO) on 23 April 2007 to implement VAHAN and SARATHI and issue Smart cards for DL and RC under a Public Private Partnership (PPP) scheme. The GoK entered into a concession agreement for "Implementation of Computerised Service Delivery Systems at Transport Offices in Karnataka" with M/s Rosemerta Technologies Pvt. Ltd. (RTPL) in February 2009. M/s RTPL completed the work of computerisation in November 2009 and commenced issue of smart cards for DLs and RCs in a phased manner in all the 54 RTOs/ARTOs.

The GO stipulated that the private vendor would supply and maintain computer hardware, software, UPS, associated peripherals and would establish support infrastructure such as server room, electrical fittings, furniture, generators, etc. The private vendor would also be responsible for backlog data entry of existing vehicle registration and driving licenses, issue of smart cards at all the RTOs/ARTOs, technical consultants at all the offices, training to Transport Department employees, periodic supply of consumables. The private vendor is permitted to collect ` 49 each for issue/renewal of DL and ` 63 for issue of each RC directly from the applicant.

4.7.7 Database Architecture/State-National Registers

The database has been created at the RTO level in a distributed pattern with each RTO having two servers, one active and one back up in the same premises. There is no lateral connectivity across the RTOs and one RTO cannot access information from the database of other RTOs. However, for the purpose of maintaining a State Register and National Register of licences and registration certificates, limited upward connectivity has been provided to a central server in NIC, State HQ in Bangalore. The central server captures data from each RTO through Virtual Private Network (VPN) on broadband by using Oracle Database Integrator (ODI) and replicates them in the server as separate and distinct databases for each RTO. This constituted the State

⁴ Belgaum, Chitradurga, Dharwad, Gulbarga, Mandya, Mangalore, Mysore and Tumkur

Consolidated Register (SCR), where each RTO database remains independent and separate at NIC State HQ. The data from SCR is converted/ aggregated and transferred to the State Register which is maintained in a separate server with the NIC state HQ at Bangalore. The National Register database has been established in Hyderabad which will capture and store the aggregated data from all the State servers. Data transfer to different registers is an automatic and scheduled activity.

Audit Findings

VAHAN application Software

4.7.8 Planning and Implementation

4.7.8.1 Deficiencies noticed in formulation of IT Policies

The project documents of computerisation of the Department envisages to achieve better monitoring of tax collection and renewal of registration and licences, implementation of web applications for online services to the public, provision of reliable Management Information System (MIS), networking of all offices for sharing of data to the enforcement wing of the TD, making available data to the Police and other Departments for investigation of crimes and better traffic control and planning and ultimately converting the offices of the Department into a paperless office.

However, we observed the following deficiencies in the strategic planning and implementation:

- The Department has not evolved, documented and circulated policies relating to data security and classification, custody of IT assets, network security and for its dealing with third party service providers including NIC and M/s RTPL.
- The Department has not formulated policies which are sufficient to ensure data accuracy, integrity and reliability.
- Policies relating to business continuity and disaster recovery also need to be drawn up and implemented.
- The Department has not drawn up a staffing and recruitment policy to ensure that competent personnel are always available to support IT functions.

The Department reported in December 2011 that an annual e-governance Action Plan was prepared and furnished to the e-Governance Department, Government of Karnataka. Further, a proposal to create IT posts in the Department has been submitted to Administration Branch. Regarding policies relating to data security, the Department has stated that certain guidelines/circulars have been prepared and issued to subordinate offices and that respective RTOs have been nominated custodian of IT Assets. However, the documented policies were not made available to us though called for in July 2011.

4.7.8.2 Inadequacies in Third Party Management

NIC is responsible for supply of the software and for solving software related problems in all the offices across the State. On registration of vehicles in accordance with provisions of the MV Act and CMV Rules by the Department, access to the relevant data in VAHAN is provided to M/s RTPL for printing and issuing of smart card. Similarly, on certifying an applicant for licence by the Department, necessary entries are made in the SARATHI and access is provided to M/s RTPL for printing and issue of Smart Card. In this connection, we noticed the following:

- Information System Audit is an important detective and corrective control for ensuring the adequacy of all data integrity and security related controls. Periodic IS Audit by a qualified third party auditor is part of the best practices followed in the industry as also national or international standards for adoption of Information Technology. Even after two years of implementation, independent IS audit by a third party has neither been arranged nor envisaged. The Department accepted the same.
- The role of NIC with reference to the maintenance of VAHAN has not been defined. A Memorandum of understanding was entered with NIC by the Ministry of Road Transport and Highways, Government of India at the national level for the mission mode project to be implemented by the State Governments. However, there was no clear demarcation of duties/responsibilities between the Department and NIC, with reference to ensuring systems reliability and integrity.

4.7.8.3 Non/under utilisation of VAHAN

As of November 2011, 21.97 lakh RC and 22.45 lakh Smart card based DLs have been issued. RC Smart cards in respect of transport vehicles were being issued only in five RTOs in Bangalore from 1 May 2010. Issue of RC Smart cards for transport vehicles in other RTOs and collection of taxes in respect of transport vehicles through VAHAN had not commenced (December 2011).

We noticed that many of the modules like Surrender of vehicles, Demand Collection and Balance, Department Statutory Authority cases were not being used even as of November 2011.

The State NIC stated that the Department is required to prepare a task and targets document containing various activities related to effective implementation in all the RTOs.

4.7.9 Mapping of Business Rules

The Department is mainly concerned with regulation of the use of motor vehicles in the State and collection of tax on motor vehicles in accordance with the provisions of the Acts and Rules. The various provisions of the Acts and Rules and other relevant regulations prescribe procedures for activities like registration, tax collection and tax refunds. The VAHAN application system does not incorporate business rules relevant to certain activities of the RTOs. This limits its usefulness and encourages dependency on parallel manual procedures. We noticed non-mapping of rules in the following areas:

4.7.9.1 Jurisdictional organisation of RTOs

As per Section 40 of the MV Act, every owner of a motor vehicle shall cause the vehicle to be registered by a registering authority in whose jurisdiction he has the residence or place of business where the vehicle is normally kept. Accordingly, the RTOs have been assigned jurisdiction over specific areas.

We observed that the VAHAN has not been supported with the master data of jurisdiction of each RTO based on Postal Index Number code to enable the system to process the application for registration of the vehicles whose owners are residing in the jurisdiction of the concerned RTO and disallow and redirect

other applications to the concerned RTOs.

For instance, we verified the details of address from the registration databases of two RTOs⁵ and noticed 17 cases of registration which belonged to the jurisdictional area of other RTOs.

After we pointed out, the Department stated (December 2011) that this requires accurate identification and notification of areas and that the suggestion will be considered in consultation with the Government and NIC.

4.7.9.2 Transfer of ownership of Government vehicles

Under Rule 57 of the CMV Rules, the person who has acquired or purchased a motor vehicle at a public auction, conducted by or on behalf of the Central/State Government, shall make an application within 30 days of taking possession of the vehicle, to the registering authority who shall record the entries of transfer of ownership of the vehicle. In Karnataka, vehicles owned by Government Departments are exempted from payment of motor vehicle tax and are assigned registration number of a specified series. When the ownership of the vehicle changes to a new owner other than a Government Department, it shall be assigned a new registration number of any other series. The new owner is required to pay the tax based on the category and the class of the vehicle.

We noticed that on recording transfer of ownership of a Government vehicle to an owner other than a Government Department, VAHAN does not prompt for assigning a new registration number to the vehicle and for levy and collection of the tax due. Even after the changes are effected in the owner status and change in registration number, the system fails to prompt for demand and collection of tax.

We noticed from the databases analysed 15 instances of such re-assignments in three RTOs⁶ where no further information on payment of tax was available. On field verification of these cases, we found one

instance of a vehicle transferred from State Government to individual owner which had escaped payment of tax in RTO, Tumkur.

⁵ Bangalore (East) and Bangalore (North)

⁶ Bangalore Central, Bangalore North and Tumkur

The Department reported that provision has been made to demand tax when a Government vehicle is transferred to an individual owner and referred the matter to NIC for further information. The State NIC stated that the transfer of ownership of Government vehicle is to be adopted through reassignment option of VAHAN software for changing the vehicle registration number and then apply for transfer of ownership.

The Department may therefore in coordination with NIC take necessary action for existing and future cases accordingly.

4.7.9.3 Advance reservation of registration number

Under Rule 46-A of the KMV Rules, any person who desires to reserve any registration mark may apply in advance to the concerned registering authority, who shall, on receipt of the application and the prescribed fee, reserve registration mark applied for in favour of the applicant. The fee for reservation of advance registration mark within the range of one thousand registration marks from the first registration mark or the registration mark last assigned in the serial order is ` 6,000 for two wheelers, ` 20,000 for light motor vehicles (both transport and non-transport) and ` 30,000 for other vehicles. Fee of ` 25,000 for two wheelers and ` 75,000 for light motor vehicles is leviable for reservation of any registration mark within the range of one thousand registration marks from the next series of the series which is in

Under the KMV Rules, registration mark is assigned to motor vehicles by registering authorities in a serial order on payment of registration fee, after inspection of the vehicle, approval for registration and entry of data into system. The front end trial with test data and analysis of data of the registration module revealed the following:

- The date of approval of the registration is not captured in the database. Comparison of the registration number and the date of registration vis-à-vis the series in operation on those dates revealed 168 instances in five RTOs⁷ where registration numbers assigned were not in seriatim. Since the date of

approval was not being recorded in the database/system, the chances of manipulation by delaying the approval for registration till such time as the number of the vehicle owner's choice comes up in natural order cannot be ruled out. The Department therefore stands to lose out on revenue of fees for 'choice' numbers.

After this was pointed out by us, the Department and the project co-coordinator (NIC) stated that the VAHAN system has a provision of generating the registration number automatically based on the order of the applications received on a particular day. However, FIFO (First-In-First-Out) method of clearing transaction is not enabled, but can be enabled based on the need of the Department.

⁷ Bangalore Central, Bangalore East, Bangalore North, Tumkur and Ramanagara

4.7.9.4 Demand for tax on expiry of exemption period

The KMVT Act prescribes levy of lifetime tax in respect of motor cars, omnibuses and private service vehicles. The Government exempted electric vehicles from payment of tax for a period of five years from the date of registration.

We noticed that though the registration of electric vehicles was done by giving the exempted status, the system does not prompt for collection of tax on expiry of exempted period.

4.7.9.5 Refund of tax

As per Section 7 of the KMVT Act, the registered owner who has paid lifetime tax on a vehicle shall be entitled to a refund of tax at the rate specified in Part C, Part CC, Part C1 to C5 in the case of removal of the vehicle to any other State on transfer of ownership or change in address or cancellation of registration mark on account of scrapping of such vehicle due to accidents or other causes.

We observed that the refund activity has not been incorporated in the application system and refunds are processed manually.

After we pointed out, the Department stated that request was made to the NIC in respect of facility for computation of refund of tax. The NIC also agreed that the refund provision is not currently available in VAHAN. However, the same

can be incorporated based on the functional requirement of the Department.

4.7.9.6 Transfer of records to newly created RTO on change of jurisdiction of RTO

We noticed that the system does not have specific mechanisms incorporating all the modalities involved in the transfer of entire information pertaining to vehicles that are transferred to the jurisdiction of other RTOs as a result of formation of new RTOs or reorganization of jurisdiction of RTOs. In the absence of a specific, documented and standardised procedure for the same, this task is addressed in an adhoc manner.

We observed, for instance, that in RTO Indiranagar, a list of cases which were transferred to the jurisdiction of RTO, K.R.Puram based on jurisdiction was uploaded to the NOC module of VAHAN application system. This resulted in transfer of control of the vehicles to the new RTO without transfer of history data of the vehicle to the concerned new RTO.

The State NIC accepted the possibility of incorporating a mechanism of transfer of records on change of jurisdiction provided such jurisdiction is defined on standard parameters like Postal Index Number (PIN) Code or Ward Number.

