

## **Chapter II**

### **Taxes/VAT on Sales, Trade etc.**

## CHAPTER-II TAXES/VAT ON SALES, TRADE ETC.

### 2.1 Tax administration

Kerala General Sales Tax (KGST)/Kerala Value Added Tax (KVAT) laws and rules made thereunder are administered at the Government level by the Principal Secretary, Taxes. The Commissioner of Commercial Taxes (CCT) is the head of the Commercial Taxes Department who is assisted by Joint Commissioners (JC), Deputy Commissioners (DC), Assistant Commissioners (AC) and Commercial Tax Officers. The assessment, levy and collection of tax are done by Assistant Commissioners and Commercial Tax Officers.

KGST is leviable on sale of Ganja and opium, foreign liquor and certain petroleum products. VAT is leviable on the intrastate sale of remaining commodities and Central Sales Tax (CST) on inter-State sales.

### 2.2 Internal audit

The internal audit wing (IAW) in the Commercial Taxes Department commenced functioning from 1 June 2009. The wing headed by the Deputy Commissioner is assisted by two Assistant Commissioners and five Commercial Tax Officers. During 2014-15, the wing planned 356 units but could audit only 85 units. Potential cases and collection fall cases are compulsorily checked by the wing. Out of an overall outstanding of 4,595 paras only 448 paras (9.74 *per cent*) were cleared. The reason for low clearance of observations made by IAW, though called for (April 2015) has not been furnished by the CCT (December 2015). This indicates the poor response of the CCT to the observations of the IAW and in enforcing clearance of the paras by addressing the shortcomings/deficiencies pointed out by the wing.

### 2.3 Results of audit

Test check of the records relating to KVAT/KGST and CST assessments and connected documents in 160 out of 169 offices of the Commercial Taxes Department conducted during 2014-15 showed underassessment of tax and other irregularities involving ₹ 1,771.71 crore in 1,812 cases which fall under the following categories given in **Table - 2.1**.



**Table - 2.1**

(₹ in crore)			
Sl. No.	Categories	Number of cases	Amount
1.	Performance Audit on “System of Assessment under KVAT”	1	1,191.72
2.	Turnover escaping assessment	976	431.61
3.	Grant of irregular exemption	204	33.29
4.	Application of incorrect rate of tax	44	13.90
5.	Grant of excess input tax credit	140	6.34
6.	Other lapses	447	94.85
	<b>Total</b>	<b>1,812</b>	<b>1,771.71</b>

During the course of the year, the Department accepted underassessment and other deficiencies involving ₹ 187.09 crore in 1,162 cases which were pointed out in Audit. An amount of ₹ 8.49 crore was realised in 628 cases during the year 2014-15 of which 51 cases involving ₹ 0.60 crore were pointed out in 2014-15 and the rest in earlier years.

Department recovered full amount in a draft paragraph issued, pertaining to M/s Five Star Cone Crusher and Hollow Bricks, Peravoor and involving ₹ 9.69 lakh based on the Audit observation, in November 2013.

The reasons for non/short realisation of the amounts even in cases accepted by the Department were called for in September 2015. This has not been received (January 2016).

A Performance Audit on System of Assessment under KVAT with financial impact of ₹ 1,191.72 crore and a few illustrative audit observations involving ₹ 55.52 crore are mentioned in the following paragraphs.

## **Value Added Tax**

### **2.4. Performance Audit on System of Assessment under KVAT**

#### **2.4.1 Highlights**

- Department failed to bring majority of dealers under tax net by registering them to VAT system. Though Economic Census 2013 reported that there were 13.41 lakh establishments operating with fixed structure outside the house hold having different economic activities other than agricultural, service and defence, during 2013-14, but only 2.20 lakh dealers were registered for VAT in the State. Test check by Audit revealed non-levy of tax of ₹ 200.94 crore including interest and penalty on transactions of un-registered dealers.

*[Paragraph 2.4.7.1]*

- Non-adherence to provisions of Act and Rules while completing the assessment resulted in non/short levy of tax of ₹ 744.99 crore including interest and penalty.

*[Paragraph 2.4.7.6]*

- Lack of co-ordination with other Departments in collecting data useful for the completion of assessment resulted in non/short levy of ₹ 117.62 crore including interest and penalty.

*[Paragraph 2.4.7.7]*

- There was no system in place for analysis and utilisation of the data available in the KVATIS before acceptance of self assessments/completion of assessments. Scrutiny of cases revealed non/short levy of tax of ₹ 128.17 crore including interest and penalty due to these deficiencies.

*[Paragraph 2.4.7.8]*

- Internal control mechanism existing in the Department was not sufficient.

*[Paragraph 2.4.7.10]*

### **2.4.2 Introduction**

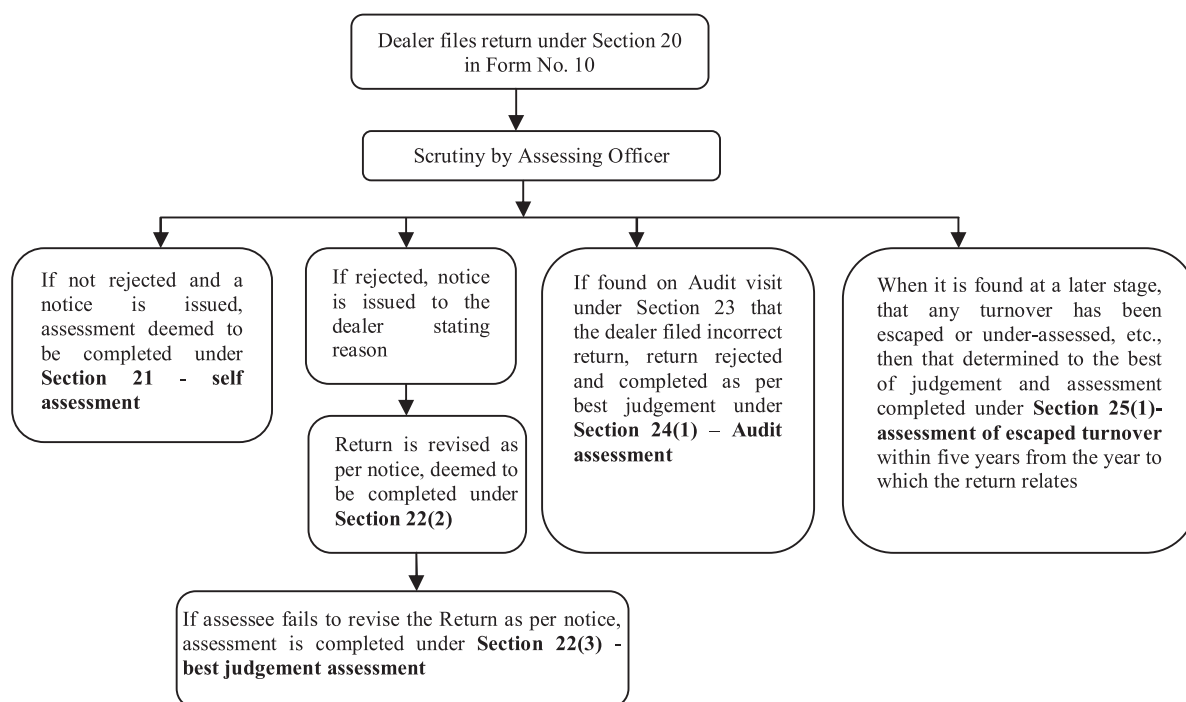
The Kerala Value Added Tax (KVAT) Act, 2003 and KVAT Rules, 2005 regulate the levy and collection of tax on sales and purchases of goods in the State. The system of value added taxation was introduced in the State with effect from 1 April 2005.

VAT is a multi-stage tax levied at each stage of the value addition chain, with a provision to allow Input Tax Credit (ITC) on tax paid at an earlier stage, which can be appropriated against the VAT liability on subsequent sale. VAT constitutes major portion of State revenue and hence assessment of VAT has a direct bearing on the tax collection and quality of tax administration.

With the introduction of VAT, the concept of assessment by assessing officers was basically withdrawn and the system of self assessment was introduced. Under the self assessment system, the dealers are required to file periodical returns and if the return so submitted is in the prescribed manner and accompanied by the prescribed documents, the assessment for the return period shall be deemed to have been completed. Provisions for reopening of the self assessments consequent to the detection of any turnover escaping assessment, application of incorrect rate of tax etc., have also been provided in the Act.

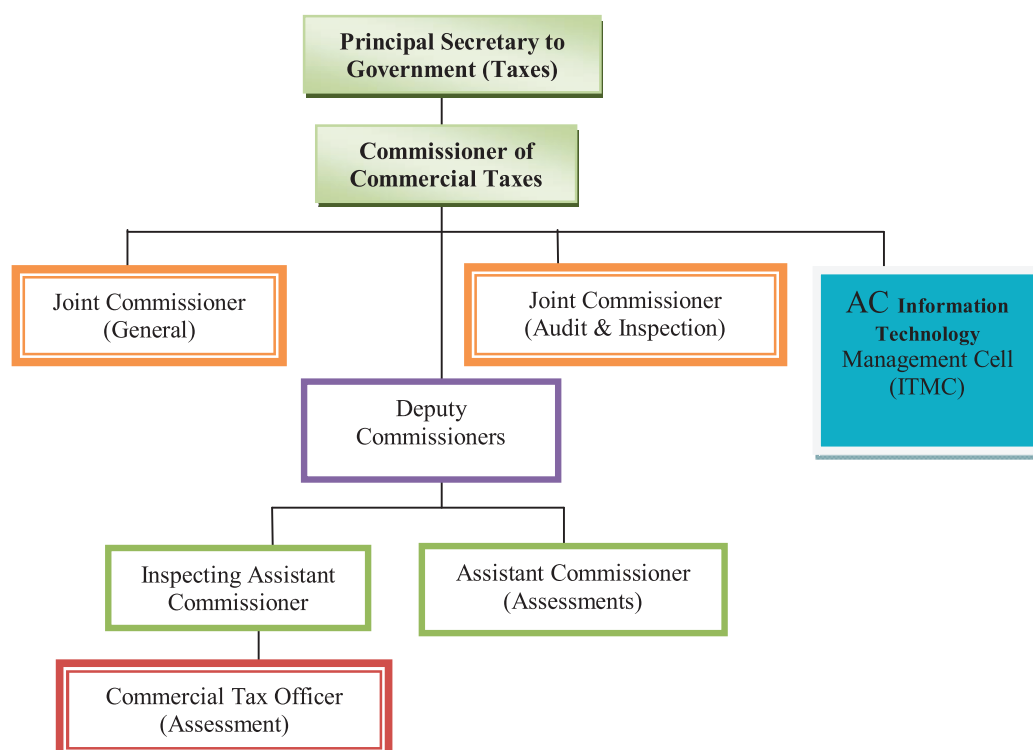
As part of the e-governance initiative and the introduction of VAT, the Department had introduced an application software system called KVATIS, to capture the complete workflow of the Department in all functional areas. The main objective of KVATIS was to develop a user-friendly IT solution for the effective and transparent tax administration with maximum tax collection and thereby reduce the tax evasion and corruption. The project also aimed at greater tax compliance by simplifying the procedures and timely delivery of better services to the stakeholders. The application software became operational during 2007-08.

The system of assessment prevailing under KVAT Act, 2003 is as under:



### 2.4.3 Organisational setup

The organisational setup of the assessment wing of the Department has been shown below:



#### **2.4.4 Audit Objectives**

The review was conducted to ascertain whether:

- the taxpayers are identified properly and the assessments are done according to provisions of the Act, Rules and orders.
- the assessment criteria has been prescribed for selection of files for detailed scrutiny and if so, the selection was made as per the prescribed criteria.
- a mechanism has been established to monitor internal control and the quality of the assessment orders.

#### **2.4.5 Scope and methodology of audit**

The Performance Audit (PA) was conducted between February 2015 and September 2015 covering the period from 2010-11 to 2014-15. Audit selected 36<sup>1</sup> out of the 73 assessment circles in six districts (fifty *per cent*). This selection was based on simple random sampling method. At each assessing officer's level, assessment files were selected through risk analysis based on gross turnover (GTO), commodity dealt, ITC claimed, sales return, check post transactions etc. During the audit, inter- departmental data from Customs department on imports of goods by dealer along with the data from other Central/State Government agencies were gathered to cross verify the same with the inputs provided by the assesseees in KVATIS. Various Local Audit Reports covering audit observations relating to KVAT assessments were also reviewed in addition to assessment records maintained at selected units.

An entry conference was conducted on 20 May 2015 with the Principal Secretary (Taxes) wherein the scope and methodology adopted for the PA were explained. An Exit conference was held on 01 December 2015 with the Principal Secretary (Taxes) where-in the audit findings were discussed.

#### **• Acknowledgement**

Audit acknowledges the co-operation rendered by the Commercial Taxes Department in providing records and other facilities. Audit also acknowledges the co-operation extended by the Customs and Central Excise Department and Income Tax Department for sharing of data, which has become helpful in conducting PA.

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<sup>1</sup> **Thiruvananthapuram** - Special Circle, CTO (Works contract), I and II Circles Thiruvananthapuram, **Kottayam**- Special Circle, CTO (Works contract), II Circle Kottayam and I Circle Changanassery, **Ernakulam**- Special Circle I, II and III, CTO (Works contract), I and II Circle Ernakulam, Special Circle Mattancherry at Aluva, Special Circle (Produce), CTO (Works contract) Mattancherry, Special Circle Perumbavoor, I and II Circles Kalamassery, I and II Circles Tripunithura and CTO Aluva, **Palakkad**- Special Circle, CTO (Works contract), I and II Circles Palakkad, **Kozhikode**- Special Circle I and II, CTO (Works contract), I Circle Kozhikode and CTO Perambra, **Kannur**- Special Circle, CTO (Works contract), I and II Circles Kannur.

### **2.4.6 Audit Criteria**

The audit criteria was derived from the following Acts and Rules.

- Kerala Value Added Tax Act, 2003.
- Kerala Value Added Tax Rules, 2005.
- Notifications and Orders issued by Government.
- Circulars and Clarifications issued by the Department.
- Circulars issued by Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC).

### **2.4.7 Audit findings**

#### **2.4.7.1 Failure to bring dealers under tax net and consequent escapement of turnover from assessment**

Section 15 of the KVAT Act, 2003 stipulates that every dealer whose total turnover in any year is not less than rupees five lakh shall get himself registered under VAT. Further, this turnover shall not apply in case of casual trader, contractors, dealers registered under Central Sales Tax Act, 1956 etc. Section 15 C of the KVAT Act, 2003 envisages that every person who intends to establish an industrial unit may get himself registered.