4.7.10 Data accuracy

4.7.10.1 Digitisation and porting of legacy data

Introduction of VAHAN and SARATHI application systems in the RTOs necessitated digitisation of all the existing manual records and porting of the legacy data from the database of previous software modules of registration, permits, licences etc.

4.7.10.1.1 The agreement with M/s RTPL stipulated nine months period from the date of agreement (25 February 2009) within which to complete the digitisation of manual records in all RTOs and obtaining of 'Data Entry Completion Certificate' from all RTOs and submission of the same to the Transport Department. We observed that the agreement does not provide a penal clause for non-completion of digitisation of legacy data within the stipulated period. We noticed that M/s RTPL has not submitted 'Data Entry Completion Certificates' in respect of any of the RTOs as of October 2011.

The details of number of RCs required to be digitised, actually digitised as of October 2011, RCs yet to digitised and percentage of RCs digitised in the test checked eight RTOs were as under:

RTO	RCs issued as on 31 March 2007	Details of legacy data available in the database pertaining to period upto 31 March 2007	Difference	Percentage of RCs digitised
Bangalore East	580610	579467	1143	99.80
Bangalore North	417801	484686	-66885	116.01
Bangalore Central	377296	327929	49367	86.92
Tumkur	166163	1698	164465	1.02
Ramanagara	41983	12038	29945	28.67
Chamarajanagar	45530	3142	42388	6.90
Mangalore	228868	435	228433	0.19
Dharwad	243744	128797	114947	52.84

It would be seen from the above that digitisation work has not been given due importance in the RTOs outside Bangalore district. Data analysis of the legacy data revealed records with redundant, invalid or incomplete data. The 66,885 records in excess of actual RCs digitised in Bangalore North indicate the possibility of entry of Junk/redundant records.

The Department agreed that there is no penalty clause for non-completion of entry of legacy data and that the same is still under progress and not been completed. The RTOs will furnish completion certificates after the completion of all legacy records.

4.7.10.1.2 Porting of data from the database of earlier software to the VAHAN and SARATHI database was entrusted to NIC. Out of 13 RTOs which had database in earlier software, the legacy data has been ported into the database of VAHAN only in respect of five RTOs in Bangalore. In the offices where the porting has been completed, it has been done without proper planning and checks to ensure that only relevant, accurate, reliable data are imported. As a result, in the three offices test checked (Bangalore Central, Bangalore East and Bangalore North), the legacy data that is processed by the application systems has several data inconsistencies as illustrated below:

- Name of vehicle owners were not captured in 2,756 cases and addresses were not captured in 5,928 cases.
- In 636 cases irrational dates of registration (like 01/0101900) were shown. This was at variance with the manufacturing year mentioned in the database.
- Owner names were mentioned as "CC issued to such and such office" and were still retained in the registration database in 3,492 cases.
- Duplicate chassis numbers were recorded in 73 cases and duplicate engine numbers were recorded in 10,683 cases.
- Seating capacity of vehicles (having codes relevant to two wheelers) were recorded as ranging from 3 to 125 in 1,408 cases. We noticed that many of these vehicles are four wheelers for which the vehicle codes of two wheelers have been wrongly assigned.
- Irrational Manufacturing Years like 9585, 2200 etc were shown in 47 cases and invalid registration numbers like "00KA043313" were captured in five cases.
- In 18 cases of migrated vehicles where new registration marks were assigned, the reassignment database had the same number for old and new numbers.
- In 4,236 cases though vehicles migrated from other States were already assigned new registration number in Karnataka, the database of registered vehicles still retained records with old registration number. Further, of these, there were 3,276 records with the respective newly assigned number also in the database of registered vehicles. This resulted in inflated number of registered vehicles in the database and vehicle records with incorrect registration number.
- There were gaps in tax collection data in respect of 1,732 vehicles in the RTOs test checked. This is possibly due to the failure of records relating to collection of quarterly taxes for transport vehicles accounted through earlier software to port into VAHAN database.

After we pointed out these, the Department stated that the matter has been referred to NIC for further information and that replies would be furnished in due course after examination of details. The State NIC opined that such inconsistency in the data was due to absence of a clean up exercise which should have been undertaken by the Department prior to porting into the current database. During the exit conference, while accepting views of audit, Department stated that action would be taken to address the problem.

4.7.11 Incomplete/invalid data

Our analysis of the database of VAHAN has revealed the following invalid/redundant data:

4.7.11.1 Duplication of Permit Numbers: The process of issue and renewal of permits is carried out through the RTA software and the VAHAN database captures the details of permits like date of issue, permit number, validity, renewal date etc.

In 80 cases in three RTOs⁸, the permit number issued to two different vehicles owned by different persons were the same. These permits were owned and renewed simultaneously by the owners. However, verification of manual records revealed that these were due to data entry errors committed during renewal of permits.

The State NIC has agreed to look into specific cases of duplication.

4.7.11.2 Duplication of chassis number and engine numbers: The chassis number and engine number of each registered vehicle shall be unique to that vehicle. The same control should also be embedded in the information system for effective management of the vehicles database.

We noticed that the field for engine number was not ensured for unique data in respect of each vehicle. We noticed that 795 cases of same engine numbers were found against two different vehicle numbers in the databases of six RTOs⁹. In instances where registration proceedings initiated for a vehicle was left incomplete with an inward number and proper registration number was assigned in the second attempt through backlog channel with slightly modified chassis number instead of completing the registration process by updating the original entries made, duplication of engine number resulted. In RTO, Koramangala, for 83 duplicate engine numbers, two or more RC smart cards have been generated and sanctified with different registration numbers. We noticed that in these cases, the only difference in data was a 'dot' suffixed for the chassis number. We sought for the physical records relating to the RC smart cards in respect of the above 83 cases for verification out of which records were made available in one case. We noticed that the registration numbers were for two different vehicles owned by different persons for which data entered was the same.

Though there were application controls to ensure unique chassis number, instances of bypassing the existing control by altering the chassis number slightly such as inserting space or additional character/s to make the system accept the entry were noticed. In cases of reassignment of registration marks to vehicles migrated from other States also, system was made to accept chassis number which was already existing with the old registration number. Thus, the system was incapable of identifying and tracing the history of a vehicle even within the same RTO, which is an essential feature particularly to prevent registration of stolen vehicles, parts etc.

In addition, the integrity not only of the database of vehicles but of the State and National register is also compromised in having multiple entries pertaining to the same vehicle. It was possible, for example, to trace both the duplicate instances of the same vehicle to the National Register access provided at the website <https://vahan.nic.in/nrservices>. It is thus clear that the necessary filters are not established in the data mining operation that draws data of vehicles to the National Register.

This also points to the absence of adequate organisational supervisory controls regarding reporting of the difficulties in the application software by the users

⁸ Bangalore Central, Bangalore East and Bangalore North

⁹ RTOs Bangalore Central, Bangalore East, Bangalore North, Tumkur, Chamarajanagar and Dharwad

at various levels to top management for technical solution instead of resorting to bypassing methods.

After we pointed out this, the Department stated that circular has been issued to RTOs regarding entry of correct data and that the matter was referred to NIC. It was also mentioned that sufficient training has been given to the Departmental staff. During the exit conference, the Department agreed to discuss the issue with the NIC to sort out the problems.

We recommend that the Department impart sufficient training and create awareness in the staff. The Department may also issue specific instructions to the data entry personnel to make sure that back log channel is not to be invoked to complete a current transaction that was initiated through the proper channel.

4.7.11.3 Presence of unapproved cases of registration of vehicles in the database: At the time of new registration, a vehicle is initially assigned an inward number. This number is required to be replaced by the Registration number finally to be assigned to the vehicle.

We noticed in the database of the six RTOs test checked that 8,639 inward numbers have not been replaced by the Registration numbers finally allotted to the vehicles. The age-wise analysis of the cases apparently pending approval in the system database is given below:

RTO	Inward number		Total
	Up to 2009	in 2010	
Bangalore Central	222	256	478
Bangalore East	131	47	178
Bangalore North	208	74	282
Tumkur	25	79	104
Mangalore	16	4	20
Dharwad	7,516	61	7,577
Total	8,118	521	8,639

This indicates absence of the required policies and controls by which entries that have not been approved are deleted after a prescribed period. We test checked 10 cases of unapproved inward numbers on the National Portal and found that these records existed in the National Register.

The Inward numbers continue to be present in the National Register, so whether the vehicle is registered or not is not known.

A certain delay in the completion of transaction being inevitable, the application system as well as the data mining procedure for updation of National Register should have sufficient controls to check such entries.

4.7.11.4 Insurance Details: Insurance details like cover note number, date from and upto which the policy is valid, etc were not captured in 11,732 cases in the databases of the eight RTOs test checked. Also, 1,009 records have the same covering note issued by the same insurance company being recorded against more than one vehicle. In 29,285 cases even RC smart cards do not contain information on insurance like insurance company name, cover policy

number, validity period etc. This would indicate that the system has no controls to ensure input of essential information.

4.7.11.5 Invalid Sale Amount for Non-Transport Vehicles: We noticed from the database that in respect of 1,456 non-transport vehicles (cars/two wheelers), which have been registered after the introduction of VAHAN, sale value has not been captured. In 1,342 other cases, the sale amount field has captured random values like '999', '9999'.

4.7.11.6 Invalid data in fields related to determination of quarterly tax: Under the KMVT Act, quarterly tax is levied based on the laden weight for goods vehicles. Passenger transport vehicles are liable to tax at the specified rate depending on floor area, seating capacity, etc. The nature of permit obtained by the owner of the transport vehicle is also a critical data in determining the tax liability. Capturing accurate data for these fields was critical for VAHAN as a reliable and effective information system.

Our analysis of the database revealed the following:

- In 21 cases of Private Service Vehicles/Omnibuses registered through VAHAN, floor area was not captured.
- The wheel base field accepts values in either centimetres or millimetres resulting in a range of wheelbase values from one to 17170 in RTO, Bangalore Central, one to 31500 in RTO, Bangalore East and one to 13250 in RTO, Bangalore North. This defeats the efficacy of the software in limiting the seating capacity in accordance with the provisions of the KMV Rules, as also in ensuring correct fixation of quarterly tax payable by the vehicle owner.

The Department stated that the matter has been referred to NIC for information. The NIC has agreed to examine the cases. Further report is awaited.

4.7.12 Ineffectiveness of system in preventing leakage of revenue

4.7.12.1 Levy of lifetime tax

At the time of payment of fee for registration of non-transport vehicles, the tax collection module of VAHAN accepts entry of data into the sale value field and calculates lifetime tax which would be collected and a receipt is issued. However, the sale value entered through tax collection module is not updated in the registration record of that vehicle, but it requires the case worker to re-enter the same.

This design weakness along with absence of supervisory controls facilitates possible entry of lower sale value at the time of tax collection and subsequently to enter the correct amount for registration certificate. Data analysis revealed variation in amount of tax calculated on sale value recorded in the database and the amount of tax actually paid to the extent of ` 16.59 crore in 3,632 cases in six RTOs¹⁰. On examination of physical records in 279 cases at these RTOs to verify the correctness of the tax calculated on the sale

¹⁰ Bangalore Central, Bangalore East, Bangalore North, Ramanagara, Mangalore and Dharwad

value, we noticed actual short levy of tax of ` 64,417 in 20 cases. The Department has not responded on recovery of taxes on these vehicles which have been registered with incorrect sale value.

After we pointed out this, the NIC has reported that the issue was discussed with the Department and the option of changing the sale amount in the registration record by the case worker during data entry after tax payment has been disabled. It was also agreed to provide a facility to approving authority for automatic checking of tax collected in comparison with sales invoice entered by the treasury/registration clerk.

4.7.12.2 Under the KMVT Act and Rules made thereunder, transport vehicles are liable to pay tax for each quarter in advance. Accordingly, demand for tax due is to be created in each RTO in respect of all the transport vehicles registered in that Office (home RTO). Vehicle owners are permitted to pay tax in any RTO in the State. The tax paid by the vehicle owners are collected through “Tax Collection” module of VAHAN and accounted for receipts of the RTO.

The application system also provides a “manual tax or fee collection” module to enter details of tax paid at other RTOs such as challan number, date, period for which tax is paid, RTO at which payment has been made etc. to enable the home RTO to collect tax for subsequent periods.

Our cross verification of “Tax Module” table and “Manual tax or fee collection module” revealed that the details of tax paid recorded in the “Manual tax or fee collection” module are not found in the “Tax Module” table. Thus, in absence of the complete details, in the “Tax Module” table the amount of tax and fees due from a vehicle cannot be ascertained.

We further noticed that though the Manual Tax module was designed to record the details of the taxes paid by a vehicle owner at the RTOs other than the RTO in which he was registered, it was incorrectly being used by the parent RTO itself. We noticed 317 such instances in three RTOs.

The system that permits settlement of arrears based on details of tax paid at other RTOs should have adequate controls by which the veracity of such payments can be ensured. We observed that the system does not incorporate any control by which these transactions may be supervised, verified or reconciled as below:

- As the RTOs have not been networked, the payment of tax in other RTOs in the State cannot be accounted against the tax demand in the home RTO on real time basis. As a result demand position would remain overstated/unreconciled when taxes were paid in other than home RTOs.
- The tax collection module at the time of payment of quarterly tax of a vehicle in the home RTO alerts the case worker regarding the arrears position of tax from that vehicle. However, if the owner of the vehicle pays tax for any quarter/year in a RTO other than the home RTO, the system accepts the payment and issues receipt.
- There were no system controls to ensure the authenticity of the entries made through “manual tax or fee collection” module. As there is no

method of cross verification with the other RTOs where the payment is actually made and the home RTO where the vehicle is registered. We noticed 13 instances where “manual tax or fee collection” was recorded at RTO, Indiranagar but the same were not traceable to the tax collection database of the RTO, Indiranagar.

- The Department has standardised the format for receipt number having two characters followed by seven digits. This format was not adopted in the database structure to validate entries to this field of this module. As a result a record can be generated with any random entry to the field.

These weaknesses in design is a potential risk which permits transactions to be carried out without collection of revenue due to Government and compromises the effectiveness of VAHAN as an accounting system in preventing leakage of revenue.

After we pointed out these, the Department stated that the matter has been referred to the NIC for further comments. Final reply has not been received.

We recommend that the Department may consider sharing the tax payment database backup with the concerned RTOs periodically. Also, since the databases of all RTOs are being uploaded into the SCR on a daily basis, possibility of establishing reconciliation among the RTOs and disseminating of differences to concerned RTOs may be considered.

4.7.12.3 Mode of tax payment–Inadequate integration between Registration and Taxation Modules

In the VAHAN system, registration module assigns code for mode of tax payment for each vehicle based on class of the vehicle, eligibility of owner etc to facilitate tax collection module to levy and collect the applicable tax or to allow eligible exemption. Our analysis of these fields in the RC database and testing of the front end with test data revealed the following:

- Under the KMVT Act, though tax exemption is admissible only to Government vehicles, it was also possible to assign exempted status to other owners at the time of data entry. We noticed that in the database in 389 records, exempted status was shown against individual owners liable for lifetime tax.
- We noticed from Tax Module “Taxation Table” that though the vehicle owners of 191 vehicles were paying tax either annually or quarterly but these were recorded as life time tax payers in the Registration Module in “Owners Table”. Thus correct position of tax due against the owners of vehicles was not ascertainable.
- In seven cases where vehicles were registered under annual tax option they had made LTT payment.

The Department stated that the matter has been referred to the NIC for further comments.

4.7.12.4 Clearance of tax

The VAHAN application system offers the facility to clear tax in respect of vehicles for specific periods. The tax clearance module is independent of tax payment modules in as much as it provides clearance for periods for which there is no evidence for payment of tax in either the tax module or the manual tax payment module.

The reasons for providing such a facility has not been documented and not made available to us. An effective information system would provide for processing of all legitimate transactions of the organisation through proper front end channel and any difficulty/error in processing of information shall have adequate trouble shooting techniques. Any arrangements/facilities provided to by-pass the workflow and complete the transaction would make the system vulnerable to misuse. The databases of RTO Bangalore Central, Bangalore East and Bangalore North where transport operations were initiated in May 2010, there are 1,080 instances where tax has been cleared for periods after June 2010 for vehicles though payments for the same are not represented in either tax module or manual tax module.

The Department stated that the matter has been referred to the NIC for further comments and that the latest VAHAN version (1.3.45 prime) has incorporated biometric control to prevent misuse of this provision.

4.7.12.5 Past Arrears not cleared with current acceptance of taxes

Data analysis also revealed that in respect of 87 vehicles in two RTOs¹¹ though there were arrears of tax for earlier periods ranging from less than a month to more than a year, tax for subsequent periods were accepted, without clearance of past arrears.

The DCB module integrated with VAHAN does not capture such instances where intervening periods are in default. This points to imperfect design of the DCB, affecting the dependability of the demand position as presented by it.

Our test check of records at the field offices, however, failed to reveal any instance of actual escapement either since the missing payments was collected manually or records pertaining to payment were not ported into the database.

The Department stated that specific instances were referred to NIC for clarification. The NIC explained that such gaps in tax payment data might be due to failure on the part of the Department to update payment records in the previous application system prior to porting into the present system in May 2010. The explanation does not, however, account for tax gaps that have occurred after May 2010.

4.7.12.6 Issue of No Objection Certificate/Clearance Certificate

Under the CMVT Act and Rules made thereunder, vehicles migrating from one State to another shall obtain a No Objection Certificate (NOC) from the parent RTO and produce the same before the RTO of the migrated State for registration in that State. Similarly for a vehicle migrating from one RTO to another within the State due to change of address or ownership, a Clearance Certificate (CC) is required to be obtained. The NOC/CC certifies the vehicle

¹¹ Bangalore Central and Bangalore North

with regard to tax paid, clearance of offences booked against the vehicle, if any, etc.

We noticed on comparison of data of NOC/CC module with tax collection module data of three RTOs¹² that in 147 instances NOC/CC were issued even though there were arrears of tax from those vehicles.

The Department stated that the matter was referred to the NIC for further information and that specific cases will be separately replied to by the RTO concerned. Reply of the concerned RTOs has not been received (January 2012).

4.7.13 Data Safety and Security

4.7.13.1 Information System Security

Logical Access Controls

We made the following observations in connection with the logical access controls present in the VAHAN application system.

4.7.13.1.1 The RTO is the designated system administrator at the unit level. However, the Department has not formulated a comprehensive Security Policy Document outlining the procedural issues and other details relatable to logical access controls, approved at the highest level and distributed at the level of all users.

4.7.13.1.2 The designation based assignment of roles prevailing in the Department is not built into the system as a result of which it is possible to assign even supervisory roles to non-supervisory staff.

We noticed in RTO, Bangalore (East) that the privilege for clearance of fitness certificate was assigned to a Clerk and also the Inspector of Motor Vehicles who is the competent authority under the CMV Rules for issue of fitness certificate.

4.7.13.1.3 The Department has assigned different privileges to different people. However, front end analysis of application system showed that the same user could be given permissions for various processes in an activity like:

Registration: data entry, superintendent approval and approval of registration.

Backlog data: Backlog data entry and back log approval.

Fitness certificate: Data entry and approval for fitness certificate etc.

4.7.13.1.4 As per International guidelines for adoption of information technologies like COBIT (Control Objectives for Information and related Technologies), the computerised entity has to formulate controls for password setting, password change etc. We noticed that the VAHAN application system does not incorporate controls in relation to password setting, change etc. Front end analysis revealed that the system does not require passwords to adhere to a minimum length of at least eight characters with a combination of alphanumeric and special characters. The system does not prompt for change of password after a specified period of time. There is also no provision to

¹² Bangalore Central, Bangalore East and Bangalore North

effect lockout after a specified number of failed login attempts. The system also permits the assignment of username itself as password.

The Department stated that the matter has been referred to NIC for further details/reply. The NIC agreed that the matter of strengthening of passwords will be addressed in consultation with the Department.

4.7.13.2 Audit Trail

A standard audit trail provides for recording and monitoring of database activity. The NIC team during discussion has affirmed the existence of audit trails at the level of the RDBMS (Relational Database Management System), application system and database table level triggers for audit purpose. However, the same has not been made available to audit and hence its adequacy could not be ascertained.

4.7.13.3 Backlog data entry module

Digitisation of legacy data is provided with separate backlog data entry module by which data finds its way to the database of the system. In the interest of data security, entry of legacy data should be done, completed and closed under close supervision. After the completion of the task, the backlog data entry module should be disabled permanently. Otherwise, the back log channel is a vulnerability that can be used to create manipulated records that do not exist in manual form.

The backlog data entry module of the VAHAN application system requires the entry of the vehicle number. There is no input restriction in the module to disallow a RC number that is yet to be assigned by the RTO or to disallow entry of record with transaction date which is subsequent to date of computerisation. Thus, it is possible to enter a registration number ahead of its assignment by the same RTO and create an RC.

The Department stated that the matter has been referred to NIC for further details/reply. Further the Department also stated that data entered is validated by the case workers, which is a continuous process of updation whenever transactions occur. During the exit conference, Government accepted our views.

4.7.13.4 Smart Card Registration Certificates

After the introduction of VAHAN application system during July 2009, the Department was issuing RC in the form of Smart Cards. On payment of the registration fee and tax and on completion of the procedures involved in approval of registration in accordance with MV Act and CMV Rules, the registration is approved through VAHAN software. The details of registration are then recorded in a table in the VAHAN Software. Data to be printed on the RC smart cards is transferred to the card printing system as flat files. After printing and recording, the cards are 'sanctified' through digital encryption. The data in the sanctified table is recaptured in VAHAN database.

Our analysis of the data captured on approval of the registration and data captured after sanctification of cards in the VAHAN application system revealed the following mismatches:

- In 83 records in four RTOs¹³, the names of owners were spelt differently in both the tables.
- In 24 records in four RTOs¹⁴, the chassis numbers were different in the two tables.
- In 14 records in four RTOs¹⁵, the engine numbers were different in the two tables.
- In 25 cases, in RTO, Bangalore East, records from the database of sanctified cards could not be traced in the database of approved cases.
- In 42 cases, in RTO, Bangalore Central, the dates of registration of Motor Vehicles fall on holidays i.e. Sundays, second Saturdays etc.

Even though the variations are not materially significant, these nevertheless indicate the possibility of insertion/modification after approval and prior to smart card printing, probably during the flat file stage.

The Department stated that the matter has been referred to the NIC for further information. The State NIC stated that a mechanism of ‘personalisation’ where the data on the smart card is verified with respect to that of the approved entry prior to ‘sanctification’ existed in the application system and where such mismatches are there, the cards would be rejected. However, as stated above, smart cards with the mismatches have been issued.

SARATHI APPLICATION SYSTEM

Planning and Implementation

4.7.14 Inadequacies noticed in Third Party Management

On certifying an applicant for licence by the Department, necessary entries are made in the SARATHI and access is provided to M/s RTPL for printing and issue of smart card.

- The role of NIC with reference to the maintenance of SARATHI has not been defined. A Memorandum of understanding was entered with NIC by the Ministry of Road Transport and Highways, Government of India at the national level for the mission mode project to be implemented by the State Governments. However, there was no clear demarcation of duties/responsibilities between the Department and NIC, with reference to ensuring systems reliability and integrity.

Data accuracy

4.7.15 Issue of more than one Licence to the same Person

The CMV Rules stipulate that an individual should not be in possession of more than one driving licence. However, the SARATHI Application does not incorporate controls by which to ensure that the same person is not issued with

¹³ Bangalore (East), Bangalore (North), Tumkur and Chamarajanagar

¹⁴ Bangalore (East), Bangalore (North), Tumkur and Chamarajanagar

¹⁵ Bangalore (East), Bangalore (North), Tumkur and Chamarajanagar

more than one licence. The database of issued licences of six RTOs¹⁶ contain 718 instances where the same person (identified by name, father's name and date of birth) have been issued with two or more licences (bearing different licence numbers).