As of 31 March 2014, a total of 2.20 lakh dealers were registered with the CTD as per the data furnished by the Commissioner of Commercial Taxes (CCT).

The Sixth Economic Census 2013 conducted by the Department of Economics and Statistics revealed that there were 13.41 lakh establishments operating with fixed structure outside the household having different economic activities other than agricultural, service and defence. Moreover, The Economic Review (2014) of the State Planning Board showed that the total number of Small Scale Industries and Micro, Small and Medium enterprises registered in the State as of 31 March 2014 was 2.34 lakh. The CTD had failed to collect the data available with other Departments like Economic and Statistics, State Planning Board, District Industries Centre, Kerala State Industrial Development Corporation and Kerala Financial Corporation and to make use of the same to analyse and find whether all those dealers who were liable to be registered under the Act were actually registered or not. As per data available in KVATIS, Audit found that the CTD failed to bring all the dealers under tax net who were compulsorily to be registered. This resulted in escapement of dealers from assessment and consequent non levy of tax as narrated in the following paragraphs.

Government stated (December 2015) that measures have been initiated to widen the tax base by introducing a scheme called ‘One time incentive to new registrant scheme’, by simplifying the registration procedures of entities engaged in

electronic commerce etc. However, the details of dealers registered under scheme called for had not been furnished.

- **Non levy of tax on transportation of goods outside the State by non-registered dealers<sup>2</sup>**

Audit analysed the data relating to inter-State transaction of goods sent outside the State through various check-posts and found that 140 non-registered dealers transported goods amounting to ₹ 156.82 crore outside the State (**Appendix IV**). Though this data was readily available with the CTD, no action was taken to register the dealers and levy tax on the transfer of goods. Non levy of tax including interest and penalty worked out to ₹ 26.61 crore.

Analysis of data by Audit revealed that deviation from the provisions of the Act was by 102 dealers by transporting readymade garments having tax effect of ₹ 21.20 crore, 10 dealers in chassis with tax effect of ₹ 0.57 crore, five dealers in tea with tax effect of ₹ 2.72 crore and 23 dealers in multiple commodities with tax effect of ₹ 2.12 crore.

Government stated (December 2015) that since the security amount collected were not ascertainable from the online system, such transaction will be ascertained from the respective check posts. Reply of the Government is not tenable, as the observation was not about the collection of security amount but transportation of goods by dealers without registration escaping the tax net and consequent loss of revenue to Government.

- **Loss of revenue due to non-registration of Online traders**

Section 2[xliii] of KVAT Act, 2003 defines sales as a transfer of goods in the course of trade for a consideration and Section 2[xv] of the Act defines a ‘dealer’ as a person who, carries on the business of buying, selling, supplying or distributing goods for cash, or for deferred payment.

In the Online business, the customer can get an online market platform provided by a company, place the order for purchase of his choice from the vast variety of products either by paying cash or deferred payment and the company’s responsibility is to deliver the goods at the place of the customer’s choice. Since a direct business to customer relationship can be established only at the *situs* of sale, the right of levying tax on the sale lies with the destination State. Hence, the online trade comes under the purview of local sales attracting tax under KVAT Act, 2003 when delivery takes place in Kerala.

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<sup>2</sup> Who transported goods valued more than ₹ 10 lakh, having tax liability.



Even though there were 30<sup>3</sup> major online dealers in Kerala, Audit found that no action was taken by the Department under the KVAT Act, 2003 to levy tax on the online business taking place in Kerala, except in the case of two dealers who had paid ₹ 3.30 crore as tax during 2014-15. The loss of revenue for the three years 2012, 2013 and 2014 worked out to ₹ 174.33 crore as shown in **Table - 2.2**.

Table – 2.2

(₹ in crore)			
Items	2012	2013	2014
Total estimated online trading in India	47,400.00	53,400.00	81,600.00
Estimated towards sales of goods (37%)	17,538.00	19,758.00	30,198.00
Percentage of Share of State of Kerala (4)	701.52	790.32	1,207.92
Turnover of Exempted goods (9.46%)	66.36	74.76	114.27
Turnover of 1% taxable goods (17.50%)	122.77	138.31	211.39
Turnover of 5% taxable goods (44.06%)	309.09	348.22	532.21
Turnover of 14.5% taxable goods (28.98%)	203.30	229.03	350.05
Tax due @ 1%	1.22	1.38	2.11
Tax due @ 5%	15.45	17.41	26.61
Tax due @ 14.5%	29.48	33.21	50.76
Total tax due	46.15	52.00	79.48
Total due for the three years	<b>177.63</b>		
Less Tax Collected	<b>3.30</b>		
Balance tax due	<b>174.33</b>		

Government stated (December 2015) that online transactions could not be taxed under KVAT Act as there is no explicit provision to tax them. The reply is not tenable as provisions of Section 2[xliii] of the Act cited are enough to bring these online traders under the tax net.

Audit found that the Department was not using various inputs available in KVATIS to monitor the trade activities of unregistered dealers. Audit found that the increase in the number of dealers registered was not commensurate with the number of dealers as reported by other agencies discussed above.

**Recommendation No. 1 - Department may take measures to bring all dealers into the tax net by utilising the inputs available in KVATIS and with other agencies.**

<sup>3</sup> Flipkart.com, Jabong.com, Myntra.com, Snapdeal.com, amazon.in, ebay.in, naaptol.com, yebhi.com, yepme.com, infibeam.com, Homeshop18.com, Shopclues.com, Indiatimes shopping, Rediff shopping, inkfruit.com, pepperfry.com, Fashionara.com, Firstcry.com, Babyoye.com, Zovi.com, Koovs.com, cromaretail.com, Fashionandyou.com, Shopperstop.com, Grabmore.in, Shop.seventymm.com, Tradus.in, Futurebazaar.com, edabba.com and Govasool.com.



#### **2.4.7.2 The system of scrutiny of returns not properly defined in the Act or in any guidelines issued**

Sections 22, 24 and 25 of the Act envisages detailed scrutiny on returns filed. Audit examined whether any criteria existed in CTD regarding selection of files for detailed scrutiny. As per the Act, it is mandatory to verify all the tax returns submitted, but has not been prescribed whether all or any of the return so submitted are to be scrutinised in detail by the assessing authority. The CCT had not issued any instructions regarding criteria for selection of cases for detailed scrutiny. Hence the assessing officers were selecting assessment files for scrutiny arbitrarily.

On introduction of VAT, compulsory assessment was done away with. Scrutiny of returns is the only mechanism to ensure whether legitimate tax due has been remitted to Government account. After the introduction of KVATIS, the Department issued instructions<sup>4</sup> for the scrutiny of returns through KVATIS and the assessing authority was to endorse a certificate in KVATIS to that effect. Audit analysed the quantum of online scrutiny of periodical/annual returns by assessing officers in twenty<sup>5</sup> assessment units done during 2012-13 and 2013-14 and found the extent of scrutiny to be very meager as shown in **Table – 2.3**.

**Table – 2.3**

<b>Year</b>	<b>2012-13</b>	<b>2013-14</b>
Number of dealers in the 20 units selected	17,966	20,139
Number of Periodical Returns filed in the 20 units	2,04,029	2,25,705
Number of Periodical Returns scrutinised	11,703	8377
<b>The percentage of scrutiny of Periodical return</b>	<b>5.73</b>	<b>3.71</b>
Number of Annual returns filed in the 20 units	16,389	18,429
Number of Annual returns scrutinised	247	400
<b>The percentage of scrutiny of Annual return</b>	<b>1.50</b>	<b>2.17</b>

In the absence of scrutiny, assesseees, especially dealers having high GTO and dealers dealing in evasion prone commodities will have a tendency to understate their liability to pay tax.

Government stated (December 2015) that many parameters have been fixed for selection of returns which are discussed in the review meetings. For improving system based scrutiny, a departmental committee has furnished a detailed proposal which will be implemented as soon as the server constraints are

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<sup>4</sup> Circular No. 29/2011

<sup>5</sup> CTO, Special Circle, CTO, I and II Circles Thiruvananthapuram, CTO, Special Circle I, II and III and CTO, I and II Circle Ernakulam, CTO, Special Circle and CTO, Special Circle (Produce) Mattancherry, CTO, Special Circle Perumbavoor, CTO I and II Circles Kalamassery, CTO, I and II Circles Tripunithura, CTO, Aluva, CTO, Special Circle I and II, CTO, I Circle, Kozhikode and CTO, Perambra.

resolved. However, details of implementation of proposals of the Departmental Committee called for had not been furnished (January 2016).

Further, Audit called for the details of scrutiny, both online and manual for the years 2010-11 to 2014-15. However, since online scrutiny commenced only in 2013-14 and the details of manual scrutiny during 2014-15 were not complete, Audit verified the scrutiny for the year 2013-14 conducted in 12 Special Circles<sup>6</sup> and found that during the year 2013-14, 735 out of 4,984 assessment files were selected for detailed scrutiny. In the absence of any instructions or guidelines, Audit found that criteria like turnover of the dealer, commodities dealt, the quantum of ITC availed, the volume of goods transported into the State etc, were not adopted in selecting the files for detailed scrutiny. Thus, such adhocism was affecting the transparency in the selection process of files for scrutiny and permitting the assessing officers to use their discretion in selecting files, which was currently unfettered in the absence of such norms/ guidelines/ instructions. An analysis of the dealers with their GTO and selection of their files for detailed audit is shown in **Table – 2.4**.

**Table – 2.4**

Year	2013-14
Number of dealers in the twelve special circles	4,984
Number of files selected for scrutiny	735
Number of self assessment reopened and completed	235
Additional tax demand created (₹ in crore)	51.85
Number of top dealers whose GTO is above ₹ 10 crore	1,965
Number of files scrutinised on the top dealers	230
Number of self assessment of the top dealers reopened and completed	75
Additional tax demand created on top dealers (₹ in crore)	44.35
Number of self assessment of other dealers reopened and completed	160
Additional tax demand created on other dealers (₹ in crore)	7.50
Additional tax demand created per file of top dealers (₹ in lakh)	59.13
Additional tax demand created per file of other dealers (₹ in lakh)	4.68

Audit observed that more than thirty *per cent* of the self assessment cases selected for scrutiny were reopened and the assessments were completed by creating additional tax demand. It was noticed that the additional demand created on the files of top dealers was more than twelve times in respect of other dealers.

Government stated (December 2015) that instructions have been issued setting forth important criteria. System of centralised selection of files has also been

<sup>6</sup> CTO, Special Circle I, II and III Ernakulam, CTO, Special Circle Kottayam, CTO, Special Circle and CTO, Special Circle (Produce) Mattancherry, CTO, Special Circle Perumbavoor, CTO, Special Circle I and II Kozhikode, CTO, Special Circle Palakkad, CTO, Special Circle Kannur and CTO, Special Circle Thiruvananthapuram.

implemented now. However, the details of instructions issued for the selection of files though called for had not been furnished (January 2016).

Audit looked at Central Revenue Departments such as CBDT and CBEC which issues guidelines each year regarding selection of assesseees for detailed scrutiny and monitoring mechanism for assessment cases.

Audit found that no such system is existing in the Department for selection of scrutiny of files.

**Recommendation No. 2 - *Government may examine the guidelines issued for selection of files for desk review by CBDT/CBEC and similar system of selection with relevant parameters be put in place in the State for VAT cases.***

#### **2.4.7.3. Absence of review mechanism of reports of scrutiny**

As per Circular<sup>7</sup> of CCT every assessing officer should send monthly reports to the jurisdictional Deputy Commissioners (DC) showing the details of scrutiny such as period, number of files selected and results etc., done by them. Audit verified whether these reports were received, reviewed and analysed to see whether the selection of files for scrutiny was fair and adequate and also whether any directions were issued for strict compliance.

Scrutiny of the minutes of the monthly conferences conducted in three districts<sup>8</sup> during 2012-13 by the DCs revealed that though there was lack of scientific approach in the selection of files for detailed scrutiny, no specific directions were issued. The monthly/quarterly reviews were limited only to collection of tax against the target fixed and an analysis of reports of scrutiny was not being done regularly.

Government stated (December 2015) that this has been emphasised in all the review meetings of the Deputy Commissioners. Nodal officer mechanism involving senior officers is in place to monitor every district since 2015. Also that thematic review meeting is conducted periodically for specific areas of evasion of tax. Reply is not acceptable as documents to substantiate the statement were not made available to Audit (January 2016).

**Recommendation No. 3 - *The CCT may issue guidelines to the DCs regarding the aspects to be considered while reviewing the monthly/quarterly reports.***

#### **2.4.7.4 Time limit for completion of assessment reopened not prescribed in the statute**

As per Sections 22, 24 and 25 of KVAT Act, 2003, it is mandatory to issue notice to the dealer for being heard about the discrepancies noticed in the return or

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<sup>7</sup> Circular No. 18/2005 dated 17.08.2005 of Commissioner of Commercial taxes.

<sup>8</sup> Ernakulam, Kannur and Kozhikode.

accounts before proceeding for assessment to the best of assessing authority's judgement. However, there was no provision in the statute fixing a time limit to complete the assessment if no reply is received within the time limit of one to two weeks prescribed in the notice or if the reply received from the dealer is not satisfactory.

In the absence of such a provision in the statute, Audit found that in eight cases<sup>9</sup> out of 120 files test checked in three assessment circles, assessments were not completed even after five years though pre-assessment notices to reopen the self assessments had been issued.

Analysis by Audit revealed that these assesseees were engaged in building/construction business. The assessments of M/s Koroth Gulf Link Builders (P) Ltd were pending since 2010 and that of M/s Heavenly Homes (P) Ltd since 2012, under Commercial Tax Office (Works Contract), Ernakulam.

Thus, non-completion of assessments by the assessing officers in which discrepancies were detected affected the collection of tax.

Government stated (December 2015) that supervisory officers have been directed to have a close monitoring. The directions issued in this regard and compliance there on called for by Audit had not been furnished.

**Recommendation No. 4 - *Government may consider fixing the time limit for completion of assessments.***

#### **2.4.7.5 Lack of a Department Manual to formulate a system in the assessment of tax under KVAT Act, 2003**

A Department manual is essential for regulating and streamlining its functions and activities which has offices functioning throughout the State and has deployed its manpower in all offices. Though there was a manual in the erstwhile KGST regime where the assessment was totally different from VAT, the Department failed to formulate a manual to be followed in VAT assessments even after ten years of introduction of the new system. In the absence of a manual, the following discrepancies were noticed.