After we pointed out these cases, the Department referred the matter to the NIC for further information. The NIC also has agreed to look into the specific cases.

Other implementation issues

4.7.16 Smart Card Readers

One of the objectives of computerisation of Transport Department was to enable the issue of RC and DLs in the form of Smart Cards complying with the Smart Card Operating System for Transport Application (SCOSTA) Standards. After printing of the card and encoding the smart card chip, each card is 'sanctified' before issue. Sanctification is a process by which the information recorded on the chip is digitally attested using two encryption keys allotted to the RTOs. A card without sanctification is not deemed to be authentic.

However, we noticed that the smart card readers provided to the RTOs, MVIs etc., are not technically equipped to verify whether the smart card is sanctified or not. Neither are the readers able to detect tampering with the data after sanctification, as the information of the encryption keys is not available in them.

Absence of proper detection devices can defeat the purpose of the high level of security envisioned in the process of digital attestation.

The Department stated that the matter has been referred to the NIC for further comments. The NIC has stated that the card readers can be equipped to identify non-sanctified/modified cards by use of an Endorsement Authority Card which was in the possession of the Department. Once the Endorsement Authority cards are issued to field level officers, it would enable effective monitoring of genuinity of the smart card issued by the RTOs. The Department, though in possession of the Endorsement Authority Card, has not furnished any reasons for non-issue of the same to field level officers for use.

Thus the issue of tamper proof/encrypted Smart Cards, remained unresolved and was not implemented.

4.7.17 Conclusion

Introduction of VAHAN and SARATHI application systems was undertaken with a view to improve the over all efficiency of the Transport Department and to enable better service delivery. RTOs outside Bangalore are yet to undertake registration, tax collection or issue of smart cards in respect of Transport Vehicles. The module for generating DCB has not been made operational by RTOs, arrear of tax were not being cleared while accepting

¹⁶ Bangalore Central, Bangalore East, Bangalore North, Chamarajanagar, Ramanagar and Tumkur

current taxes and NOC's were issued though arrears were pending. Other functions like surrender of motor vehicles, collection of penalties pertaining to Departmental Statutory Authority cases etc are also being done manually. In absence of networking of RTOs, a number of essential controls, like reconciliation of payments made at other offices, prevention of registration of illegally acquired vehicles at a different RTO etc could not be brought into the realm of information technology. Design weakness in VAHAN together with absence of supervisory controls enabled entry of incorrect sale value of the Vehicle in the Tax Module resulting in short levy of tax. Lack of essential input validation controls in the system and absence of supervisory controls enabled habitual bypass of system controls by data entry operators leading to accumulation of junk, invalid and redundant data in the VAHAN and SARATHI databases, in turn compromising the integrity and reliability of State Registry and National Registry of Vehicles/Licenses.

4.7.18 Recommendations

In view of the various findings detailed above, we recommend that the Department:

- **Formulate and adopt a comprehensive IT Policy encompassing aspects as technology upgradation, service delivery, staffing and security to serve as a roadmap for future development;**
- **Strengthen application controls so as to ensure better mapping of the provisions of the relevant Acts and Rules;**
- **Complete the entry of legacy data and porting of legacy database on priority in a planned and time bound manner followed by permanent disablement of the back log data entry channel;**
- **Adopt a comprehensive programme of Human Resource Development involving induction of technically qualified functionaries at various levels of Information Systems Management, providing training in the various aspects of database, network and security administration etc.;**
- **Network all the RTOs in the State to enable real time communication between them, enabling better monitoring and service delivery;**
- **Adopt more secure means of interfacing with the smart card printing software and introduce Smart Card reading devices that adopt such technology as would enable detection of absence of digital attestation, tampering with data etc.;**
- **Strengthen the security infrastructure by adoption of a well formulated security policy, introduction of logical access controls in tune with best practices, enabling of a trail of user actions etc.;**
- **Bring about such operations as the generation of the DCB, monitoring and settlement of Departmental Statutory Authority (DSA) cases etc also in the ambit of information technology; and**
- **Migration to a web based system by which the general public can gain direct access to the services offered by the Department for registration, payment of fees, taxes etc will substantially improve the effectiveness of the Department in achieving the objectives of e-Governance.**

4.8 Non-observance of provisions of the Act/Rules

The KMVT Act, 1957 and the KMVT Rules, 1957 provide as under:

- Sections 3 and 3A for levy of tax and cess on tax in respect of all vehicles suitable for use on road at the rates specified in the Schedule to the Act.
- Section 4 for payment of tax so levied to be paid in advance by the registered owners for a quarter or half year at his choice, within fifteen days from the commencement of such period.
- Section 12 for composition of offence for non-payment of tax in accordance with the provisions of the Act. The KMVT Rules provide for composition of the offence on payment of a sum at 20 per cent of the arrears of tax due.

We noticed in 22 RTOs that the above provisions were not fully followed by the concerned taxation authorities. This resulted in a number of discrepancies with short realisation of Government revenue amounting to ` 64.32 lakh. Of these, the Department accepted audit observations in respect of 392 vehicles involving ` 26.60 lakh and recovered ` 16.16 lakh in respect of 252 vehicles.

4.8.1 Non-payment of tax

17 RTOs¹⁷

Tax in respect of transport vehicles and non-transport vehicles owned by employees of Central Government, nationalised banks and Public sector undertakings is payable quarterly, half-yearly or annually at the discretion of the vehicle owner. Non-payment/short payment of tax constitutes an offence and the KMVT Rules provide for composition of the offence on payment of a sum at 20 per cent of the arrears of tax due. This shall be recovered along with arrears of tax by the taxation authority concerned.

We noticed from a test check of 'B' registers¹⁸, conducted between May 2009 and February 2011, non-payment of tax of ` 42.94 lakh in respect of 596 vehicles (308 transport and 288 non-transport) for different periods between April 2005 and May 2010. The composition amount leviable on this amounted to ` 8.59 lakh. The tax was not demanded by the concerned RTOs.

After we pointed out these cases, the Government/Department reported between April 2011 to October 2011 acceptance of the audit observations involving ` 23.10 lakh in respect of 361 vehicles and of that, recovered ` 14.34 lakh in respect of 225 vehicles. We have not received the replies in respect of the remaining 235 vehicles (January 2012).

¹⁷ Bangalore (North), Bangalore (South), Bagalkot, Bailahongal, Belgaum, Bidar, Bijapur, Chickballapur, Chickmagalur, Chitradurga, Hospet, Kolar, KGF, Mandya, Mangalore, Ramanagara and Yelahanka.

¹⁸ Registers maintained in the RTOs in which tax payments are recorded.

4.8.2 Short levy of lifetime tax

10 RTOs¹⁹

Upto 31 March 2003, the rates of lifetime tax for non-transport vehicles were fixed amounts based on the engine capacity and age of the vehicle. Thereafter, from 1 April 2003, the rates were fixed as a percentage of cost of vehicle. The provision to levy lifetime tax at rates as existed prior to 1 April 2003 in respect of vehicles which were registered prior to 1 April 2003 in other States and migrated to Karnataka after 1 April 2003 was deemed to be omitted with effect from 1 April 2007.

We noticed between May 2009 and May 2010 that 16 vehicles were converted as non-transport vehicles between May 2005 and August 2008 and 60 vehicles registered in other States were migrated between May 2007 and September 2009. As against lifetime tax of ` 24.74 lakh leviable, the taxation authorities concerned had levied tax of ` 11.94 lakh. We noticed that the taxation authorities had levied lifetime tax at pre-revised rates instead of at the rates which existed on the dates of conversion in respect of converted vehicles and at the rates as existed prior to 1 April 2003 instead of the rate which existed on the date of migration in respect of vehicles migrated after 1 April 2007. This resulted in short levy of lifetime tax of ` 12.79 lakh.

After we reported these cases to the Government in June 2011, the Government/Department reported between May 2011 and October 2011 acceptance of audit observations amounting to ` 3.50 lakh in respect of 31 vehicles and of that, recovered ` 1.82 lakh in respect of 27 vehicles in eight RTOs²⁰. We have not received the replies in respect of the remaining 45 vehicles (January 2012).

¹⁹ Belgaum, Bijapur, Chickballapura, Chickmagalur, Davanagere, Gulbarga, Karwar, KGF, Tiptur and Yadgir.

²⁰ Belgaum, Bijapur, Chickmagalur, Davanagere, Gulbarga, Karwar, KGF and Yadgir.

EXECUTIVE SUMMARY

Tax collection	In 2010-11, the revenue collection from stamps and registration fee was ` 3,531.08 crore, and the same had increased by 34 <i>per cent</i> over 2009-10 which was attributed by the Department to increase in registration of documents.
Absence of Internal Audit Wing	There was no Internal Audit Wing (IAW) in the Department, thus an important control mechanism is not being exercised. The Government was yet to decide on the proposal submitted by the Department as far back as July 2008. We had recommended in 2009-10 to Government to expedite the setting up of IAW. However, the Department informed us in September 2011 that the proposal is still pending with the Government.
Insignificant recovery by the Department of observations pointed out by us in earlier years	During the years 2006-07 to 2010-11, we had, through our Audit Reports pointed out non/short levy, non/short realisation of revenue amounting to ` 383.41 crore in 23 paragraphs. Of these, the Government/Department had accepted audit observations in 17 paragraphs involving ` 302.84 crore and had since recovered only ` 64 lakh. The recovery made by the Department is only 0.21 <i>per cent</i> of the amount involved in the total accepted cases.
Results of audit conducted by us in 2010-11	In 2010-11, we test checked the records of 104 offices of the Department and found non/short levy of stamp duty and registration fee, loss of revenue due to suppression of facts, undervaluation of properties etc in 108 cases involving ` 95.04 crore. The Department accepted underassessments of ` 3.22 crore in 12 cases pointed out during the year 2010-11 and recovered ` 25.37 lakh in 29 cases pointed out in earlier years.
What we have highlighted in this Chapter	In this chapter, we present illustrative cases of ` 7.39 crore selected from observations noticed during our test check of the offices of the Department where we found that provisions of the Act/Rules were not observed.
Our Conclusion	We have through our previous Audit Reports brought out cases of non-realisation of stamp duty and registration fee in respect of instruments not presented for registration. The Department had accepted these

	<p>observations. We had recommended in the Report for the year ended 31 March 2009 that the Department install a system for co-ordination with various Departments/agencies to monitor realisation of proper stamp duty and registration fee on instruments presented in those offices. However, we continue to bring to the notice of the Department cases of unrealised revenue on documents presented in other offices.</p> <p>Besides there were cases of short levy of stamp duty due to suppression of facts in General Power of Attorney, Joint Development Agreement and due to undervaluation of properties.</p> <p>The Department needs to improve the internal control system including enforcement activities to detect leakage of revenue and suppression of facts so that the weakness in the system is addressed and omissions of the nature detected by us are avoided in future.</p> <p>It also needs to initiate immediate action to recover the non-realisation, short levy, etc. pointed out by us, more so in those cases where it has accepted our contention.</p>
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CHAPTER-V: STAMPS AND REGISTRATION FEES

5.1 Tax administration

Receipts from stamp duty and registration fees in the State are governed by The Indian Stamp Act (IS Act), 1899, The Karnataka Stamp Act (KS Act), 1957, The Registration Act, 1908 and the Rules made thereunder. The levy and collection of stamp duty and registration fee is administered by the Stamps and Registration Department headed by the Inspector General of Registration and Commissioner of Stamps (IGRCS). There are 33 District Registrar (DR) offices and 235 Sub-Registrar offices (SRO) in the State.

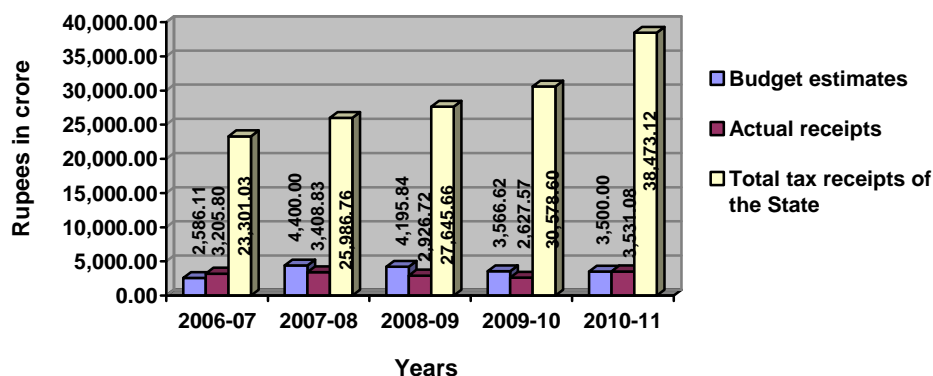
5.2 Trend of receipts

Budget Estimates (BEs) and actual receipts from stamps and registration fees during the years 2006-07 to 2010-11 along with the total tax receipts during the same period is exhibited in the following table and graphs.

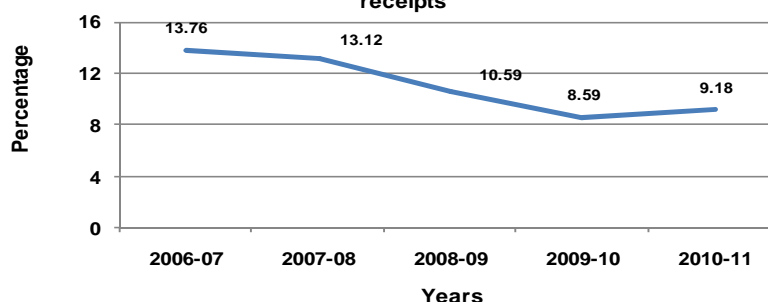
(` in crore)

Year	Budget estimates	Actual receipts	Variation excess(+)/shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
2006-07	2,586.11	3,205.80	(+) 619.69	(+) 23.96	23,301.03	13.76
2007-08	4,400.00	3,408.83	(-) 991.17	(-) 22.53	25,986.76	13.12
2008-09	4,195.84	2,926.72	(-)1,269.12	(-) 30.25	27,645.66	10.59
2009-10	3,566.62	2,627.57	(-) 939.05	(-) 26.33	30,578.60	8.59
2010-11	3,500.00	3,531.08	(+) 31.08	(+) 0.89	38,473.12	9.18

Graph 1 : Budget estimates, Actual receipts and Total tax receipts



Graph 2: Percentage of Actual receipts vis-à-vis Total tax receipts



It is seen from the table that revenue collection in 2010-11 increased by about 34 per cent as compared to 2009-10. The Department attributed the increase in revenue collection to increase in registration of documents. The variation between the BEs and actual receipts ranged between (-) 30.25 to (+) 23.96 per cent. The percentage of actual receipts in total tax receipts ranged between 8.59 and 13.76 during the five year period from 2006-07 to 2010-11.

5.3 Analysis of arrears of revenue

As per the information furnished to us by the Department in September 2011, the amount of uncollected revenue as on 31 March 2011 amounted to ` 77.57 crore. The year wise position of arrears of revenue for the period 2006-07 to 2010-11 as furnished is mentioned in the following table:

(` in crore)

Year	Opening balance of arrears	Amount collected during the year from the arrears	Closing balance of arrears	Percentage of collection to opening balance of arrears
2006-07	93.84	6.84	88.90	7.29
2007-08	88.90	11.32	77.65	12.73
2008-09	77.65	15.95	62.90	20.54
2009-10	62.90	4.83	60.53	7.68
2010-11	60.53	3.29	77.57	5.43

We observed that the closing balance of arrears computed were inaccurate. Thus, figures furnished were not reliable and needed reconciliation. Further, the percentage of collection of arrears to the opening balance of arrears ranged between 5.43 and 20.54 per cent for the years 2006-07 to 2010-11.

We recommend that the Department take remedial measures for reconciliation of figures as well as for improving the collection of arrears of revenue.

5.4 Cost of collection

The gross collection in respect of stamp duty and registration, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2008-09, 2009-10 and 2010-11 along with the relevant all India average percentage of expenditure on collection to gross collection for the respective preceding years were as follows:

Year	Gross collection	Expenditure on collection	Percentage of cost of collection to gross collection	All India average percentage for the preceding year
	(` in crore)			
2008-09	2,946.37	41.01	1.39	2.09
2009-10	2,650.17	53.18	2.01	2.77
2010-11	3,554.48	53.52	1.51	2.47

The above table indicates that the percentage of cost of collection to gross collection was less than the all India average percentage for all the three years.

5.5 Working of Internal Audit Wing

The objective of an IAW is to have a deterrent and reforming effect in the direction of prevention of mistakes and to play a corrective role by pointing out mistakes and ensuring remedies without loss of time.

There was no IAW in the Department, thus leaving it vulnerable to risk of control failure. The Department had reported (August 2010) that proposals for setting up an IAW were submitted to Government in 2008. We had in Audit Report (Revenue Receipts) for the year ended 31 March 2010 recommended that the Government expedite the setting up of IAW in the Department, especially as the proposals are lying with them since 2008. However, as reported by the Department in September 2011, the proposal is still pending with Government.

5.6 Impact of Audit Reports

During the last five years, through our Audit Reports, we had pointed out non/short levy, non/short realisation and loss of revenue, etc., with revenue implication of ₹ 383.41 crore in 23 paragraphs. Of these, the Government/Department had accepted audit observations in 17 paragraphs involving ₹ 302.84 crore and had since recovered ₹ 64 lakh. The details are given in the following table:

(₹ in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ¹	Number	Amount ¹
2006-07	03	31.26	01	0.35	-	--
2007-08	02	2.44	01	0.03	01	0.03
2008-09	06	325.83	05	283.04	03	0.45
2009-10	07	16.49	05	12.03	04	0.08
2010-11	05	7.39	05	7.39	01	0.08
Total	23	383.41	17	302.84	9	0.64

As seen from the above table, the recovery made by the Department is only 0.21 per cent of the amount involved in the total accepted cases.

We recommend that the Government intensify its measures to ensure expeditious recovery of revenue in respect of the accepted cases.

5.7 Results of audit

We conducted a test check of the records of 104 offices of the Stamps and Registration Department during the year 2010-11, which revealed evasion, non-realisation, short levy of stamp duty and registration fee, etc., amounting to ₹ 95.04 crore in 108 cases, which fall under the following categories:

(₹ in crore)

Sl. No.	Category	Number of cases	Amount
1.	Non/short levy of stamp duty and registration fees	69	44.24
2.	Loss of stamp duty and registration fee due to suppression of facts	11	41.99

¹ Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

			(` in crore)
Sl. No.	Category	Number of cases	Amount
3.	Short levy due to undervaluation of properties	11	8.33
4.	Other irregularities	17	0.48
Total		108	95.04

During the course of the year 2010-11, the Department accepted underassessments of ` 3.22 crore in 12 cases pointed out in audit during the year. The Department also recovered an amount of ` 25.37 lakh in 29 cases pointed out in earlier years.

A few illustrative audit observations involving ` 7.39 crore are mentioned in the succeeding paragraphs.

5.8 Non-observance of provisions of the Act/Rules

The KS Act, 1957 provides as under:

- *Section 3 for stamping of all instruments chargeable with duty as per the schedule to the Act and executed by any person in the State of Karnataka before or at the time of execution.*
- *Section 28 to set forth in the instrument the consideration and all other facts and circumstances affecting the chargeability of any instrument with duty or the amount of the duty with which it is chargeable. Section 61 for punishment with fine which may extend to five times the amount of the deficient duty thereof for any person, who, with an intent to defraud the Government, executes any instrument in which all the facts and circumstances required to be set forth are not fully and truly set forth.*
- *Section 45A for estimating the market value, if the registering officer, while registering any instrument has reason to believe that the market value of the properties has not been truly set forth and upon payment of duty on such market value, to register the document.*
- *Section 46 A for issue of notice on any person to show cause notice as to why the proper duty should not be collected from him in respect of any instrument which has not been duly stamped.*
- *Section 67B for power to enter and search any premises excluding residential premises and if on such inspection, the authorised officer² is of opinion that any instrument chargeable with duty is not duly stamped, he shall require the person liable, to pay the proper duty or the amount required to make up the same and also penalty not exceeding five times the amount of the deficient duty thereof, if any leviable.*

The Registration Act, 1908 and the Karnataka Registration Rules, 1965 provides as under:

- *Section 23 for presentation of a document for registration within four months from the date of its execution. Section 25 provides for directions of DR to concerned SR to register a document which is presented after the prescribed four months but within a delay which does not exceed four months from the time prescribed for presentation on payment of a fine not exceeding ten times the amount of registration fee. Rule 52 of the*

² Deputy Commissioner or an Assistant Commissioner or any officer not below the rank of a Sub-Registrar authorised by the Deputy Commissioner or Chief Controlling Revenue Authority.

Karnataka Registration Rules, 1965 prescribes the rates of fine leviable depending upon the period of delay.

- *Section 80 for levy of fees in respect of various documents presented for registration.*
- *Section 80(A) for recovery of registration fee not paid or insufficiently paid on any document as an arrear of land revenue from the person who presented the document for registration based on a certificate of the IGRCS which is granted after giving the person an opportunity of being heard.*

We noticed in eight SROs and information obtained during audit of office of the Deputy Commissioner of Excise, Bangalore (South) and two offices of the Income-tax Department that the above provisions were not fully followed by the concerned authorities. This resulted in a number of discrepancies which led to non/short realisation of Government revenue amounting to ` 7.39 crore. The Department reported in November 2011 that it had initiated action in all the cases and recovered ` 7.93 lakh in one case.

5.8.1 Short levy of stamp duty/registration fee due to suppression of facts

As per Article 41(e) of the schedule to the KS Act, when General Power of Attorney (GPA) was given for consideration and or when coupled with interest and authorising the attorney to sell any immovable property, stamp duty was the same as a conveyance on the consideration or market value of the property, whichever is higher.

5.8.1.1 During test check in November 2010 of the documents registered and the 'A' register in the SRO, Srirangapatna, we noticed that five sale agreements and corresponding five GPA were registered on 11 April 2009 (three sale agreements and corresponding GPAs) and 12 August 2009 (two sale agreements and corresponding GPAs). The sale agreements were without possession of the properties and hence stamp duty

and registration fee of ` 300 each were

levied on the sale agreements. The GPAs authorised the attorney (in favour of the authorised signatory of the purchaser company mentioned in the sale agreement) to sell the properties and accordingly stamp duty of ` 19.73 lakh and registration fee of ` 2.77 lakh at the rates applicable were levied on ` 2.77 crore being the estimated guideline market value of the properties. Our scrutiny of the recitals in the corresponding sale agreements between the vendors and purchaser revealed that the purchaser had paid the entire sale consideration of ` 49.33 crore which was also acknowledged in the sale agreements. Since both the GPA and Agreement for sale, came together for registration, the registering officer should have linked the sale consideration as per Agreement to the GPA, instead of the estimated guideline market value. This was not done resulting in short levy of stamp duty of ` 3.31 crore and

registration fee of ` 46.56 lakh on the differential market value of ` 46.56 crore. Further, a penalty of ` 16.56 crore could have been levied for suppression of facts.

After we pointed out the case to the IGRCS in January 2011; the IGRCS reported in September 2011 that the DR, Mandya had been instructed to initiate action under section 46(A) of the KS Act and section 80(A) of the Registration Act.

We reported the cases to the Government in July 2011; we have not received their reply (January 2012).

As per articles 20 and 41(eb), Stamp Duty on conveyance deeds and GPA were leviable on the market value of the property. As per definition in the KS Act, market value of a property is the price which the property would fetch, in the opinion of the Deputy Commissioner, if sold in the open market on the date of execution of instrument or consideration stated in the document whichever is higher.