- **Non maintenance of registers**

Audit found that the field offices were not maintaining important registers such as DCB register, Scrutiny register, Audit visit register, Notice issued register, Assessment register, Appeals pending register etc. in connection with the assessment/collection of tax.

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<sup>9</sup> CTO (WC) Palakkad- One case, CTO (WC) Kannur-2 cases and CTO (WC) Ernakulam – 5 cases.

In the absence of these registers, the details of important information in an office such as period up to which the returns were scrutinised in the cases of each assessee, details of permission sought/ received for conducting Audit visit, details of self assessments reopened etc., were not available. The non maintenance of registers affected both transparency in selection of files and effectiveness in collection of tax.

- **Lack of clarity in the assignment of duty to men in position**

After the introduction of the KVATIS, the works attended by the supporting staff in the assessment circles were considerably reduced due to automation of functions. Thus, the Department could have utilised their service effectively in areas such as scrutiny of returns of presumptive tax dealers/returns with less turnover reported, conduct street survey etc., towards ensuring better tax collection regime.

Audit observed that though the Department issued directions<sup>10</sup> specifying the duties and responsibilities of the Assessing Officers and clerks, the duties mentioned for clerks in the circular were not relevant after the introduction of KVATIS system. The directions were silent on duties and responsibilities of other important categories like Inspector, Junior Superintendent etc.

Government stated (December 2015) that the above issues would be looked into. Further developments in this regard had not been intimated.

**Recommendation No. 5 - Department may prepare a manual detailing all aspects of assessment to ensure uniformity in the system of assessment. Further, it may be ensured that necessary reports are generated automatically from the KVATIS.**

#### **2.4.7.6 Non adherence to provisions of Act and Rules while completing the assessment**

Sections 22, 24 and 25 of the Act provide for assessment of tax under KVAT. Section 31(5) states that if tax due was not paid in time, interest at the rate of one per cent per month will accrue on it. As per section 67, if any dealer acts in contravention to the provisions of Act and Rules, penalty at twice the rate of tax due from him may be imposed upon him. Specific provisions of the Act/Rule relating to the irregularities are mentioned in the succeeding paragraphs.

Audit scrutinised 3,417 annual returns filed by 1,496 dealers in the selected 36 assessment circles and cross verified the details with other manual and e-data collected and found that the assessing officers failed to follow the provisions in the Act and Rules, which affected the quality of assessment as under.

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<sup>10</sup> Circular No.1-C/2007.

- Accounted sales escaping assessment

Section 42 (1) of KVAT Act, 2003 stipulates that every dealer whose total turnover in a year exceeds rupees sixty lakh shall get his accounts audited annually by a Chartered Accountant or Cost Accountant and shall submit a copy of the audited statement of accounts and certificate in Form 13 & 13A. Section 24(1)(a) of the Act, stipulates rejection of the return, if there is discrepancy between the return filed and audited accounts and to complete the assessment to the “best of judgement”. As per section 42(2) of the Act, the dealer is liable to pay any additional tax with reference to the audited figures, interest thereon under Section 31(5) and penal interest at twice the rate of interest accrued.

Audit noticed that in 14 assessment circles, 15 dealers failed to report the accounted sales whereas 14 dealers failed to report the turnover accounted as ‘other receipts’.

The ‘other receipts’ were warranty claim, AMC receipt, trade discount, subsidy or other receipts to make up the loss sustained etc. which were liable for tax. The total turnover escaped from assessment of tax worked out to ₹ 323.22 crore and the resultant short levy of tax including interest under Section 31(5), penal interest and penalty under Section 67 amounted to ₹ 105.30 crore (**Appendix V**). The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.5**.

Table – 2.5

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover escaped	Total Tax due
Deputy Commissioner, Ernakulam	15	139.67	43.38
Deputy Commissioner, Mattancherry	7	114.14	49.02
Deputy Commissioner, Kottayam	3	0.41	0.11
Deputy Commissioner, Palakkad	2	24.82	4.25
Deputy Commissioner, Kozhikode	1	40.28	6.89
Deputy Commissioner, Thiruvananthapuram	1	3.90	1.65
<b>Total</b>	<b>29</b>	<b>323.22</b>	<b>105.30</b>

Audit observed that amongst the defaulters, M/s Hindustan Unilever Limited of Special Circle Mattancherry was the biggest defaulter with tax effect of ₹ 41.61 crore. The nature of business dealt with by other dealers are given below:

- Four in Fast Moving Consumer Goods with tax effect of ₹ 51.09 crore.
- Four in Supermarket with tax effect of ₹ 7.50 crore.
- Three in batteries with tax effect of ₹ 4.50 crore.
- Eighteen in multiple commodities with tax effect of ₹ 42.21 crore.



Thus, failure of assessing officers to adhere to the provisions of the Act and rules resulted in non-detection of irregularities.

- **Failure to report turnover accounted as interstate stock transfer out**

The movement of goods from one State to another State that occasioned otherwise than by way of sale is treated as local sale and tax shall be levied under section 6 of KVAT Act, if the transfer is not supported by statutory Forms.

Audit found that eight<sup>11</sup> out of 17 dealers scrutinised in five assessment circles failed to report in their annual return, the transactions accounted as interstate stock transfer out. The dealers did not report the transaction and also failed to submit statutory Forms to claim exemption. Though statutory declarations were not filed, the assessing officer did not levy tax on the turnover of goods treating it as a local sale. Non-reporting of transactions worth ₹ 384.79 crore resulted in short levy of tax including interest and penalty of ₹ 140.53 crore. The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.6**.

**Table – 2.6**

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover escaped	Total Tax due
Deputy Commissioner, Ernakulam	4	260.83	94.27
Deputy Commissioner, Palakkad	2	10.1	1.59
Deputy Commissioner, Mattancherry	1	110.72	43.54
Deputy Commissioner, Thiruvananthapuram	1	3.14	1.13
<b>Total</b>	<b>8</b>	<b>384.79</b>	<b>140.53</b>

Audit observed that amongst the defaulters, M/s Mondelez India Foods Limited of Special Circle II Ernakulam was the biggest defaulter with tax effect of ₹ 68.37 crore.

- **Turnover exempted without mentioning the nature of exemption**

As per Rule 10 of the KVAT Rules, 2005, the allowable deductions from the local sale of taxable goods are (1) sale of goods to units in Special Economic Zone (SEZ) (2) sale to his agent or principal (3) sale of medicines purchased on invoices in Form 8H.

Audit found that in case of 25 out of 42 dealers whose returns scrutinised in nine assessment circles, the assessee availed exemption of turnover of ₹ 671.45 crore

<sup>11</sup> Asian Paints Ltd (₹ 10.50 crore), Mondelez India Foods Limited, (₹ 68.37 crore), Parle Biscuits (P) Ltd. (₹ 14.18 crore), Concord Enterprises (₹ 1.22 crore), Hindustan Unilever Limited (₹ 43.54 crore), South Indian Federation of Fishermen (₹ 1.13 crore), Kiran Global Chems Ltd (₹ 1.17 crore), Precot Meridian Limited (₹ 0.42 crore).

from their local sales turnover without mentioning the nature of exemption. Since no exemption is allowable from the local sales of a dealer under the Act other than those mentioned above, the exemption availed was not in order. However, the assessing authority accepted the returns without assessing the irregular exemptions. This resulted in short levy of tax including interest under Section 31(5) and penalty under Section 67 of ₹ 234.89 crore (**Appendix VI**). The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.7**.

Table – 2.7

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover of exemption availed	Total Tax due
Deputy Commissioner, Ernakulam	17	476.68	196.99
Deputy Commissioner, Thiruvananthapuram	2	22.66	5.07
Deputy Commissioner, Kottayam	2	68.38	10.59
Deputy Commissioner, Mattancherry	1	24.31	9.84
Deputy Commissioner, Kozhikode	1	3.87	1.25
Deputy Commissioner, Palakkad	1	32.78	4.44
Deputy Commissioner, Kannur	1	42.77	6.71
<b>Total</b>	<b>25</b>	<b>671.45</b>	<b>234.89</b>

Audit observed that amongst the defaulters, M/s Indian Oil Corporation of Special Circle II Ernakulam was the biggest defaulter with tax effect of ₹ 148.64 crore. The nature of business dealt by these dealers are indicated below:

- Four in Automobiles with tax effect of ₹ 38.79 crore.
- Three in Hill produce with tax effect of ₹ 15.02 crore.
- Three in Fast Moving Consumer Goods with tax effect of ₹ 11.69 crore.
- Fifteen in multiple commodities with tax effect of ₹ 169.39 crore.

Audit noticed that M/s Indian Oil Corporation, M/s Concorde Motors India Ltd of Special Circle II Ernakulam, M/s Hindustan Unilever Limited of Special Circle Mattancherry and National Handloom Development Corporation Ltd. of CTO, II Circle, Kannur repeated the default for three years.

- **Irregular exemption of sales to units situated in Special Economic Zone**

As per Section 6(7)(b) of the KVAT Act, 2003, sale of any building materials, industrial inputs, plant and machinery including components, spares, tools and consumables in relation thereto to any developer or industrial unit or establishments situated in any SEZ in the State for setting up the unit or use in the manufacture of other goods shall, subject to such conditions or restrictions, as may be prescribed, shall be exempted from tax.



Audit found that eight out of 14 dealers whose returns were scrutinised in four assessment circles, under Deputy Commissioner, Ernakulam, the assessee availed exemption of turnover of ₹ 108.97 crore treating it as the sales to units situated in SEZ. Audit found that the goods sold were surgical equipments, furniture, computers, electronic goods, petroleum, furnace oil, etc. Since these goods do not fall under the exempted category of goods as mentioned in Section 6(7)(b), the exemption availed was irregular. Lack of scrutiny by assessing officers even though the data was available in KVATIS resulted in short levy of tax including interest and penalty works out to ₹ 43.80 crore (**Appendix VII**).

Audit observed that amongst the defaulters, M/s Bharat Petroleum Corporation Ltd. of Special Circle II, Ernakulam was the biggest defaulter with tax effect of ₹ 15.60 crore.

Audit noticed that M/s Bharat Petroleum Corporation Ltd and M/s Blue Star Limited of Special Circle II, Ernakulam repeated the default for three years.

• **Turnover exempted without furnishing the statutory documents**

As per Rule 10 of the KVAT Rules, the dealer is entitled to deduct the turnover 2005 if the turnover is supported by Form 43, Form 25F, Form 8H invoices, Form E1 or the documents supporting high sea sales as the case may be.

Audit observed that 22 out of 37 dealers in 12 assessment circles exempted a turnover of ₹ 1,007.71 crore by claiming that the goods were sold (1) to a unit situated in SEZ, (2) through auction (3) as tax previously suffered on its MRP. However, no statutory documents such as Form 43, Form 25F or Form 8H, were produced to prove their claims. Audit found that the assessing officers were not completing the assessments, even in the absence of such statutory declarations. In the absence of such statutory forms, the exemption claimed was not in order resulting in short levy of tax including interest u/s 31(5) and penalty u/s 67 amounting to ₹ 151.38 crore (**Appendix VIII**). The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.8**.

**Table – 2.8**

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover exempted	Total Tax due
Deputy Commissioner, Ernakulam	7	108.04	20.07
Deputy Commissioner, Mattancherry	5	342.89	50.70
Deputy Commissioner, Kozhikode	5	46.75	6.71
Deputy Commissioner, Kottayam	3	422.72	62.09
Deputy Commissioner, Thiruvananthapuram	2	87.31	11.81
<b>Total</b>	<b>22</b>	<b>1007.71</b>	<b>151.38</b>

Audit observed that amongst the defaulters, M/s MJM Traders of Special Circle Kottayam was the biggest defaulter with tax effect of ₹ 51.37 crore. The nature of business dealt by these dealers are as follows:

- Seven in Medicine with tax effect of ₹ 40.79 crore.
  - Five in Tea auction with tax effect of ₹ 50.70 crore.
  - Six were sellers to Special Economic Zone with tax effect of ₹ 58.55 crore.
  - Four were sub contractors with tax effect of ₹ 1.34 crore.
- **Output Tax (OPT) reversed without furnishing requisite documents**

As per Rule 10 of KVAT Rules, 2005, the dealer is entitled to deduct from his turnover, all amounts allowed to purchasers in respect of goods returned by them, where the goods are taxable on the amount for which they have been sold. Section 41 of the Act stipulates that the selling dealer shall issue credit notes and the purchaser effecting the sales return shall issue debit notes in Form No.9. Proviso to Rule 59 states that a credit note claim shall be supported by debit notes.

Audit observed that 27 out of 41 dealers whose returns were scrutinised in ten assessment circles had adjusted ₹ 19.66 crore from their tax due, claiming it as the tax element on sales return. However, the claim was not supported by the corresponding debit notes issued by the purchasers to the credit note of the dealers. Lack of scrutiny by assessing officer resulted in escapement of such omissions undetected. The short levy of tax on this account worked out to ₹ 64.45 crore. The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.9**.

Table – 2.9

(₹ in crore)

Name of the Tax District	Number of dealers	Tax on sales return reversed	Total Tax due
Deputy Commissioner Ernakulam	16	3.96	12.78
Deputy Commissioner Thiruvananthapuram	4	13.69	45.12
Deputy Commissioner Mattancherry	3	1.08	3.42
Deputy Commissioner Kannur	1	0.38	1.30
Deputy Commissioner Kottayam	2	0.08	0.26
Deputy Commissioner Kozhikode	1	0.47	1.57
<b>Total</b>	<b>27</b>	<b>19.66</b>	<b>64.45</b>

Audit observed that amongst the defaulters, M/s TV Sundaram Iyenger & Sons Private Limited of Special Circle Thiruvananthapuram was the biggest defaulter with tax effect of ₹ 44.20 crore.

Audit noticed that M/s Nestle India Limited and M/s Prism Cement Limited of Special Circle I Ernakulam repeated the default for three years and M/s T.V Sundram Iyengar & Sons Private Limited of Special Circle Thiruvananthapuram repeated the default for four years.

• **Excess claim of special rebate**

As per Section 12(1) of the Act, a dealer is entitled to deduct from the tax payable by him, a sum equal to the tax paid under sub-Section (2) of Section 6 where such goods are intended for resale or for use in the manufacture of taxable goods or for use in the execution of works contract or for use as containers or packing materials for the packing of taxable goods in the state.

Audit noticed that three out of seven dealers whose returns were scrutinised in two assessment circles had availed special rebate of ₹ 6.13 crore against a purchase tax due/paid amounting to ₹ 5.97 crore during the year 2012-13. Since the claim of special rebate cannot be in excess of purchase tax due, the excess claim of special rebate resulted in short levy of tax including interest and penalty of ₹ 0.51 crore as shown in **Table – 2.10**.

**Table – 2.10**

(₹ in crore)

Name of the office	Name of the dealer	TIN	Special rebate available (purchase tax due plus paid)	Special rebate claimed	Short levy including interest and penalty
CTO, Special Circle, Kottayam	JMJ Traders	32051107585	0.21	0.28	0.23
	St Mary's Rubbers Pvt. Limited	32050276345	4.09	4.13	0.12
CTO, Special Circle III, Ernakulam	Rubber Mark	32070491155	1.67	1.72	0.16
	<b>Total</b>		<b>5.97</b>	<b>6.13</b>	<b>0.51</b>

• **Non reversal of ITC on interstate sale of rubber**

The Government, through a notification<sup>12</sup>, exempted the payment of tax on the interstate sale of natural rubber subject to the condition that the natural rubber has suffered tax under the Act. The CCT issued direction<sup>13</sup> that if the sale of a goods is exempted through notification, no ITC shall be allowed on the purchase turnover of such goods sold during interstate.

Audit found that two out of eight dealers whose returns were scrutinised in two assessment circles were liable to reverse their ITC claim of ₹ 2.33 crore, being the tax suffered on the purchase turnover of rubber sold interstate, but reversed only ₹ 2.08 crore. This resulted in short payment of tax including interest and penalty of ₹ 0.83 crore as show in **Table – 2.11**.

<sup>12</sup> SRO 753/2011.

<sup>13</sup> Circular No.17/2013.

Table – 2.11

(₹ in crore)

Name of the office	Name of the dealer	TIN	Year	IPT to be reversed	IPT reversed	Short levy including interest and penalty
CTO, Special Circle, Kottayam	St Mary's Rubbers Pvt. Limited	32051107585	2012-13	0.17	0	0.56
			2013-14	0.04	0	0.13
CTO, Special Circle III, Ernakulam	Rubber Mark	32070491155	2012-13	2.12	2.08	0.14
	<b>Total</b>			<b>2.33</b>	<b>2.08</b>	<b>0.83</b>

Government stated (December 2015) that detailed verification was needed in all the cases pointed out and that final report will be submitted after verification. Audit feels that the Government may explore the possibilities of investigation in all the cases.

- Irregular claim of exemption from the contract receipt by dealers who opted to pay tax under compounding scheme**

As per Section 8(a) of the Act, a dealer, instead of paying tax under Section 6, can opt for payment of tax at the rate stipulated for the whole amount of contract. As such, a dealer who opted to pay tax under Section 8(a), is not eligible to deduct any amount from the contract receipt received by him. This position was upheld in a judicial review by the High Court of Punjab and Haryana<sup>14</sup>.

Audit found that 12 out of 22 works contractors/ builders in four assessment circles had availed exemption of the value of land amounting to ₹ 33.14 crore from their contract receipt to arrive at the taxable turnover. This is against the provisions of the Act and had resulted in short payment of tax including interest and penalty of ₹ 3.30 crore (**Appendix IX**). The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.12**.

Table – 2.12

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover exempted	Total Tax due
Deputy Commissioner Palakkad	4	5.47	0.53
Deputy Commissioner Ernakulam	3	4.11	0.40
Deputy Commissioner Kozhikode	3	17.05	1.75
Deputy Commissioner Kannur	2	6.51	0.62
<b>Total</b>	<b>12</b>	<b>33.14</b>	<b>3.30</b>

<sup>14</sup> CWP Case No. 5730 of 2014 in CHD Developers Vs The State of Haryana and others.

Audit observed that amongst the defaulters, M/s Hilite Builders of Works Contract Office, Kozhikode was the biggest defaulter with tax effect of ₹ 1.19 crore. Audit noticed that M/s Pazheri Properties & Developers (P) Ltd of Works Contract Office Kozhikode repeated the default for three years.

Audit found that acceptance of returns of the dealers who were not adhering to the provisions in the statute led to evasion of tax.

Government stated (December 2015) that the Law department had opined that land value was excluded in the works contract. Reply was not tenable as the audit objection was based on provisions of the Act which had also been upheld judicially.

#### **2.4.7.7 Lack of coordination between other departments in collecting data useful for the completion of assessment**

The white paper published by empowered committee on State level Value Added Tax emphasised the need for cross verification of data between various implementing and taxation authorities so as to check tax evasion and to ensure growth of revenue.

Audit found that the Department was not collecting these details from any other Central/State Government agencies and compiling a data bank either in the macro or in the micro level. Audit found suppression in import purchase reported at Customs and turnover reported at Income Tax Department escaped from assessment as detailed below:

- **Suppression of import purchases than that reported with Customs Department**

Audit collected the data of import made through Kochi, Mangalore and Tuticorin ports by the dealers in Kerala from the Director General of Systems and Management, Central Excise and Customs, New Delhi and cross verified it with their assessment records. Audit cross checked the import details furnished by 79 dealers and found that 40 dealers in 14 assessment circles had imported marble/tile, timber and cement amounting to ₹ 817.57 crore against which ₹ 569.19 crore only was conceded. The suppression of import purchase worked out to ₹ 248.38 crore and the resultant short levy of tax, interest and penalty worked out to ₹ 108.38 crore (**Appendix X**). The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.13**.

Table – 2.13

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover suppressed	Total Tax due
Deputy Commissioner, Ernakulam	12	23.65	10.25
Deputy Commissioner, Kozhikode	9	103.02	44.48
Deputy Commissioner, Mattancherry	8	81.07	35.71
Deputy Commissioner, Kannur	7	4.18	1.82
Deputy Commissioner, Kottayam	3	36.36	16.08
Deputy Commissioner, Thiruvananthapuram	1	0.10	0.04
<b>Total</b>	<b>40</b>	<b>248.38</b>	<b>108.38</b>

Audit observed that amongst the defaulters, M/s Hillwood Furniture of Special Circle II, Kozhikode was the biggest defaulter with tax effect of ₹ 30.97 crore.

Audit noticed that M/s Southern Timber depot of Special Circle, Kottayam repeated the default for five years and M/s Hillwood furniture of Special Circle II, Kozhikode repeated the default for four years.

The nature of business dealt by these dealers is indicated below.

- Twenty four in Timber with tax effect of ₹ 87.98 crore.
- Twelve in Marble/tiles with tax effect of ₹ 13.01 crore.
- Four in Cement with tax effect of ₹ 7.39 crore.

The Principal Secretary (Taxes) agreed in the exit meeting (December 2015) to take measures to improve the co-ordination with other Departments.

- **Short return of turnover than that reported with Income Tax Department**

Audit collected the details of scrutiny assessments completed for the financial year 2010-11 and 2011-12 in Corporate Circle 1(1), Corporate Circle 1(2) and Corporate Ward 1(3), Ernakulam of the Income Tax Department. The cross verification of this data with the turnover details returned by 22 dealers in four assessment circles of Commercial Taxes Department revealed that four dealers short reported their turnover than that reported with the Income Tax Department. The consequent short payment of tax including interest and penalty worked out to ₹ 9.24 crore as shown in **Table – 2.14**.



**Table – 2.14**

(₹ in crore)

Name of the Office	Name and TIN	Turnover escaped		Total Tax due
		2010-11	2011-12	
CTO, Special Circle II, Ernakulam	India Techs Ltd 32070389512	3.52	3.96	1.60
CTO, Special Circle III, Ernakulam	Hi Build Coatings 32070469195	0.45	0.45	0.12
Works Contract Office, Ernakulam	Holyfaith Constructions 32072022472	5.20	11.00	4.88
CTO, II Circle, Thripunithura	Kerala Shipping and Inland Navigation Corporation Limited 32070335095	2.71	6.11	2.64
<b>Total</b>		<b>11.88</b>	<b>21.52</b>	<b>9.24</b>

Department failed in utilising the data available with Government agencies to generate additional revenue.

Audit observed that there is no system in place in the Department to collect data relating to various taxable events from other Departments and cross verifying the same to analyse whether tax due was paid or not.

**Recommendation No. 6 - *A system may be established to collect the data relating to the taxable events from other departments and transfer the results of analysis to the lower/sub-ordinate level for utilising in the assessment process.***

#### **2.4.7.8 Data in KVATIS not relied upon for analysis before accepting the self assessments/ completing the assessments**

The KVATIS is capturing all the details of transportation of goods in and out of the State through various check posts, the purchases made by a registered dealer from another registered dealer in the State, the sales effected by a registered dealer, the commodity traded and its rate of tax, the certified statement of accounts etc. However, the Software was not equipped with self assessing the tax due from a dealer by analysing the data captured through different modules in the system.

Audit found that all aspects of taxable transactions were not considered while accepting the self assessments since data in KVATIS was not relied upon. Though there were differences in the turnover as per returns filed and that captured by other modules in KVATIS, the assessments were finalised without reconciling the differences. The shortfall in the collection of tax due to under-utilisation of data in KVATIS is discussed in succeeding paragraphs:

- **Failure to pay tax on the entire sales effected through invoices.**

As per Section 20A of the Act, every dealer shall file his return as well as purchase and sales list through electronic filing in addition to hard copy to be filed along with the return.

Audit found that 52 out of 74 dealers scrutinised in 14 assessment circles issued sales invoices worth ₹ 1,248.60 crore, whereas the turnover reported for paying tax was only ₹ 1,175.01 crore resulting in short reporting of turnover by ₹ 73.58 crore. The resultant short levy of tax including interest and penalty worked out to ₹ 16.41 crore (**Appendix XI**). The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.15**.

Table – 2.15

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover escaped	Total Tax due
Deputy Commissioner Thiruvananthapuram	25	49.61	11.37
Deputy Commissioner Ernakulam	23	21.11	4.6
Deputy Commissioner Kozhikode	2	2.22	0.33
Deputy Commissioner Kottayam	2	0.64	0.11
Total	52	73.58	16.41

Audit observed that amongst the defaulters, M/s Marikar (Motors) Ltd. of Special Circle, Thiruvananthapuram was the biggest defaulter with tax effect of ₹ 5.63 crore. The nature of business dealt by these dealers was as under:

- Five in Grocery with tax effect of ₹ 0.69 crore.
- Five in Iron and Steel with tax effect of ₹ 0.24 crore.
- Three in Computer with tax effect of ₹ 0.30 crore.
- Thirty nine in multiple commodities with tax effect of ₹ 15.18 crore.

Audit observed that though these details were available in the KVATIS, the Department failed to address the issue. Thus, the Government needs to streamline the working of the Department and that the Departmental officials need to be vigilant about the availability of such details while doing assessment.

- **Short return of interstate purchases than that was reported at the check posts**

Audit found that 30 out of 56 dealers scrutinised in 11 assessment circles assessee transported into the State through various check posts, goods worth ₹ 1,148.16 crore as interstate purchase and interstate stock transfer against which only ₹ 921.85 crore was reflected in the annual returns. Though the data was readily available in KVATIS, the assessing officers failed to utilise the same,



resulting in short reporting of purchases by ₹ 213.59 crore. The resultant short levy of tax including interest and penalty worked out to ₹ 63.62 crore. The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.16**.

**Table – 2.16**

(₹ in crore)

Name of the Tax District	Number of dealers	Purchase short reported	Total Tax due
Deputy Commissioner, Ernakulam	22	203.08	61.88
Deputy Commissioner, Kottayam	5	5.67	0.99
Deputy Commissioner, Thiruvananthapuram	3	4.84	0.75
<b>Total</b>	<b>30</b>	<b>213.59</b>	<b>63.62</b>

Audit observed that amongst the defaulters, M/s Indus Motors Light Commercial Vehicles Pvt. Ltd. of Special Circle II, Ernakulam was the biggest defaulter with tax effect of ₹ 30.08 crore.

In exit meeting (December 2015) the Principal Secretary (Taxes) stated that once the process of upgrading the server capacity and application upgradation is completed, full use of the information would be made.

- **Excess claim of ITC than the Output Tax (OPT) paid to Government account**

Audit found 10 out of 24 dealers scrutinised in eight assessment circles availed ITC of ₹ 91.12 crore for their purchases from eight selling dealers whereas the sales details of these dealers show that they had paid only ₹ 85.23 crore as tax collected from the above 10 dealers. Since the OPT paid by the selling dealers is less than the ITC claim of the purchasing dealers, the allowance of entire claim of ITC means excess withdrawal of money from Government account amounting to ₹ 5.88 crore. The resultant short levy of tax including interest and penalty worked out to ₹ 19.84 crore (**Appendix XII**). The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.17**.

**Table – 2.17**

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover escaped	Total Tax due
Deputy Commissioner, Ernakulam	4	2.12	6.93
Deputy Commissioner, Mattancherry	2	1.52	5.33
Deputy Commissioner, Thiruvananthapuram	1	1.15	4.02
Deputy Commissioner, Kozhikode	1	0.06	0.19
Deputy Commissioner, Palakkad	1	0.43	1.41
Deputy Commissioner, Kannur	1	0.60	1.96
<b>Total</b>	<b>10</b>	<b>5.88</b>	<b>19.84</b>

Audit observed that amongst the defaulters, M/s T.V Sundram Iyengar & Sons Pvt. Ltd. of Special Circle Thiruvananthapuram was the biggest defaulter with tax effect of ₹ 4.02 crore.

- **Input tax credit was claimed through invoices without valid registration**

Section 2(xxiii) of KVAT Act, 2003 defines input tax as the tax paid or payable under the Act by a registered dealer to another registered dealer on the purchase of goods in the course of business.

Audit found that 11<sup>15</sup> out of 23 dealers scrutinised in seven assessment circles availed ITC of ₹ 23.83 crore. Out of this, ITC amounting to ₹ 0.82 crore was claimed by furnishing either the dealer's own registration number or registration numbers which were not assigned. Since the purchases were not from a registered dealer, the ITC claimed to that extent was to be disallowed. The resultant short levy of tax including interest and penalty worked out to ₹ 2.70 crore. The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.18**.