5.8.1.2. During test check of the assessment records of the Income-tax Department, we noticed that in the appraisal reports of the Department and information furnished to the Income-tax Department, the persons concerned had acknowledged receipt of money as consideration received for transactions relating to sale of two immovable properties. We cross-

verified the details of the transactions of immovable properties as reported to the Income-tax Department with the instruments relating to these properties registered in the office of the SRO, Mysore North in June 2010. A GPA and two sale deeds were registered between January 2006 and February 2007, wherein Stamp duty of ` 50.53 lakh and registration fee of ` 5.96 lakh were levied on the estimated guideline market value/consideration stated in the documents. The consideration for these transactions as acknowledged by the executants of the documents to the Income-tax Department was ` 14.04 crore, whereas non-disclosure of the actual consideration in the documents resulted in short levy of stamp duty of ` 68.35 lakh and registration fee of ` 8.08 lakh on the differential market value of ` 8.08 crore. Besides, a penalty of ` 3.42 crore was leviable for suppression of facts.

After we pointed out the case to the IGRCS in July 2010; the IGRCS reported in November 2011 that the DR, Mysore had initiated action under section 46(A) of the KS Act and section 80(A) of the Registration Act.

We reported the cases to the Government in July 2011; we have not received their reply (January 2012).

5.8.1.3 During test check in September 2010 of the documents registered and the 'A' register in SRO,

As per schedule, stamp duty on Joint Development Agreement (JDA) was 1 per cent of the market value of the property or cost of proposed construction or development whichever was higher. Registration fee on JDA ranged between ` 1,000 and ` 15,000 depending upon the market value of the property. As per the KS Act, market value of the property is the value that in the opinion of the Deputy Commissioner, the property would fetch in the open market on the date of execution of document or consideration stated in the document whichever is higher.

Shivajinagar, we noticed that a JDA between a owner of a property and developer was registered on 1 September 2009 on which stamp duty of ` 4.31 lakh and registration fee of ` 5,000 were levied on the guideline market value of ` 4.31 crore. Scrutiny of the recitals revealed that the owner had acquired the property in a court sale for a

consideration of ` 18.18 crore

in an auction held by the Court and registered the document in the same SRO on 1 December 2008, as revealed in our cross verification. Thus, non-disclosure of the true market value of the property in the JDA, as per purchase value of the property, resulted in short levy of stamp duty of ` 13.87 lakh and registration fee of ` 10,000 on the differential market value of ` 13.87 crore.

Besides, penalty of ` 69.35 lakh was leviable for suppression of facts.

After we pointed out the case to the IGRCS in November 2010, the IGRCS reported in September 2011 that the DR, Shivajinagar had been instructed to initiate action under section 46(A) of the KS Act and section 80(A) of the Registration Act.

We reported the case to the Government in July 2011; we have not received their reply (January 2012).

As per Article 5(e) of the Schedule to the KS Act, when an agreement related to sale of immovable property wherein part performance of the contract, possession of the property was delivered or agreed to be delivered without executing the conveyance, stamp duty was the same as that for a conveyance on the market value of the property. Stamp duty of `200 was leviable if possession was not delivered

5.8.1.4 During test check in November 2010 of the documents registered and 'A' register in SRO, Srirangapatna, we noticed that two Sale Agreements for Sale of 3 acres and 36 guntas of land were registered on 7 May 2008. The consideration/ value of the properties set forth in the documents was ` 78 lakh. Stamp duty and

registration fee of ` 200 each were levied on the two Sale Agreements as applicable to sale agreements without possession. We also noticed that two GPAs were also registered in the same office on the same day as the sale agreements in respect of these properties between same parties. Stamp duty

and registration fee of ` 100 each were levied on the GPAs. As per the recitals of the GPA, the attorney holder was authorised to represent the vendor in all Government offices, get the documents relating to the property changed to his name, enter into sale agreements, receive consideration etc. The Agreement for Sale had a clause that the entire sale transaction would be completed within 30 days of communication order of conversion/change of land. The parties to the Agreement were also obliged to have a proper sale deed executed on conversion of the Land.

We could not verify whether the Sale Deed was executed and neither could the SRO confirm the Registration of the same. Stamp duty of ` 5.85 lakh and registration fee of ` 78,000 were leviable. The Government is advised to verify the same by issuing notices to the parties.

After we pointed out the cases to the IGRCS in January 2011, the IGRCS reported in September 2011 that the DR, Mandya had been instructed to initiate action under section 46(A) of the KS Act and section 80(A) of the Registration Act.

We reported the cases to the Government in July 2011; we have not received their reply (January 2012).

5.8.2 Non-realisation of stamp duty

As per the Schedule to the KS Act, any instrument of lease or any agreement to let or sub-let shall be chargeable to duty. The rates of duty depend upon the duration of the lease and consideration reserved for the lease. Under the Registration Act, 1908, documents relating to leases of immovable properties for periods exceeding one year are to be compulsorily registered.

5.8.2.1 We noticed from the records of the Deputy Commissioner of Excise, Bangalore (South) that a hotel had presented an agreement to lease executed in April 2008 in respect of the hotel premises for obtaining CL-7 licence³. The lease period was for 10 years with option to renew. As per terms of the Agreement, the lessee was to deposit a sum of

` 1.5 crore as refundable security deposit and the lease rent was ` 21 lakh per month for the first year of lease and enhanced by 4 *per cent* thereof every calendar year. Our scrutiny of the Agreement to lease revealed that the document was executed in the State of Maharashtra in respect of property situated in Karnataka. We requested the jurisdictional SRO that is, SRO, Begur to verify whether the document was registered and stamp duty realised in Karnataka. The SRO, Begur confirmed that the document was not presented for registration in his office. Consequently, stamp duty of ` 46.10 lakh⁴ as

³ Licence granted by the State Excise Department for selling liquor in Hotel and Boarding House.

⁴ As per section 19 of the KS Act, this amount is subject to adjustment of stamp duty, if any, paid outside the State of Karnataka.

leviable under the KS Act and registration fee of ` 7.45 lakh were not realised, though the document was registrable in the State.

After we pointed out the case to the IGRCS in May 2011; the SRO, Begur reported in October 2011 that a demand notice was issued to pay the stamp duty.

We reported the cases to the Government in July 2011; we have not received their reply (January 2012).

5.8.2.2 We noticed from the records of two offices⁵ of the Income-tax Department that two assesseees had furnished six lease agreements executed in Karnataka between August 2006 and March 2007 to the Income-tax Department as proof of sources of income. We requested the jurisdictional SROs that is, SRO, Chamarajpet and SRO, Dasanapura to verify whether the documents had been registered and stamp duty realised. The jurisdictional SROs confirmed that the lease deeds were not presented for registration. Consequently, stamp duty of ` 1.44 crore and registration fee of ` 21.94 lakh were not realised.

After we pointed out these cases to the IGRCS in May 2011, the IGRCS reported in November 2011 that the DR, Basavangudi and DR, Jayanagar had initiated action under section 67B of the KS Act.

We reported the cases to the Government in July 2011; we have not received their reply (January 2012).

5.8.3 Short levy of stamp duty and registration fees

Two SROs

As per Article 5(f) of the schedule to the KS Act, when an agreement relates to construction or development or sale of an immovable property, including a multi-unit house or building or unit of apartment or flat or portion of a multi-storied building by a person having a stipulation that after construction or development, such property shall be held jointly or severally by that person and the owner of such property or that it shall be sold jointly or severally by them or that a part of it shall be held jointly or severally by them and the remaining part thereof shall be sold jointly or severally by them, stamp duty was to be levied at 1 per cent on the market value of the property, or the estimated cost of construction or proposed construction or development or proposed development of the property or on the consideration for such transfer whichever is

higher. Assistant Commissioners of Income Tax, Circles 1 and 2, Bangalore

5.8.3.1 During test check in August 2010 of the documents registered and 'A' register in SRO, Dharwad, we noticed that an instrument titled 'Development and authority to sell/transfer of land' was registered on 25 February 2010. Stamp duty of ` 75,000 as applicable to Agreement for Development under Article 5(f) and Registration fee of ` 1,000 were levied. Scrutiny of the recitals revealed that a consideration of ` 75 lakh

had been agreed upon and the owner had handed over possession of the property to the developer. There was no stipulation to either jointly or severally own or sell the developed property. The developer was authorised to enter into sale agreements and execute sale deeds in favour of prospective purchasers. The developer was solely responsible for any dealings with third parties and the owners were in no way responsible for any sort of agreement between the developer and third parties. The document had all the recitals of a Sale Agreement. Hence, the document was to be treated as a conveyance by which the property was transferred to the developer. Stamp duty to be levied as applicable to a conveyance amounted to ` 5.04 lakh and ` 75,000 respectively. Thus, incorrect classification of the document resulted in short levy of stamp duty of ` 4.29 lakh and registration fee of ` 74,000.

After we pointed out the case to the IGRCS in September 2010, the IGRCS reported in September 2011 that the DR, Dharwad had been instructed to initiate action under section 46(A) of the KS Act and section 80(A) of the Registration Act.

We reported the case to the Government in July 2011; we have not received their reply (January 2012).

As per Article 45 of the Schedule to the KS Act, where release⁶ is not between family members and the release is not for any consideration, stamp duty was leviable at 2.5 *per cent* of the market value of the property, which is the subject matter of release. If the release is between family members, stamp duty of ` 1,000 was leviable. As per explanation below the article, family in relation to a person means husband, wife, sons, daughter, father, mother, brother, wife/children of a predeceased brother, sister, husband/children of a predeceased sister, wife of a predeceased son and children of a predeceased son or predeceased daughter.

5.8.3.2 We noticed from the records of SRO, Raichur in December 2010 that a release deed was registered on 4 February 2009. Stamp duty of ` 1,200 and Registration fee of ` 500 were levied as applicable to a release between family members. Scrutiny of the recitals of the document revealed that the releaser and releasee were two firms which was the family business and were being jointly run by the partners. Both the firms were represented by the same partner. Since firms do not come under the definition of “family” as given in the explanation below the Article, the document was not

a release between family members, but between two firms. As the release was not for consideration, stamp duty (at 2.5 *per cent*) of ` 18.14 lakh and registration fee of ` 7.26 lakh were leviable on ` 7.26 crore, which was the estimated guideline market value of the property. Thus, incorrect

⁶ Release, that is to say, any instrument whereby a person renounces a claim upon another person or against any specified property.

classification resulted in short levy of stamp duty of ` 18.13 lakh and registration fee of ` 7.26 lakh.

After we pointed out the case to the IGRCS in January 2011, the IGRCS reported that the DR, Raichur had been instructed to initiate action under section 46(A) of the KS Act and section 80(A) of the Registration Act.

We reported the cases to the Government in July 2011; we have not received their reply (January 2012).

5.8.4 Short levy due to undervaluation

Three SROs

Under the KS Act, if the registering officer while registering any instrument has reason to believe that the market value of the properties has not been truly set forth, he shall estimate the market value and upon payment of duty on such market value, register the document.

During test check between May 2010 and October 2010 of the documents registered and 'A' registers in three SROs, we noticed that stamp duty of ` 10.03 lakh and registration fee of ` 1.04 lakh were short levied. This was due to levy of stamp duty on consideration stated in the document and incorrect determination of market value in respect of three documents, as

detailed below:

(` in lakh)		
SRO/Nature of document/ Date of registration	Nature of observation	Short levy of stamp duty/ registration fee
Dharwad/ Sale deed/ 30.09.2008	Stamp duty was levied on the consideration of ` 3.06 crore stated in the document which comprised of land (66836 sq.ft)- ` 56 lakh, building - ` 200 lakh, plant and machinery - ` 35 lakh and Furniture, interior and fixtures - ` 15 lakh. As the market value of land as per estimated guidelines was ` 210/sq.ft, the estimated market value of the land worked out to ` 1.40 crore as against ` 56 lakh considered for valuation and levy of stamp duty. The short levy of stamp duty and registration fee on the differential market value of land of ` 84.36 lakh worked out to ` 7.09 lakh and ` 84,000 respectively. After we pointed out the case to the IGRCS in September 2010, the IGRCS reported in September 2011 a recovery of ` 7.93 lakh.	7.09/ 0.84
Shivajinagar/ Joint Development Agreement/ 08.10.2009	As per article 5(f) of the schedule, stamp duty on JDA was to be levied on market value of property or estimated cost of development or construction whichever was higher. In the instant case, the recitals stated that the owner and developer were sharing the built up area on 50:50 basis and that the cost of construction of the developer's share was ` 1.56 crore.	1.57/ 0.04

	<p>Hence, cost of development of entire property was `3.13 crore. However, stamp duty was levied on `1.56 crore. The incorrect determination of cost of construction resulted in short levy of stamp duty and registration fee.</p> <p>After we pointed out the case to the IGRCS in November 2010, the IGRCS reported in November 2011 that the DR, Shivajinagar had initiated action under section 46(A) of the KS Act and section 80(A) of the Registration Act.</p>	
Hubli/ Sale deed/ 30.06.2008	<p>As against the consideration of ` 10 lakh stated in the document conveying 7540 sq.ft of undivided share in a commercial property, the SRO determined the market value at ` 21.36 lakh and levied stamp duty and registration fee thereon. However, the market value of the property as per the estimated guideline value worked out to ` 37.70 lakh at ` 500 per sq.ft. The incorrect determination of market value resulted in short levy of stamp duty and registration fee.</p> <p>After we pointed out the case to the IGRCS in June 2010, the IGRCS reported in November 2011 that the DR, Shivajinagar had initiated action under section 46(A) of the KS Act and Section 80(A) of the Registration Act</p>	1.37/ 0.16
Total		10.03/ 1.04

We reported these cases to the Government in July 2011; we have not received their reply (January 2012).

5.8.5 Non-levy of fine

SRO, Udupi

The Registration Act 1908, stipulates that no document other than 'will' shall be accepted for registration unless presented for that purpose within four months from the date of its execution. If owing to urgent necessity or unavoidable accident, any document executed is not presented for registration till after four months from its execution, the Registrar, in cases where the delay does not exceed four months, may direct that on payment of a fine not exceeding ten times the amount of the proper registration fee, such document shall be accepted for registration. Any application for such direction may be lodged with the Sub-Registrar who shall forthwith forward it to the Registrar to whom he is subordinate. As per the Karnataka Registration Rules 1965, when the delay in presentation for registration exceeds two months but does not exceed four months, the fine leviable was equal to ten times the registration fee.

While test checking in December 2010 the documents registered, we noticed that a lease deed executed on 11 December 2006 was presented for registration on 31 December 2008 after a delay of over 20 months. Contrary to the provisions of registration, the Sub-Registrar accepted the same for registration and registered the document. Stamp duty of ` 4.93 lakh and registration fee of ` 98,540 were levied. However, it was noticed

that no fine was levied. A fine of ` 9.85 lakh was realisable for a delay of even four months. This resulted in loss of revenue of ` 9.85 lakh.

After we pointed out the case to the IGRCS in February 2011, the IGRCS reported in November 2011 that action was initiated under section 80(A) of the Registration Act.

We reported the case to the Government in July 2011; we have not received their reply (January 2012).

EXECUTIVE SUMMARY

Tax collection	In 2010-11, the revenue collection from Land revenue was ` 177.53 crore. The revenue collection increased by 39 <i>per cent</i> over 2009-10.
Insignificant recovery by the Department of observations pointed out by us in earlier years	During the years 2006-07 to 2010-11, we had, through our Audit Reports, pointed out non/short levy, non/short realisation of revenue amounting to ` 223.64 crore in 11 paragraphs. Of these, the Government/Department had accepted audit observations contained in eight paragraphs involving ` 110.45 crore and had since then recovered, only ` 20 lakh related to observation in three paragraphs. The recovery made by the Department is negligible when compared with the amount involved in the total accepted cases.
Results of audit conducted by us in 2010-11	In 2010-11, we test checked the records of 55 offices of the Tahsildars and 10 offices each of the Assistant Commissioners/Deputy Commissioners and found non/short levy of conversion fine and compounding amount, short levy of fee for pre-mutation sketch and other irregularities amounting to ` 32.53 crore in 164 cases. The Department accepted underassessments of ` 9.09 crore in 49 cases pointed out during the year 2010-11 and recovered ` 96.19 lakh in 58 cases pointed out in earlier years.
What we have highlighted in this Chapter	In this chapter, we present illustrative cases of ` 54.37 lakh selected from observations noticed during our test check of the offices of the Department where we found that provisions of the Act/Rules were not observed.
Our conclusion	The Department needs to strengthen the internal control mechanism so that weaknesses in the system are addressed and omissions of the nature detected by us are avoided in future. It also needs to initiate immediate action to recover the non/short levy of revenue pointed out by us, more so in those cases where it has accepted our contention.

CHAPTER-VI: LAND REVENUE

6.1 Tax administration

The levy of Land revenue is administered by the Revenue Department at the Government level. The State is divided into four revenue zones viz. Bangalore, Mysore, Belgaum and Gulbarga, each headed by a Regional Commissioner (RC). At the field level, the levy and collection of Land revenue is administered by the Deputy Commissioner (DC)/Special Deputy Commissioner at district level, Assistant Commissioner (AC) at sub-division level, Tahsildar including Special Tahsildar at taluk level, Revenue Inspector/ Village Accountant at the village level. The provisions of the Karnataka Land Revenue (KLR) Act, 1964 and the KLR Rules, 1966 framed thereunder govern the levy and collection of Land revenue.

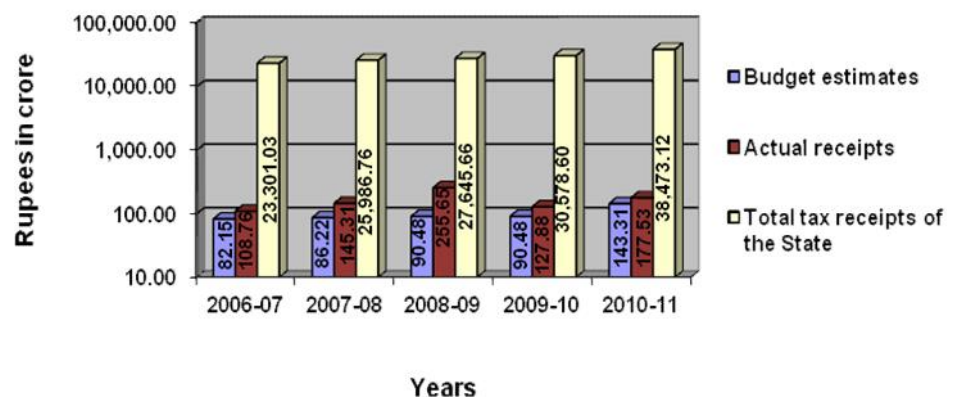
6.2 Trend of receipts

Budget Estimates (BEs) and actual receipts from land revenue during the years 2006-07 to 2010-11 along with the total tax receipts during the same period is exhibited in the following table and graphs:

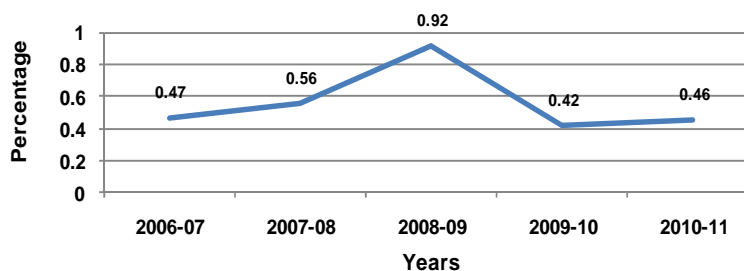
(` in crore)

Year	Budget estimates	Actual receipts	Variation excess(+)/shortfall(-)	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts
2006-07	82.15	108.76	(+) 26.61	(+) 32.39	23,301.03	0.47
2007-08	86.22	145.31	(+) 59.09	(+) 68.53	25,986.76	0.56
2008-09	90.48	255.65	(+) 165.17	(+) 182.55	27,645.66	0.92
2009-10	90.48	127.88	(+) 37.40	(+) 41.34	30,578.60	0.42
2010-11	143.31	177.53	(+) 34.22	(+) 23.88	38,473.12	0.46

Graph 1 : Budget estimates, Actual receipts and Total tax receipts



Graph 2: Percentage of Actual receipts vis-à-vis Total tax receipts



It is seen from the table that the variation between the BEs and Actual receipts ranged between (+) 23.88 and (+) 182.55 *per cent*. Further, revenue increased by 39 *per cent* in 2010-11 as compared to 2009-10 under all minor heads under the Head of account '0029-Land Revenue'. The Department did not furnish reasons for increase in revenue though called for (July 2011). The percentage of actual receipts in total tax receipts ranged between 0.42 and 0.92 *per cent* during the five year period 2006-07 to 2010-11.

6.3 Impact of Audit Reports

During the last five years, through our Audit Reports, we had pointed out non/short levy of tax with revenue implication of ` 223.64 crore in 11 paragraphs. Of these, the Government/Department had accepted audit observations involving ` 110.45 crore in eight paragraphs and had since recovered ` 20 lakh. The details are shown in the following table:

(` in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	Number	Amount	Number	Amount ¹	Number	Amount ¹
2006-07	01	1.08	-	-	-	-
2007-08	02	209.09	01	106.02	-	-
2008-09	02	1.38	02	0.20	-	-
2009-10	03	11.55	02	4.09	01	0.11
2010-11	03	0.54	03	0.14	02	0.09
Total	11	223.64	08	110.45	03	0.20

As can be seen from the above table, the recovery made by the Department is negligible when compared to the amount involved in the total accepted cases.

We recommend that the Government issue directions to the Department to intensify its measures for expeditious recovery of the amount involved in the accepted cases.

6.4 Results of audit

We conducted a test check of the records of 55 offices of the Tahsildars and 10 offices each of the ACs and DCs during the year 2010-11. This revealed non/short levy of conversion fine and compounding amount, short levy of fees for pre-mutation sketch and other irregularities amounting to ` 32.53 crore in 164 cases. The observations broadly fall under the following categories:

¹ Indicates the amount of acceptance and recovery in respect of individual cases included in the respective paragraphs.

(` in crore)

Sl. No.	Category	No. of cases	Amount
1.	Non/short levy of conversion fine/compounding amount	36	1.26
2.	Short levy of pre-mutation sketch and <i>phodi</i> fee	49	0.41
3.	Other irregularities	79	30.86
	Total	164	32.53

During the course of the year 2010-11, the Department accepted underassessments of ` 9.09 crore in 49 cases pointed out during the year. The Department also recovered ` 96.19 lakh in 58 observations pointed out in earlier years.

A few illustrative audit observations involving ` 54.37 lakh are mentioned in the succeeding paragraphs.

6.5 Non-observance of provisions of the Act/Rules

The KLR Act, 1964 and the KLR Rules, 1966 provide as under:

- Section 128 of the KLR Act for preparation of a pre-mutation sketch prepared by a licensed surveyor while reporting mutation of land.
- Section 95 of the KLR Act for permission for diversion of agricultural land for non-agricultural purposes on payment of conversion fine prescribed under the KLR Rules.
- Section 96 of the KLR Act for compounding of the diversion of the agricultural land for non-agricultural purposes without permission of DC by levy of the compounding amount.
- Rule 131(3) of the KLR Rules for issue of copies of Record of rights (RTC²) on payment of fees prescribed by Government using software specified under sub-rule (3) of Rule 62 of KLR Rules. As per Government circular No.RD 28 MRR 2002 dated 1 July 2006, fees collected has to be remitted to Personal Deposit account of the DC. All Government receipts should be remitted to the Government account in accordance with the provision of the Karnataka Financial Code, 1958.