**Table – 2.18**

(₹ in crore)

Name of the Tax District	Number of dealers	Excess claim of ITC	Total Tax due
Deputy Commissioner Kottayam	5	0.42	1.39
Deputy Commissioner Ernakulam	3	0.30	0.98
Deputy Commissioner Thiruvananthapuram	2	0.05	0.16
Deputy Commissioner Kozhikode	1	0.05	0.17
<b>Total</b>	<b>11</b>	<b>0.82</b>	<b>2.70</b>

The under utilisation of data captured in KVATIS resulted in under-assessment of tax.

Analysis revealed that two assesseees traded in rubber with tax effect of ₹ 0.52 core and the rest nine dealers traded multiple commodities with tax effect of ₹ 2.18 crore.

Audit observed that though these details were available in the KVATIS, the Department failed to address the issue. Thus, the Government needs to streamline the working of the Department and that the Departmental officials need to be vigilant about the availability of such details while doing assessment.

<sup>15</sup> Rose Flames (₹ 0.67 crore), Plant Lipids (P) Ltd (₹ 0.24 crore), ABT Industries Limited (₹ 0.17 crore), Manju.L.John Timbers (₹ 0.09 crore), Gopan Rubber Company (₹ 0.30 crore), India Rubber & Chemicals, (₹ 0.16 crore) Kavanar Latex Ltd (₹ 0.22 crore), JMJ Traders (₹ 0.62 crore), Mehar Reynold (₹ 0.09 crore), Cosmic Group (₹ 0.07 crore), Aiswarya Enterprises (₹ 0.07 crore).

Government stated (December 2015) that detailed verification is needed in all the cases pointed out. Final report would be submitted after verification.

**Recommendation No. 7 - Department may ensure that the final assessments are completed by utilising the data captured in KVATIS.**

#### **2.4.7.9 Failure to assess dealers who did not comply with the provisions in the Act**

Audit found that failure to assess the dealers who did not comply with the provisions of the Act resulted in non levy of tax as shown below.

- Assessments not completed in respect of assesseees who failed to file returns**

As per Section 20(1) of the Act, every registered dealer and every dealer liable to be registered under the Act shall submit to the assessing authority such return or returns before such dates and in such manner and accompanied by such documents as may be prescribed. Under Section 22(3), if any dealer fails to submit any return as provided under Section 20(1), the assessing authority shall estimate the turnover of the return period and complete the assessment to the best of its judgment.

In four assessment circles, 123 dealers out of the 3,791 dealers failed to file their annual returns during 2013-14. The best judgement assessments under Section 22 were initiated against only eight dealers. Audit verified 74 out of the 115 cases on which assessments were pending and found that 10 dealers<sup>16</sup> had tax liability. Deputy Commissioners were not monitoring the assessments in respect of return defaulters resulting in non levy of tax of ₹ 22.40 crore including interest and penalty. The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.19**.

**Table – 2.19**

(₹ in crore)

Name of the Tax District	Number of dealers	Turnover escaped	Total Tax due
Deputy Commissioner, Ernakulam	6	121.89	22.26
Deputy Commissioner, Thiruvananthapuram	4	0.66	0.14
<b>Total</b>	<b>10</b>	<b>122.55</b>	<b>22.40</b>

<sup>16</sup> Eureka Forbes Limited (₹ 3.62 crore), MMTC Limited (₹ 15.57 crore), Leela Soft Pvt Ltd. (₹ 1.42 crore), Hindalco Industries Limited (₹ 1.39 crore), Bharath Glass House (₹ 0.21 crore), Chemplast Sanmar Limited (₹ 0.05 crore), Foot Care (₹ 0.03 crore), OG Arcade (₹ 0.05 crore), Nasr Trade Links (₹ 0.03 crore), Gift Palace (₹ 0.03 crore).

Audit found that of the 10 cases, five were on account of short reporting of inter state purchase, three on account of irregular exemption claimed and two on account of short reporting of sales invoices.

- **Failure to assess tax due from the dealers at the time of cancellation of their registration**

As per Section 2(xlii) of the Act and Rule 15 of the KVAT Rules, if any goods for which input tax credit has been availed but such goods remain unsold at the time of cancellation of registration, the input tax so availed would be reversed. Similarly, if any goods imported into the State by issuing statutory forms remain unsold, tax should be levied on such goods, treating it as sale within the State. As per Section 22(3), if any dealer fails to submit any return as provided under Section 20(1) for a period of time and later his registration is cancelled, then the assessing authority shall estimate the turnover of such return periods and complete the assessment to the best of its judgment.

Audit noticed that out of 75 dealers in five assessment circles whose registrations were cancelled during the years 2010-11 to 2013-14, assessment was completed in 11 cases only. All dealers who cancelled their registration are to be assessed which is not being done. Audit verified balance 64 cases and found 10 dealers<sup>17</sup> had tax liability. Deputy Commissioners were not monitoring the assessments on cancelled dealers resulting in non levy of tax of ₹ 3.20 crore including interest and penalty. The Tax district-wise deviation from provisions of the Act/Rules is detailed in **Table – 2.20**.

**Table – 2.20**

(₹ in crore)

Name of the Tax District	Number of dealers	Total Tax due
Deputy Commissioner, Kozhikode	5	2.19
Deputy Commissioner, Ernakulam	2	0.82
Deputy Commissioner, Kannur	2	0.18
Deputy Commissioner, Palakkad	1	0.01
<b>Total</b>	<b>10</b>	<b>3.20</b>

Audit found that failure to analyse the outstanding tax liability of the assessee at the time of cancellation of their registration resulted in non demand of tax.

Further, analysis revealed that M/s Calicut Gas in the rolls of Commercial Tax Officer, Special Circle II, Kozhikode alone had tax liability of ₹ 2.03 crore.

<sup>17</sup> Malabar Agencies (₹ 0.0045 crore), Maneesh Pharmaceuticals (₹ 0.12 crore), Sunitha Furniture and Foam Palace (₹ 0.16 crore), Sreechakra Agencies (₹ 0.02 crore), Calicut Gas (₹ 2.03 crore), KM Wood (₹ 0.0023 crore), VS Timbers (₹ 0.03 crore), Allied System (₹ 0.01 crore), Tebma Shipyard (₹ 0.69 crore), Asian Electronics (₹ 0.13 crore).

Government stated (December 2015) that detailed verification is needed in all the cases pointed out. Final report would be submitted after verification.

#### **2.4.7.10 Inadequate Internal control mechanism**

- Internal Audit Wing**

Internal audit 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 internal control. An efficient functioning of internal auditing can improve an organisation's operations.

Though the VAT was introduced in April 2005, the internal audit wing was formed in June 2009 only. The wing does not have any internal audit manual. The details of coverage of internal audit for the year 2010-11 to 2014-15 were as detailed in **Table – 2.21**.

**Table – 2.21**

Year	No. of units to be audited	No. of units audited	Percentage of coverage	No. of paras involved	Amount involved	Amount realised
					(₹ in lakh)	
2010-11	356	46	13	919	330.53	Not available
2011-12	356	32	9	445	2,738.20	
2012-13	356	56	16	369	1,488.88	
2013-14	356	60	17	1,333	1,675.15	
2014-15	356	85	25	1,976	3,492.00	

Audit found that the coverage of units audited was less than twenty five *per cent* of the total units which needs to be widened. The low coverage of internal audit depicts the ineffectiveness of the internal audit wing.

Government stated (December 2015) that now the wing consists of one Deputy Commissioner, two assistant commissioners and five commercial tax officers. The shortfall in conducting internal audit is attributed to acute shortage of staff.

Reply was not acceptable viewed in the light of the fact that deficiencies and non-compliance by officials called for strengthening of internal control mechanism including internal audit.

- Lack of follow up action in crime cases reported by the intelligence wing**

Reports on crime cases received from the intelligence wing should be utilised for creating additional demands by reopening the self assessment. Audit found that in four assessment circles test checked, action was not initiated in 82 crime cases involving ₹ 0.89 crore reported by the Intelligence Wing (**Appendix XIII**). In

eight cases, three years had elapsed after reporting the crime by the Intelligence Wing indicating the lapse of proper monitoring mechanism in the Department.

Audit found that all the 82 cases related to Builders/Works contractors in the office of the Commercial Tax Officer (Works Contract), Kannur, Kozhikode and Palakkad.

Government stated (December 2015) that out of 82 cases pointed out, assessments in 27 cases have been completed and instructions issued to assessing authorities to verify the remaining cases.

- **Lack of follow up action in realising additional demand created through assessment**

Audit found that additional demand created amounting to ₹ 2.75 crore through 101 assessment files in five assessment circles was not realised. Follow up action was not initiated to collect demand in seven cases even after four years of its creation resulting in lack of proper monitoring mechanism to collect the arrears of revenue.

Though the assessing officers had sent the details of defaulters to the respective Inspecting Assistant Commissioners responsible for initiating RR action, but the cases were pending for want of action. The reasons stated by the Inspecting Assistant Commissioners were: (a) Stay by courts and others, (b) whereabouts of the dealers were not traceable, (c) RR proceedings were in the initial stage etc.

Government stated (December 2015) that out of 101 cases pointed out, one case had been quashed by Court and final reply would be submitted in the remaining cases.

- **Lack of a system to ensure quality of assessments**

As per Section 55 of the Act, any person aggrieved by any order or proceedings passed by an assessing authority may within thirty days from the date on which the order was served on him, appeal against such order to the Deputy Commissioner (Appeals), if the order was passed by Assistant Commissioner. If the order was passed by Commercial Tax Officer, AC (Appeal) is the Appellate Authority. The Appellate Authority after hearing and examination of related records, disposes the appeals, by an order stating the reasons for arriving at the decision such as the appeal is allowed, dismissed or modified or set aside.

Audit had called for details in respect of cases of appeals disposed in all the seven appellate authorities, however, data was made available only from one appellate authority. Audit found that the Appellate authority<sup>18</sup> had disposed of 794 cases of appeals during 2013 and 2014 out of which 527 cases were disposed of as allowed in favour of the assessee or stood modified. Audit test checked 121 of these cases

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<sup>18</sup> Deputy Commissioner (Appeal)-II, Ernakulam.



and found that the assessments were completed in contravention of the provisions of the Act such as non-affording of opportunity of being heard, non-availability of material evidence, non-verification of records produced etc., or the claim made by the assessee was not rebutted which led to its disposal as above.

The quality of an assessment depends on its sustainability with law and the collection of demanded tax. But the assessments were completed without analysing all provisions of the Acts and Rules. In order to ensure the quality of assessment orders, in Central Receipts, Chief Commissioners/ Director General of Income tax are required to analyse at least 50 quality assessments of their respective charges and send the report to the respective Zonal Member.

Government stated (December 2015) that a peer review mechanism is being implemented to minimize the apparent legal and factual errors creeping into the assessment orders.

***Recommendation No. 8 - Department may ensure the quality of assessments by adopting the system prevailing in Central Receipts as basis so that the number of cases which are failing in judicial review would be on a lower side.***

## **Conclusion**

Audit arrived at the following conclusions:

- VAT is a self-assessment system, which contemplates that the tax liability is calculated and paid by the tax payer (assessee) through periodical returns. Thus, it is necessary to check and ensure that the tax payers are disclosing their tax liability properly while filing the returns. Certain dealers are evading/minimising the tax liability through various methods such as, unaccountal of purchases and corresponding sales, concealment of a portion of turnover, ineligible/incorrect claiming of input tax on bogus purchase invoices, incorrect claiming of concessional rate and exemption of tax, non-filing the periodical returns though they are conducting business and not paying the legitimate tax due to Government.
- KVATIS is not robust enough to ensure the accuracy of the returns filed. Hence, scrutiny of the return filed by dealers, detailed audit of returns and books of accounts of the errant dealers are imperative in the administration of VAT.
- Internal Control mechanism existing in the Department was not adequate to maximise tax collection.

Fifty five cases which were considered by Audit for inclusion in the Audit Report noticed during regular audit are also given in the following paragraphs.

## **2.5. Short payment of tax due to non revision of self assessments having defects/deficiencies**

Assessing authorities did not re-assess tax in the case of defective self assessments.

**As per Section 25(1) of KVAT Act, 2003 where for any reason the whole or any part of turnover of business of a dealer has escaped assessment to tax in any year or has been assessed at a rate lower than the rate at which it is assessable, or where any input tax credit or special rebate has been wrongly availed of the assessing authority may, at any time within five years from the last date of the year to which the return relates, proceed to determine, to the best of its judgement, the turnover which has escaped assessment to tax or has been assessed at a rate lower than the rate at which it is assessable or input tax credit or special rebate that has been wrongly availed of and assess the tax payable on such turnover or disallow the input tax credit or special rebate wrongly availed of.**

Audit noticed between June 2013 and November 2014 irregularities such as purchase suppression, sales suppression, misclassification of commodities etc., in the annual returns filed by the assesseees in five cases. However, the assessing authorities did not detect the defect and assessed to tax the escaped turnover or the turnover misclassified. This resulted in short payment of tax, cess and interest of ₹ 26.08 crore as detailed in the following paras.

- **CTO, Special Circle, Kottarakkara**

M/s Sree Vinayaka Motors, Kottarakkara, a dealer in motor vehicles and spare parts while filing the revised return for 2011-12, had not included interstate purchase turnover of ₹ 54.03 crore relating to motor vehicles and spare parts. This resulted in short payment of tax, cess and interest of ₹ 10.65 crore. In addition, penalty of ₹ 15.10 crore was also leviable under Section 67 of KVAT Act, 2003.

The Government stated (July 2015) that the assessment had been revised creating additional demand of ₹ 11.39 crore. It was also stated (October 2015) that the dealer approached the Hon'ble High Court of Kerala and the Hon'ble High Court allowed (April 2015) instalment facility for remittance of the amount in 12 equal instalments with accrued interest from 30 April 2015. The dealer remitted (between July 2015 and September 2015) ₹ 2.06 crore. Upto September 2015, the assessee had to remit ₹ 4.75 crore with interest against which amount remitted was only ₹ 2.06 crore. Government had not explained the reason for the short



remittance of the dues by the assessee. Further report had not been received (January 2016).

- **CTO, Special Circle, Mattancherry**

M/s Labtech Medico Private Ltd., Karukutty, a dealer in laboratory scientific equipments and Medical surgical equipments and spares including bandages conceded in their annual return for 2011-12 import of the above items taxable at 12.5 *per cent* and four *per cent* for ₹ 68.07 lakh and ₹ 158.48 lakh respectively. Audit found from the HSN<sup>19</sup> code affixed on the bill of entry that the assessee imported goods taxable at 12.5 *per cent* and four *per cent* for ₹ 210.51 lakh and ₹ 16.23 lakh respectively during the year. Thus, the assessee had misclassified import purchase of goods taxable at 12.5 *per cent* amounting to ₹ 1.42 crore as four *per cent* taxable goods. Misclassification of purchase turnover and corresponding sales turnover resulted in short payment of tax, cess and interest of ₹ 15.69 lakh.

The Government stated (January 2016) that assessment of the dealer had been completed (July 2015) creating additional demand of ₹ 17.59 lakh and the demand was advised for RR proceedings. Further report had not been received (January 2016).

- **CTO, Kuthiathode**

M/s. Royal Ocean, Aroor was a manufacture and dealer in meat and fish products. During 2012-13, they conceded a total sales turnover of ₹ 16.76 crore as exports sales. However, as per Form 13 A, forming part of annual accounts certified by Chartered Accountant, filed by the assessee, they had a local sales turnover of ₹ 1.25 crore, which was not self assessed to tax by the assessee. This resulted in short payment of tax and interest of ₹ 7.08 lakh.

Government stated (May 2015) that assessment had been completed creating total additional demand of ₹ 21.98 lakh. The assessee had remitted ₹ 6.60 lakh (January 2015) as per the stay condition of DC (Appeal) Kollam. Further report had not been received (January 2016).

- **CTO, Special Circle, Thrissur**

M/s Superstone Diamonds, Thrissur, was a dealer in jewellery and precious stones. Audit found that the assessing authority while finalising the assessment for 2010-11 allowed special rebate of ₹ 5.50 lakh to the assessee which was not admissible. Further, the assessing authority after allowing special rebate of ₹ 5.50 lakh refunded ₹ 3.52 lakh, instead of demanding balance tax due amounting to ₹ 1.98 lakh. The incorrect allowance of special rebate resulted in short levy of tax and interest of ₹ 6.98 lakh.

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<sup>19</sup> Harmonised System of Nomenclature.

Government stated (October 2015) that the DC, Thrissur had been directed to re-examine the case. Further report had not been received (January 2016).

- **CTO, II Circle, Kozhikode**

M/s. PVR Enterprises, Kozhikode, a dealer in toughened glasses and automobile spare parts filed annual return for 2011-12 conceding sales turnover of item taxable at 4 *per cent* and 12.5 *per cent* as ₹ 77.61 lakh and ₹ 48.11 lakh respectively. Audit found from Form 13A that sales turnover of items taxable at 12.5 *per cent* conceded by the assessee was ₹ 35.65 lakh less than the cost of goods sold which amounted to ₹ 83.76 lakh. There was corresponding difference between purchase and sales turnover of four *per cent* taxable items. Application of incorrect lower rate of tax on sales turnover of goods taxable at higher rate resulted in short payment of tax, cess and interest of ₹ 3.46 lakh.

Government stated (August 2015) that assessment had been completed (October 2013) creating additional demand of ₹ 5.56 lakh. The assessee had paid ₹ 2.50 lakh and the remaining dues were under revenue recovery. Further report had not been received (January 2016).

Though the assessments were completed in the cases where the short levy was pointed out by Audit, it was seen that most of the defects were similar to those pointed out during previous years. No action was however found taken on assessing officers for persistent omissions to improve the quality of assessment to avoid by way of institutional reforms at Government level. The Department had failed to improve the system to avoid the similar defects in succeeding years. Moreover, penalty under Section 67 of KVAT Act was also not levied in these cases.

## **2.6. Short payment of tax due to application of incorrect rate of tax**

Rate of tax applied on the taxable turnover was less than the rate applicable as per the statute.

### **2.6.1 Government issued a notification<sup>20</sup> in January 2006 including a list of goods which are taxable at 12.5 *per cent*. The rate of tax was enhanced to 13.5 *per cent* with effect from 1.4.2012.**

Audit noticed between November 2013 and December 2014 that in four cases, the assessee applied incorrect rate of tax resulting in short payment of tax, cess and interest of ₹ 6.19 crore as detailed in the following cases.

<sup>20</sup> SRO No. 82/2006 (GO(P) No. 4/2006/TD dated 21 January 2006.

- **CTO, Special Circle I, Ernakulam**

M/s. 3F Industries Ltd., Kochi, was a dealer in edible oil, milk products etc. During 2012-13, they assessed to tax sales turnover of edible oil for ₹ 56.54 crore at one *per cent*. Audit found from the check post module of KVATIS that during 2012-13, the assessee had interstate purchase and interstate stock transfer of margarine into the State for ₹ 85.52 lakh and ₹ 36.87 crore respectively. However corresponding sales turnover of margarine was misclassified by the assessee as edible oil and self assessed to tax at one *per cent* instead of the applicable rate of 13.5 *per cent*. Application of incorrect rate of tax on the sales turnover of margarine resulted in short payment of tax and interest of ₹ 5.33 crore.

Government stated (October 2015) that based the audit objection, a notice under Section 25A had been issued by the assessing authority and the case had not been finalised. Further report had not been received (January 2016).

- **CTO, Ettumanoor**

M/s Jojo Industries, Ettumanoor, self assessed to tax local sales turnover of parts of space craft, spacecraft launch vehicles etc., for ₹ 44.11 lakh, ₹ 87.88 lakh, ₹ 204.47 lakh and ₹ 254.71 lakh respectively for the years 2008-09, 2009-10, 2010-11 and 2011-12 at four *per cent* classifying as steel and iron products. Audit found that the entire local sales were made to Vikram Sarabhai Space Centre, Indian Space Research Organisation, Thiruvananthapuram for use as parts in spacecraft, suborbital and spacecraft launch vehicles which are taxable at 12.5 *per cent*. Application of incorrect rate of tax resulted in short payment of tax, cess and interest of ₹ 65.17 lakh.

Government stated (July 2015) that assessment had been completed (February and March 2015) creating additional demand of ₹ 81.29 lakh. It was also stated (December 2015) that the assessee had remitted ₹ 11.17 lakh as per the direction of the Hon'ble High Court of Kerala.

The details of collections though called for (November 2015) had not been received (January 2016).

- **CTO, II Circle, Palakkad**

Audit observed that M/s Kottukapilly Sand and Metals Pvt. Ltd., Palakkad, a dealer in sand and metal had assessed the sales turnover of metals of various sizes produced with the aid of crushing machines for ₹ 128.87 lakh at five *per cent* instead of the applicable rate of 13.5 *per cent* during 2012-13. Application of incorrect rate of tax resulted in short payment of tax and interest of ₹ 13.04 lakh.

Government stated (July 2015) that assessment had been completed (February 2015) creating additional demand of ₹ 14.41 lakh. The assessee had remitted (March 2015) an amount of ₹ 4.32 lakh. Recovery of the balance amount was

under interim stay by Hon'ble High Court of Kerala.

The details of collections though called for (November 2015) had not been received (January 2016).

- **CTO, Koothuparamba**

M/s Malabar Construction Materials (P) Ltd, Kannavam, was an assessee engaged in crushing of metal. During 2010-11, the assessee self assessed to tax the sales turnover of M- sand for ₹ 73.3 lakh, at four *per cent* instead of the applicable rate of 12.5 *per cent*. Application of incorrect rate of tax resulted in short payment of tax, cess and interest of ₹ 8.18 lakh.

Government stated (July 2015) that assessment of the dealer had been completed (January 2014) creating additional demand of ₹ 8.36 lakh and dues were advised for Revenue Recovery. The assessee had remitted 40 *per cent* of the demand and preferred appeal before DC (Appeal) Kozhikode who had issued modification (January 2015) directing the assessing authority to give exemption to the sales turnover of M-Sand conceded by the assessee. The DC, Kannur had reported that there was no scope for second appeal against the order of the DC (Appeal), Kozhikode, as the dealers who had opted for compounding were exempted from payment of tax on the turnover of M-Sand as per the proviso to Section 8 (b) of KVAT Act, 2003. The reply was not acceptable since the crushers compounded and the crusher used for producing M-Sand were different.

Audit noticed that though the assessments were completed in the above cases where the short levy was pointed out by Audit, it was seen that most of the defects were similar to those pointed out during previous years. Thus, Department failed to improve the system to avoid the similar defects in succeeding years.

### 2.6.2 Bakery items

**Bakery products including biscuits sold under brand name, registered under the Trade Mark Act, 1999 are liable to be taxed at 12.5 *per cent* and 13.5 *per cent* during 2011-12 and 2012-13 respectively, under SI No. 11 of list of goods notified<sup>21</sup> under KVAT Act, 2003.**

Audit noticed between June 2013 and December 2014 that in three cases, the assessee self assessed tax on sales turnover of bakery products at four/five *per cent*. Audit found that the bakery products sold by the assessee were under brand name. This resulted in short payment of tax, cess and interest of ₹ 1.81 crore as given in succeeding paragraphs.

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<sup>21</sup> SRO No. 82/2006.

- **CTO, Special Circle II, Ernakulam**

M/s Elite Foods Private Limited, Ernakulam, was a manufacturer of Bakery products selling goods under a brand name 'Elite' under Trade Mark Act, 1999. They self assessed to tax the sales turnover of bakery products for the period from April 2012 to September 2012 amounting ₹ 16.22 crore at five *per cent* instead of the applicable rate of 13.5 *per cent*. This resulted in short payment of tax and interest of ₹ 1.64 crore.

Government stated (July 2015) that assessment had been completed (June 2015) creating an additional demand of ₹ 1.75 crore and the amount was under collection. Further report had not been received (January 2016).

- **CTO, II Circle, Kozhikode**

M/s Ojin Bakes, Nadakkavu, was a manufacturer and dealer of bakery products. During 2011-12, they self assessed tax on sales turnover of bakery products for ₹ 1.18 crore at four *per cent*. Audit found that the bakery products sold by the assessee were under brand name 'OJIN' registered under Trade Mark Act, 1999 and as such taxable at 12.5 *per cent*. Application of incorrect rate of tax resulted in short payment of tax, cess and interest of ₹ 11.46 lakh.

Government stated (September 2015) that assessment had been completed (May 2015) creating total additional demand of ₹ 13.89 lakh. Further report had not been received (January 2016).

- **CTO, III Circle, Kozhikode**

M/s Ojin Bakes, Kozhikode was a dealer of bakery products. They self assessed tax on sales turnover of bakery products at four *per cent* on ₹ 31.22 lakh during 2011-12 and at five *per cent* on ₹ 23.94 lakh during 2012-13. Audit found that the bakery products sold by the assessee were under the brand name 'OJIN' registered under Trade Marks Act, 1999 and were liable to be taxed at 12.5 *per cent* and 13.5 *per cent* during 2011-12 and 2012-13 respectively. Application of incorrect rate of tax resulted in short payment of tax, cess and interest of ₹ 5.79 lakh.

Government stated (August 2015) that assessment of the dealer had been completed (March 2015) creating additional demand of ₹ 6.17 lakh. Further report had not been received (January 2016).

As per Section 67 of KVAT Act, the assessing officer may impose penalty upto double the tax evaded or sought to be evaded. Though the assessee evaded tax by filing returns showing incorrect rate of tax for goods dealt with, no penalty was levied by the assessing officer.



Though Audit had pointed out the same defect in respect of the same assessee in Audit Report 2012, Government had not addressed the issue. The Principal Secretary (Taxes) and Commissioner of Commercial Taxes were requested (November 2015) to take remedial action. Their replies had not been received (January 2016).

### 2.6.3 Works Contract

**Under Section 8 (a)(ii) of KVAT Act, works contractors registered under the provisions of CST Act, 1956 or an importer, when opted for payment of compounded tax, are liable to pay tax at three *per cent* of the contract amount after deducting the purchase value of goods excluding freight and gross profit element consigned into the State on stock transfer or purchased from outside the State and for the purchase value of goods so deducted shall pay tax at the scheduled rate applicable to such goods. Further, the compounded tax payable by any works contractor registered under the provisions of CST Act, 1956 or an importer shall be four *per cent* of the whole contract amount in respect of contract awarded by Government of Kerala.**

- **CTO (WC), Kozhikode**

M/s Uralungal Labour Contract Co-operative Society Ltd., Vadakara, was a contractor, who was also an importer. Audit found that during 2010-11, 2011-12 and 2012-13, the works contract receipts from the work of Government of Kerala and local bodies amounting to ₹ 72.73 crore, ₹ 72.59 crore and ₹ 65.03 crore were self assessed to tax by the assessee at three *per cent* against the correct rate of four *per cent*. Application of incorrect rate of tax resulted in short payment of tax and interest of ₹ 2.95 crore.

Government stated (October 2015) that based on the audit objection, the assessment of the dealer for the year 2012-13 had been completed (August 2015) taking into account other defects also, creating total additional demand of ₹ 4.02 crore which included the amount pointed out by Audit also. The dealer remitted (between September and November 2015) ₹ 86.39 lakh. Further report for the remaining period had not been received (January 2016).

- **CTO, Aluva**

M/s. Padmaja Specialties, Aluva, was a works contractor who had trading of chemicals also. During 2012-13, they had inter-State purchase of chemicals taxable at 13.5 *per cent* for ₹ 1.44 crore. Though chemicals valued at ₹ 1.08 crore effected through inter-State purchase were incorporated into the work during the year, the assessee self assessed the entire works contract receipts of ₹ 6.45 crore at three *per cent* only. Non levy of tax at 13.5 *per cent* on the inter-State purchase turnover of goods resulted in short payment of tax and interest of ₹ 18.15 lakh.



Government stated (August 2015) that assessment had been completed (July 2015) creating additional demand of ₹ 21.53 lakh. Further report had not been received (January 2016).

- **CTO (WC), Kozhikode**

Shri. T Asokan, Kozhikode, was a works contractor registered under CST Act, 1956. During 2010-11, 2011-12 and 2012-13, he self assessed to tax his contract receipts of ₹ 5.62 crore, ₹ 2.38 crore and ₹ 5.96 crore received from Government of Kerala and local bodies at three *per cent* instead of the applicable rate of four *per cent*. Application of incorrect rate of tax resulted in short payment of tax and interest of ₹ 15.44 lakh.