We noticed during test check of the records of one AC office, two DC offices and 25 Tahsildars' offices that the above provisions were not followed by the concerned offices. This resulted in a number of discrepancies with non/short realisation of the Government revenue amounting to ` 54.37 lakh. Of these, the Department furnished replies and accepted audit observations in 1,699 cases involving ` 13.87 lakh and of that, recovered ` 9.08 lakh in 742 cases.

6.5.1 Short levy of fees for pre-mutation sketch

23 Tahsildar offices³

The fee for each pre-mutation sketch upto 11 August 2008 was ` 403 of which ` 300 was payable to the licensed surveyor and balance was Government revenue. The Government, vide order dated 12 August 2008, enhanced the fee for pre-mutation sketch to ` 600 with no enhancement in payment to the

² licensed surveyor.

² Record of Title, Tenancy and Crop Inspection Certificate

³ Alur, Arkalgud, Bellary, Belur, Bhadravathi, Channarayapatna, Chintamani, Dodaballapura, Gowribidanur, Harihara, Hassan, Hiriya, Hosadurga, K.R.Pet, Kanakapura, Kolar, Madhugiri, Mandya, Pandavapura, Sagar, Shimoga, Srirangapatna and Tiptur.

⁴ Sketch prepared by licensed surveyor for the purpose of sub-division of parcels of land.

After we pointed out the short levy, 11 Tahsildars⁵ stated that the order revising the fee was received in December 2008/January 2009 and hence fee had been levied at pre-revised rates during the above period. Delay on the part of the DCs to communicate the revised rates to Tahsildars resulted in short levy of fee of ` 25.06 lakh. Further, the Government/Department reported (June/July 2011) raising of demand of ` 3.34 lakh in 1,695 cases and of that, recovered ` 1.46 lakh in 741 cases in four Tahsildar offices⁶.

6.5.2 Non/short levy of conversion fine and compounding amount

Three Tahsildar offices, One AC office and Two DC offices

Under the KLR Act 1964 and the Rules framed thereunder, when any land assessed or held for the purpose of agriculture is permitted to be diverted for purposes other than agriculture, conversion fine is leviable. The rate of fine leviable depends on the place where the land is situated and the purpose for which the land is put to use. The table of conversion fine in the KLR Rules categorises the rates for specific taluks mentioned in the table and lands situated within 18 kms from their municipal limits, for 'all other taluks' and lands falling within 8 kms from their municipal limits and for 'other places'. The rate of conversion fine for 'all other taluks' was ` 5.38 per square meter and ` 8.07 per square meter for residential and non-residential purposes respectively. The rates of conversion fine for all 'other places' was ` 2.18 per square meter and

6.5.2.1 We noticed from the records of Tahsildar, Maddur and AC, Davanagere in July 2010 and August 2010 respectively that 11 orders permitting diversion of agricultural land measuring 12 acres 29.62 guntas (51,577.68 square meters) for non-agricultural purposes (residential-30,273.37 square meters and non-residential-21,307.31 square meters) were issued between April 2007 and January 2010. In these cases, conversion fine of ` 1.87 lakh was levied at the rates specified for 'other places' in the KLR Rules. We noticed from the spot inspection reports prepared in connection with conversion of lands that the lands were situated within the prescribed distances from the municipal limits of the taluks concerned and hence conversion fine applicable to 'all

other taluks' was to be levied. The conversion fine leviable at the correct rates amounted to ` 3.35 lakh. Adoption of incorrect rates of conversion fine resulted in short levy of conversion fine of ` 1.48 lakh.

After we pointed out the cases to the concerned, AC, Davanagere contended (August 2010) that the lands were situated in taluks governed by Town

⁵ Bellary, Bhadravathi, Channarayapatna, Chintamani, Gowribidanur, Harihara, K.R.Pet, Kanakapura, Kolar, Madhugiri and Shimoga.

⁶ Arkalgud, Belur, Channarayapatna and Harihara

Panchayats and hence the rates levied were correct. The reply is not tenable since Honnali is a taluk and the lands were within 5 kms from municipal limits of the taluk, conversion fine had to be levied at the rates applicable to 'other taluks'. Replies in respect of Maddur have not been received (January 2012).

The provisions relating to levy of conversion fine apply mutatis mutandis in respect of diversion of non-agricultural lands held for specific purposes for other non-agricultural purposes.

6.5.2.2 We noticed from the records of the Tahsildars, Hollalkere, K.R.Pet and DC, Mandya, between May 2010 and June 2010, that gomal/tank bed land measuring 79 acres 12 guntas (3,21,538.58 square meters) were leased in nine cases to windmill power units, road to wind mill, hydel power unit and Karnataka Power Transmission Corporation Limited (KPTCL) between December 2005 and January 2010. Scrutiny of the lease orders revealed that though the land was permitted to be used for non-agricultural purposes, conversion fine amounting to ` 17.30 lakh as per the prescribed rates was not levied.

After we pointed out the cases, DC, Mandya contended (June 2010) that conversion fine in respect of lands leased to KPTCL was exempted as lands were granted for public purposes in accordance with the Government circular dated 13 November 2006. The reply was not tenable since the circular clarified that no conversion fine shall be levied in respect of land granted for public purposes to the institutions specified in Rule 108(2) of the KLR Rules and KPTCL was not specified under Rule 108(2) for exemption of conversion fine. Replies in respect of the remaining cases have not been received (January 2012).

As per the KLR Act, the DC may compound diversion of agricultural land for non-agricultural purposes without permission on payment of the compounding amount at prescribed rate.

6.5.2.3 We noticed from the records of the DC, Bangalore (Urban) in October 2010 that three orders were issued between July 2009 and March 2010 for conversion of 3 acres 28.08 guntas of agricultural land for non-agricultural purposes (residential/non-residential). We noticed from the spot inspection reports prepared prior to issue of orders for conversion that the Department had recorded unauthorised constructions to an extent of 16,989.12 square feet in these three cases. However, we noticed that the compounding amount of ` 2.35 lakh leviable was not levied. This resulted in non-levy of compounding amount of ` 2.35 lakh as given below:

Purpose for which diverted	Extent in square feet	Rate of compounding amount/square feet	Amount of compounding amount not levied (in `)
Residential	16,117.56	11.50	1,85,352
Non-residential	871.56	57.50	50,115
Total	16,989.12		2,35,467

After we pointed out the cases, DC, Bangalore (Urban) reported issue of demand notice in all the three cases. Report of recovery has not been received (January 2012).

Thus, conversion fine and compounding amount of ` 21.13 lakh was either not levied or levied short.

We reported all the above cases to the Government in May 2011; we have not received their reply (January 2012).

6.5.3 Misappropriation of Government revenue

Tahsildar, Shimoga

As per the KFC, all monetary transactions should be entered in the cash book as soon as they occur. As per article 329(v), when Government moneys are paid into the treasury or the bank, the head of the office should compare the receipt on the challan or pass book with the entry in the cash book before attesting it and satisfy himself that the amounts have been actually credited in to the treasury or bank. After the end of the month, he should obtain from the Treasury a consolidated receipt for all remittances made during the month which should be compared with the postings in the Cash Book.

We found (between November 2010 and February 2011) that the Tahsildar, Shimoga was maintaining a register called "Remittance Register" which contained the details of the funds remitted by his office into the treasury. The amounts due to the Government were collected by issue of receipts to the payees. We found from the challans available in the office that they had collected fees of `8,00,179 on account of RECORD OF RIGHTS and mutation in Bhoomi kiosks and ` 18,286 for copying

application remitted between August 2009 and November 2010. The fees were shown to have been deposited under the Heads of account under '8443 PD Account of Deputy Commissioner' and '1475 Other General Economic Services' respectively in the 'Remittance Register'. Our cross verifications of the "Challans" and "remittance Register" with the treasury records revealed that the amounts mentioned above were not remitted into the treasury resulting in misappropriation of ` 8.18 lakh. We found that the office had not reconciled the Remittance register with the treasury records as such the misappropriation got unnoticed.

After this being pointed out by us, the Treasury Officer in February 2011 confirmed non-remittance of the fees. Further, the Government reported (August 2011) that ` 7.62 lakh has been recovered from the concerned persons. It was further stated that action had been initiated for recovery of the balance amount.

CHAPTER-VII: NON-TAX RECEIPTS

7.1 Results of audit

We conducted a test check of records of 16 offices of the Deputy Conservator of Forest and 21 offices of the Deputy Director/Senior Geologist (Mines) during the year 2010-11. This revealed underassessments and non-realisation of revenue amounting to ` 165.45 crore in 125 cases. The observations broadly fall under the following categories.

(` in crore)			
Sl. No.	Category	Number of cases	Amount
	Forestry and Wildlife		
1.	Non/short recovery of lease rent	08	11.70
2.	Loss of revenue due to non-extraction of dead and fallen trees	03	2.73
3.	Non/short levy of seignorage rates	06	0.23
4.	Non/short levy of forest development tax	08	0.15
5.	Other irregularities	20	2.19
	Total	45	17.00
	Mineral Receipts		
1.	Non/short collection of Environment Protection Fee	24	96.02
2.	Non/short levy of interest/penalty	22	36.41
3.	Non/short levy of royalty/dead rent, penalty, interest	16	3.68
4.	Other irregularities	18	12.34
	Total	80	148.45
	Grand Total	125	165.45

During the course of the year 2010-11, the Departments accepted audit observations involving ` 95.96 crore in 61 cases pointed out during the year and of that, recovered ` 3.75 crore. The Departments also recovered ` 3.22 crore in 28 cases pointed out in earlier years.

One case of non-demand of water rates involving ` 5.71 crore is mentioned in the succeeding paragraph.

IRRIGATION RECEIPTS

7.2 Non-raising of demands for water rate and penal water charges

Seven Tahsildar offices


Under the Karnataka Irrigation (Levy of Water Rate) Rules, 1965, the Irrigation Officer prepares a demand statement of water rate and penal water charges payable by each landholder and sends it to the tahsildar concerned for raising demand and effecting recovery. On receipt of the demand statement from the Irrigation Department, these demands are to be booked in the demand, collection and balance (DCB) register and a copy of the demand statement sent to the concerned village accountants to enable them to serve demand notices on individual parties and recover the amount.

We noticed between August 2008 and December 2010 during cross verification of the demand statements received from Irrigation Department with DCB register of seven tahsildars in five districts that Revenue Department had not initiated action to book and raise demand for water rate and penal water charges of ` 5.71 crore for the period 2006-07 to 2009-10. Details are given below:

(` in lakh)

Sl. No.	Taluk (District)	Year to which demand relates	Amount of - water rate not booked	Amount of penal water charges not booked	Total amount of non-booking of demand for water charges
1	Mandya (Mandya)	2007-08	9.88	57.15	67.03
		2008-09	126.47	47.13	173.60
		2009-10	121.42	7.39	128.81
2	Kanakapura (Ramanagara)	2007-08	1.81	-	1.81
		2009-10	2.68	-	2.68
3	Holenarasipura (Hassan)	2006-07	7.82	-	7.82
		2007-08	10.86	-	10.86
		2008-09	12.90	-	12.90
		2009-10	15.47	-	15.47
4	Channarayapatna (Hassan)	2007-08	6.01	13.48	19.49
		2008-09	14.23	21.34	35.57
		2009-10	10.67	9.12	19.79
5	Hiriyur (Davanagere)	2008-09	8.62	-	8.62
6	Honnali (Davanagere)	2007-08	22.83	-	22.83
7	Yelandur (Chamarajanagara)	2007-08	-	14.58	14.58
		2008-09	-	29.46	29.46
Total			371.67	199.65	571.32

After we reported the cases to the Government (Revenue Department) in June 2011, Government reported (June/August 2011) that demand of ` 39.52 lakh for water rates and ` 43.94 lakh for penal water charges had been booked and raised in respect of Hiriyur and Channarayapatna taluks. Of this, water rates of ` 14.73 lakh was recovered in Channarayapatna taluk.



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