Government stated (July 2015) that assessment for the year 2012-13 had been completed (August 2014) creating additional demand of ₹ 6.36 lakh and the assessee had paid the amount of ₹ 6.63 lakh including up-to-date interest. Further report for the years 2010-11 and 2011-12 had not been received (January 2016).

#### **2.6.4. PVC Panels**

**Under Sl.No.29 (1)(a) of list of goods notified under KVAT Act, 2003 vide SRO No. 82/2006, doors, windows and their frames and thresholds for doors having HSN code 3925.20.00 are liable to be taxed at 12.5 *per cent* during 2010-11 and 2011-12 and at 13.5 *per cent* during 2012-13. Further, PVC ceiling panels with hole and Celluca PVC Board (White) are not covered by any other entry of that list or any entry of the schedule to the KVAT Act, 2003 and hence taxable at the above rate as per Sl. No. 103 of the above list.**

Audit noticed in June 2014 that in the following two cases the assessee misclassified the items taxable at higher rate as goods taxable at lower rate to evade tax. This resulted in short payment of tax, cess and interest of ₹ 68.84 lakh as detailed in the following cases.

- **CTO, Special Circle (Produce), Mattancherry**

M/s. Jaihind Aluminium Traders, Kochi, was dealing with PVC panels taxable at 12.5 *per cent* during 2010-11 and 2011-12 and 13.5 *per cent* during 2012-13. However, the assessee misclassified sales turnover of the above commodities and assessed to tax at four/five *per cent*. This resulted in short payment of tax, cess and interest of ₹ 60.23 lakh.

Government stated (September 2015) that assessments for the years 2010-11 to 2012-13 had been completed creating total additional demand of ₹ 87.97 lakh. The assessee had remitted (between October 2014 and December 2014) ₹ 26.97 lakh as per the stay condition of DC (Appeal) Ernakulam. Further report had not been received (January 2016).

- **CTO, Special Circle (Produce), Mattancherry**

M/s. Jaihind International, Mattancherry, was dealing with PVC panels which were taxable at 13.5 *per cent* during 2012-13. However, the assessee misclassified sales turnover of the above commodities amounting to ₹ 89.63 lakh at five *per cent*. This resulted in short payment of tax, cess and interest of ₹ 8.61 lakh.

Government stated (August 2015) that assessment had been completed (August 2014) creating additional demand of ₹ 12.02 lakh. The assessee had remitted (December 2014) ₹ 4.40 lakh as per the stay condition of DC (Appeal) Ernakulam. Further report had not been received (January 2016).

## **2.7. Short levy of tax due to escape of turnover from assessment**

Turnover conceded in the return was less than that arrived at as per Rule

**2.7.1.** As per Rule 10(2)(a) of the KVAT Rules, 2005, in relation to works contract in which transfer of property takes place not in the form of goods but in some other form, the taxable turnover in respect of the transfer of property involved in the execution of works contract, shall be arrived at after deducting labour and other charges specified thereunder from the total amount received for the execution of the works contract. However, if the taxable turnover so arrived at falls below the cost of goods transferred in the execution of works contract, an amount equal to the cost of goods transferred in the execution of works contract together with profit, if any, shall be the taxable turnover in respect of such works contract. As per Explanation therein cost of goods means the price of goods together with all expenses incurred by the contractor in bringing the goods to the work site.

Audit noticed between January 2014 and January 2015 that in the following five cases, the works contractors while filing annual returns conceded taxable turnover which were less than the turnover arrived at as per the provision of KVAT Rules, 2005. This resulted in short payment of tax, cess and interest of ₹ 4.12 crore as given in the following paras.

- **CTO (WC&LT), Ernakulam**

M/s ABB Ltd., Kochi, a works contractor filed annual return for 2011-12 conceding total and taxable turnover of ₹ 25.31 crore and ₹ 6.04 crore respectively availing ₹ 19.27 crore as exemption under Rule 10. Audit found that cost of goods transferred to the works during the year was ₹ 17.15 crore. Thus the taxable turnover should not be less than ₹ 17.15 crore against which the assessee assessed to tax ₹ 6.04 crore only. Escape of turnover of ₹ 11.11 crore from assessment due to filing of incorrect return by the assessee resulted in short payment of tax, cess and interest of ₹ 1.70 crore.

Government stated (July 2015) that assessment had been completed (May 2015) creating total additional demand of ₹ 1.52 crore. As per the application for rectification filed by the assessee, the assessment order had been rectified (May 2015). After giving credit to the TDS which was omitted to be taken earlier, the additional demand was reduced to ₹ 1.28 crore. Further report had not been received (January 2016).

- **CTO (WC & LT), Alappuzha**

M/s KEC International Limited, Mavelikkara, self assessed to tax a contract receipts of ₹ 2.87 crore during 2012-13 availing exemption of ₹ 2.94 crore from the total contract receipt of ₹ 5.81 crore. Audit found that cost of goods transferred to the work during the years was ₹ 7.99 crore. As such the taxable turnover should not be less than ₹ 7.99 crore. Escape of turnover from assessment resulted in short payment of tax and interest of ₹ 89.77 lakh.

Government stated (August 2015) that assessment had been completed (May 2015) creating additional demand of ₹ 2.58 crore. The demand was under conditional stay before DC (Appeal), Kollam. Assessee paid (September 2015) ₹ 40 lakh and bank guarantee for ₹ 2.18 crore as per direction of Hon'ble High Court of Kerala in writ petition filed by the assessee. Further report had not been received (January 2016).

- **CTO (WC&LT), Ernakulam**

M/s Essar Projects (India) Limited, Kochi, a works contractor self assessed to tax a turnover of ₹ 9.03 crore and ₹ 7.70 crore during 2011-12 and 2012-13 respectively. Audit found that the cost of goods transferred in the execution of work was ₹ 12.88 crore and ₹ 10.24 crore during these years. As such the taxable turnover should not be less than ₹ 12.88 crore and ₹ 10.24 crore. Escape of turnover from assessment resulted in short payment of tax, cess and interest of ₹ 74.63 lakh.

Government stated (July 2015) that assessment for the year 2011-12 had been completed (June 2015) creating additional demand of ₹ 91.64 lakh and action was being initiated to collect the demand. Though the details of action taken to collect the amount were called for from Government in October 2015, their reply had not been received (January 2016).

- **CTO (WC&LT), Alappuzha**

M/s. New Modern Technomech Pvt. Ltd., Thakazhy, a works contractor filed annual return for 2010-11 to 2012-13 conceding total and taxable turnover for the above years as given in **Table-2.22**.

Table - 2.22

(₹ in crore)			
	2010-11	2011-12	2012-13
Total turnover	7.34	3.98	2.80
Taxable turnover	3.34	0.80	0.55
Cost of goods consumed	3.55	1.13	1.90

The assessee failed to include the cost of goods consumed as taxable turnover. This resulted in short levy of tax, cess and interest of ₹ 53.04 lakh.

Government stated (July 2015) that assessment for the year 2010-11 had been completed (March 2015) creating total additional demand of ₹ 37.68 lakh. The assessee had remitted (July 2015) an amount of ₹ 15.07 lakh as per the stay condition of DC (Appeal), Kollam. Further report for the remaining period had not been received (January 2016).

- **CTO (WC&LT), Alappuzha**

Sri. John Panackal Peter, Alappuzha, a works contractor filed annual return for 2011-12 and 2012-13 conceding the turnover given in **Table-2.23**.

Table - 2.23

(₹ in crore)			
Year	Total turnover	Exemption availed	Taxable turnover
2011-12	5.42	3.05	2.37
2012-13	9.62	6.31	3.31

Audit found that the cost of goods transferred to the work during 2011-12 and 2012-13 were ₹ 3.03 crore and ₹ 4.27 crore respectively. As such, the taxable turnover during the years should not be less than ₹ 3.03 crore and ₹ 4.27 crore. Against this the taxable turnover conceded were ₹ 2.37 crore and ₹ 3.31 crore respectively. This led to short levy of tax of ₹ 24.34 lakh.

Government stated (July 2015) that assessments had been completed creating additional demand of ₹ 13.67 lakh and ₹ 12.47 lakh for 2011-12 and 2012-13 respectively. The assessee had remitted (July 2015) an amount of ₹ 3.80 lakh for the year 2012-13 and balance amount was under revenue recovery. Further reports had not been received (January 2016).

The defects pointed out above are similar to those pointed out in the previous Audit Reports. No preventive/precautionary measures were taken by Government to avoid repetition of cases pointed out by Audit. Thus, the Government did not

take care to ensure system improvements to guard against the loss of revenue every year despite having been pointed out by Audit year after year.

**2.7.2. Explanation VII under Section 2(lii) of the KVAT Act, 2003 stipulates that where a dealer sells any goods purchased by him at a price lower than that at which it was purchased and subsequently receives any amount from any person towards reimbursement of the balance of the price, the amount so received shall be deemed to be turnover in respect of such goods.**

Test check of the records of the Commercial Taxes Department, Government of Kerala revealed that seven dealers of cement under four CTOs had done self-assessment of the tax in respect of their sales but while doing so they had evaded tax to the tune of ₹ 140.63 lakh along with interest by not taking in to account the amount of discount received by them subsequent to sale at a price lower than purchase price. The details of the amount of tax evaded by these dealers are given in the following **Table 2.24**.

**Table-2.24**

(₹ in lakh)					
Sl. No.	Name of the dealer	Assessing authority	Period	Amount of discount	Short levy of tax including interest
1	M/s A.B Traders, Amaravila	CTO, Special Circle, Thiruvananthapuram	2011-12	208.00	30.71
2	Sri. M. Abubaker		2011-12	91.39	13.50
3	M/s Star Traders, Thiruvananthapuram		2009-10 to 2011-12	212.61	34.53
4	M/s Arya Agencies, Malayinkeezhu		2010-11 & 2011-12	83.73	12.37
5	M/s Kizhakkedathu Enterprises, Pazhavangadi	AIT & CTO, Ranni	2008-09 to 2012-13	180.42	31.23
6	M/s Krishna Hardwares, Kalpeta	AIT & CTO, Vythiri	2009-10 to 2011-12	67.90	11.89
7	M/s Akhil Ansu Agencies, Kidangoor	CTO, Pala	2011-12	42.96	6.40
<b>Total</b>					<b>140.63</b>

Audit brought above cases to the notice of Department between October 2013 and December 2015 and to Government between February 2015 and December 2015. In response to audit observations, the Government stated that assessments have been revised by creating additional demand of ₹ 64.93 lakh in six cases.

It was further observed by the Audit that after paying mandatory amount of tax (which is quite small when compared with total tax amount), these dealers had filed appeals against the demand for additional tax created by the assessing

authorities. Further action taken by the Department and the Government was awaited (January 2016).

Audit had pointed out many such instances (37 cases involving tax effect of ₹ 4.40 crore) repeatedly in the past. Present position of those cases is given in the following **Table 2.25**:

Table-2.25

Year of Report		2010	2011	2012	2013	2014	Total
No. of cases		1	Nil	10	20	6	37
Amount (₹ in crore)		0.34	Nil	2.07	1.38	0.61	4.40
Assessment not completed				3	1	1	5
Assessment completed	Full payment			2	4		6
	Part payment				2		2
	Nil payment					1	1
Appeal	Court			1	3		4
	AC/DC	1		2	6	2	11
	Tribunal			2	4	2	8
Amount remitted in appeal cases (₹ in lakh)		0.01		0.01	0.12	0.06	0.20

Further audit scrutiny of the records revealed as under:

- Out of 37 cases pointed out in earlier Reports, 23 cases are under appeal/court out of which in eight, second appeal has been filed against the decision on first appeal. Out of eight cases pending before Tribunal, six cases were filed by the Department.
- No action had been taken by the Department and the Government in cases after appeals were filed.
- There had been delays in taking decision in appeal cases.
- Government had taken action only in individual cases pointed out by Audit and issued instructions in such cases.

There had been no action on the part of the Government to stem the problem by issuing instructions in a consolidated manner to carry out systemic changes to avoid reoccurrence of such cases in future.



- **CTO, Special Circle, Palakkad**

M/s Ramesh Iron and Steel Company India Private Limited was a dealer in iron & steel and its products. During 2012-13, the dealer self assessed tax on a sales turnover of ₹ 109.72 crore while its purchase cost was ₹ 111.22 crore. Though the assessee sold goods at a price lower than the purchase price discount of ₹ 240.19 lakh received subsequently was not reckoned as turnover and assessed to tax. This resulted in the short payment of tax and interest of ₹ 10.73 lakh.

Government stated (July 2015) that assessment had been completed (May 2015) creating additional demand of ₹ 14.05 lakh. The assessee paid ₹ 4.22 lakh and the balance amount was under collection. Though the details of action taken to collect the amount had been called for from Government in October 2015, their reply was still awaited (January 2016).

**2.7.3. Under Section 42(2) of KVAT Act, 2003 where any dealer detects any omission or mistake in the annual return submitted by him with reference to the audited figures, he shall file along with the audit certificate, revised annual return rectifying the mistake or omission and if the tax liability increases, the revised return shall be accompanied by proof of payment of such tax, interest due thereon and twice the interest as penal interest. Under Section 91 of the Act, when payment towards tax or any other amount due is made, it shall be appropriated first towards interest accrued, the balance available shall be appropriated towards principal outstanding.**

- **CTO, Special Circle, Kottarakkara**

M/s. Sree Vinayaka Motors, Kottarakkara, a dealer in motor vehicles submitted (May 2012) annual return for 2011-12, after remitting tax of ₹ 6.20 crore. Subsequently, the assessee revised the annual return with total tax liability of ₹ 7.20 crore. Audit found that though the assessee had paid differential tax and cess payable as per the revised annual return, they had not remitted the interest and penal interest due thereon. Moreover, payment made by the assessee amounting to rupees one crore was not appropriated first towards interest. Non levy of interest and non appropriation of payment first towards interest resulted in short payment of tax, interest and penal interest of ₹ 33.74 lakh.

Government stated (July 2015) that assessment had been completed (December 2014) creating additional demand of ₹ 13.74 lakh and the demand had been advised for revenue recovery. Commissioner of Commercial Taxes (November 2015) informed that the assessing authority had demanded (November 2015) penal interest of ₹ 21.19 lakh. Further report had not been received (January 2016).

**2.7.4. Section 2 (xliv) of the KVAT Act, 2003 provides that sale price includes any sum charged for anything done by the dealer in respect of the goods or services at the time of or before delivery thereof.**

- **CTO, Special Circle, Palakkad**

M/s Sivasakthi Engineering and Fabrications, Walayar, was a manufacturer of cement products. The sales turnover disclosed by the assessee as per the annual returns and transportation charges received by the assessee as per P&L account during the years 2008-09, 2009-10, 2010-11 and 2012-13 are as detailed in **Table – 2.26.**

**Table – 2.26**

Year	2008-09	2009-10	2010-11	2012-13
Sales turnover disclosed	₹ 5.83 crore	₹ 4.60 crore	₹ 2.26 crore	₹ 9.63 crore
Transportation charges received	₹ 51.67 lakh	₹ 59.44 lakh	₹ 31.61 lakh	₹ 1.56 crore

Audit found that the assessee had entered into agreement with KSEB for supply of electric poles to various electrical circles during the above period. In the agreement with KSEB, it was stipulated that contract was for manufacture and delivery of poles within or outside the concerned electrical circles. As such, the transportation charges received would form part of the turnover. However, the assessee did not assess to tax the above turnover. This resulted in short payment of tax and interest of ₹ 17.51 lakh.

Government stated (July 2015) that assessment for 2012-13 had been completed (January 2015) creating additional demand of ₹ 9.38 lakh. The assessee had remitted 30 *per cent* of the demand as per the stay condition of DC (Appeal), Ernakulam. Further report for the remaining period had not been received (January 2016).

## **2.8. Non/short payment of surcharge**

Surcharge leviable under Kerala Surcharge on Taxes (KST) Act, 1957 was either not levied or short levied.

**Under Section 3(1A) of the KST Act, 1957, in the case of national or multinational companies functioning in the State as retail chains or direct marketing chains who import not less than 50 *per cent* of their stock from outside the state or country and not less than 75 *per cent* of whose sales are retail business, and whose total turnover exceeds five crore rupees *per annum*, tax payable under Section 6 of KVAT Act, 2003 shall be increased by a surcharge at the rate of ten *per cent*.**

Audit noticed between January 2013 and September 2015 that in the case of following six assessees having annual sales turnover above rupees five crore, though more than 75 *per cent* of sales of the assessee were through retail business and more than 50 *per cent* of their stock were imported from outside the State/country, the output tax payable was not increased by a surcharge at 10 *per cent* as per the provisions of KST Act, 1957. This resulted in short payment of surcharge and interest of ₹ 6.09 crore as detailed below:

- **CTO, Special Circle I, Ernakulam**

M/s Joy Alukkas India Private Ltd., Ernakulam, a multi-national company dealing with gold jewellery imported more than 50 *per cent* of their stock from outside the State or country during 2008-09 and 2009-10. Though their sales turnover for 2008-09 and 2009-10 amounting to ₹ 546.68 crore and ₹ 568.02 crore respectively, exceeded rupees five crore *per annum* and more than 75 *per cent* of their sales were retail business, they had not paid surcharge at the rate of ten *per cent* on the output tax payable. This resulted in short payment of surcharge and interest of ₹ 4.30 crore.

Government stated (October 2015) that the levy of surcharge was applicable only to big retail chains and direct marketing chains. Moreover, the assessee had not given any franchisee agreement to anybody to conduct business in their name. As such, the assessee is not liable to pay surcharge.

As per the Explanation 1 below Section 3(1A), big retail chains and direct marketing chains means retail sales outlets or part of retail sales outlet of companies having a registered business name which share a registered business name or commercial name by way of franchisee agreement or otherwise with standardized sales, purchase and promotional activities. As per Explanation II, retail business shall mean sales to persons other than registered dealer. M/s. Joy Alukkas India Pvt. Ltd. is a company having retail sales outlet and a registered business name. Besides, more than 75 *per cent* of the sale were effected to persons other than to registered dealers. Hence the assessee will come under the meaning of big retail chain. As such, the assessee is liable to pay surcharge. Hence the reply furnished by the Government was not acceptable.

- **CTO, Special Circle, Thiruvananthapuram**

➤ M/s Pothys Garments, Thiruvananthapuram, an assessee in garments had more than 75 *per cent* of sales through retail business and more than 50 *per cent* of their stocks were imported from outside the State/ country during 2012-13 and 2013-14. Though their total turnover exceeded rupees five crore *per annum*, the output tax of ₹ 4.80 crore and ₹ 4.98 crore respectively were not increased by a surcharge at 10 *per cent* as per the provisions of KST Act, 1957. This resulted in short payment of surcharge and interest of ₹ 1.18 crore.

➤ M/s Pothys Textiles, Thiruvananthapuram, an assessee in textile business had more than 75 *per cent* of sales through retail business and more than 50 *per cent* of their stocks were imported from outside the State/ country during 2012-13 and 2013-14. Though their total turnover exceeded rupees five crore *per annum*, the output tax of ₹ 20.56 lakh and ₹ 28.70 lakh respectively were not increased by a surcharge at 10 *per cent* as per the provisions of KST Act, 1957. This resulted in short payment of surcharge and interest of ₹ 5.86 lakh.

Government stated (December 2015) that the above points would be verified and final reply submitted on completion of verification. Further reports had not been received (January 2016).

- **CTO, Special Circle II, Ernakulam**

➤ M/s. Lulu International Shopping Mall Private Ltd. was a retail venture by the Lulu Group. Audit found that during 2012-13, more than 75 *per cent* of sales of the assessee were through retail business and more than 50 *per cent* of their stocks were imported from outside the State/ country. Though their total turnover exceeded rupees five crore *per annum*, the output tax of ₹ 195.63 lakh was not increased by a surcharge at 10 *per cent* as per the provisions of KST Act, 1957. This resulted in short payment of surcharge and interest of ₹ 23.13 lakh.

Government stated (July 2015) that assessment had been completed (December 2014) creating additional demand of ₹ 23.52 lakh. The assessee had remitted an amount of ₹ 19.60 lakh. Balance amount was under revenue recovery. Further report had not been received (January 2016).

➤ M/s Fab India Overseas (P) Ltd., Kochi, a shopping mall was liable to pay surcharge under Section 3(1A) since their entire purchase were from outside the State and entire sales were to customers within the State. Audit found that during 2012-13 surcharge of ₹ 14.35 lakh was due from the assessee on the output tax of ₹ 143.52 lakh disclosed by them. But the assessee paid ₹ 2.29 lakh only towards surcharge. Short remittance of surcharge and interest worked out to ₹ 14.23 lakh.

Government stated (July 2015) that assessment had been completed (February 2015) creating additional demand of ₹ 17.65 lakh. The assessee remitted (March 2015) an amount of ₹ 7.50 lakh as per the conditional stay granted by Hon'ble High Court of Kerala in writ petition filed by the assessee. Further report had not been received (January 2016).

- **CTO, II Circle, Kalamassery**

M/s Monavie India Enterprises Private Limited, Palarivattom, was a multinational company involved in direct marketing of health drinks. As per Annual returns for 2011-12 and 2012-13 filed by the assessee, the entire product for sale were stock transferred from outside the state and sales turnover for the years were ₹ 6.70

crore and ₹ 5.40 crore respectively. Though their entire sales were through direct marketing/retail chain the output tax of ₹ 83.70 lakh and ₹ 69.39 lakh were not increased by a surcharge at 10 *per cent* as per the provisions of the KST Act, 1957. This resulted in short payment of surcharge and interest of ₹ 18.31 lakh.

Government stated (July 2015) that assessment of the year 2011-12 had been completed (June 2013) creating additional demand of ₹ 9.54 lakh. The appeal filed by the assessee had been allowed (July 2014) by the AC (Appeal) Ernakulam. Against this order, the DC, Ernakulam filed (January 2015) second appeal before Hon'ble Tribunal, Ernakulam. Further report for 2012-13 had not been received (January 2016).

Though similar cases were pointed out by Audit in previous Audit Reports, no preventive/precautionary measures were taken by Department/Government to avoid the defect during succeeding years. Details of action taken by the Government on the previous paras though called for had not been received (January 2016).

## **2.9. Short levy of tax due to misclassification**

Commodities were misclassified which resulted in short levy of tax.

- **CTO, Special Circle II, Ernakulam**

M/s Crompton Greaves Ltd., Kochi, was a dealer in electrical goods, pump sets and parts etc. During 2012-13, sales turnover of Home UPS for ₹ 110.91 lakh was classified as that of computer systems and peripherals and assessed at five *per cent* instead of at the applicable rate of 13.5 *per cent*. The misclassification resulted in the short payment of tax and interest of ₹ 11.22 lakh.

Government stated (July 2015) that assessment had been completed (June 2015) creating total additional demand of ₹17.89 lakh and the assessee had remitted (July 2015) ₹ 5.50 lakh. Further report had not been received (January 2016).

- **CTO, I Circle, Thrissur**

M/s Sreehari Metals, Thrissur was a dealer in rubber products and lubricants. During 2011-12, the assessee self assessed to tax the turnover of lubricants for ₹ 166.01 lakh assessable at the rate of 12.5 *per cent* at a lower rate of four *per cent*. Application of incorrect rate of tax resulted in short payment of tax, cess and interest of ₹ 16.82 lakh.

Government stated (October 2015) that the assessment of the dealer had been completed (December 2013) creating additional demand of ₹ 19.87 lakh incorporating other defects also. The dealer filed appeal against the assessment.



The Assistant Commissioner (Appeal), Thrissur set aside the above assessment order (January 2014) and directed the assessing authority to re-examine the assessment. The reassessment was pending for disposal. The current status though called for (November 2015) had not been received (January 2016).

- **CTO, II Circle, Ernakulam**

M/s. Malabar Laminates, Kochi a dealer in bamboo and plywood products conceded in their annual return for 2012-13 sales turnover of ₹ 2.38 crore and ₹ 50.08 lakh respectively. The inter-State purchase turnover of these products conceded in the return were ₹ 1.71 crore and ₹ 84.92 lakh respectively. However as per the certified annual accounts of the company the purchase turnover accounted was ₹ 2.17 crore and ₹ 38.97 lakh respectively for the same sales turnover returned. Audit found from the check post module<sup>22</sup> of KVATIS that the inter-State purchase turnover of plywood of this company was more than ₹ 85 lakh. Thus, the assessee misclassified the purchase turnover and corresponding sales turnover of plywood as that of bamboo products to evade tax. This resulted in short payment of tax and interest of ₹ 8.02 lakh.

Government stated (September 2015) that assessment had been completed (June 2015) creating additional demand of ₹ 8.76 lakh. The assessee had remitted ₹ 2.63 lakh and furnished security for the balance amount as per the stay condition of Assistant Commissioner (Appeal) Ernakulam. No action was taken to get the stay vacated. Further report had not been received (January 2016).

- **CTO, Special Circle, Thodupuzha**

M/s Sree Vijayalekashmi Traders, Thodupuzha was a dealer in grocery and pulses. Audit cross verified the annual return of the assessee for 2012-13 with the check post transaction in KVATIS module and found that the interstate stock transfer in to the state and interstate purchase turnover of items taxable at five *per cent* conceded in the annual return was less than that in the KVATIS check post transaction while the turnover of goods taxable at one *per cent* conceded was more than that in the KVATIS check post transaction. It was evident that the assessee had wrongly classified five *per cent* taxable goods as one *per cent* taxable goods. Misclassification of goods resulted in the short payment of tax and interest of ₹ 7.59 lakh.

Government stated (July 2015) that assessment had been completed (February 2015) creating additional demand of ₹ 9.17 lakh. Further report had not been received (January 2016).

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<sup>22</sup> Module of the KVATIS in which the transactions of check post are recorded.



## 2.10 Non- payment of purchase tax

The assessee did not pay purchase tax for the purchases made from unregistered dealers

- CTO, Special Circle, Kollam

**Under Section 6(2)(b) of the KVAT Act, 2003 every dealer who purchases taxable goods from unregistered dealers and despatches the goods to any place outside the State otherwise than by way of sale in the course of inter-State trade or export, shall pay tax on the purchase turnover of the goods at the rates specified under Section 6(1), provided that the maximum rate leviable under this clause shall not exceed four *per cent*.**

M/s. Kalyan Jewellers, Kollam, a dealer in gold jewellery stock transferred gold jewellery amounting to ₹ 51.18 crore and ₹ 94.06 crore outside the State, which constituted 29.59 *per cent* and 42 *per cent* of their total disposal during the year 2011-12 and 2012-13. They made local purchase of gold jewellery from unregistered dealers for ₹ 43.98 crore and ₹ 60.14 crore in the year 2011-12 and 2012-13 respectively. Though the assessee was liable to pay purchase tax proportionate to the purchases made from unregistered dealers, they had not paid any purchase tax. This resulted in non-payment of tax, cess and interest amounting to ₹ 2.31 crore.

Government stated (July 2015) that the assessee had opted for Gold Compounding Scheme under Section 8 of KVAT Act, 2003 and the Section does not permit a portion of the turnover being taxed under Section 6(1) over and above the quantum of tax fixed under Section 8(f). Hence, purchase tax assessable on portion proportionate to stock transfer out and the disallowance of special rebate for the same vide provision to Section 12 of the KVAT Act, 2003 is ultra vires to the provision of Section 8 of the KVAT Act, 2003. The reply was not acceptable since the compounded dealers had not been specifically exempted from payment of purchase tax. Further report had not been received (January 2016).

## 2.11. Short payment of tax due to incorrect exemption allowed

The assessee availed exemption in excess of that admissible as per Rule

**Rule 10(2)(b) of KVAT Rules, 2005 stipulates that where the actual turnover, in respect of the works contract in which the transfer of goods takes place not in the form of goods but in some other form, is not ascertainable from the books of accounts, the total turnover in respect of such works contract shall be computed after deducting labour and other charges as given in the table**

below the Rule from the total amount of contract. Labour and other charges deductible in works contract in respect of Annual Maintenance Contract (AMC) is 50 *per cent* of contract receipts. As per Section 6(1) (f) of KVAT Act, 2003 in the case of transfer of goods involved in the execution of works contract, where the transfer is not in the form of goods, but in some other form the rate of tax shall be 13.5 *per cent*.

- **CTO, Special Circle II, Ernakulam**

➤ M/s HCL Infosystems Ltd., Kochi, was a dealer in computer and accessories. During 2011-12, they claimed exemption of ₹ 4.95 crore from the total receipt of ₹ 5.95 crore towards AMC against the actual eligible exemption of ₹ 2.97 crore. During 2012-13, they claimed exemption of ₹ 4.65 crore from the total receipt of ₹ 6.40 crore towards AMC, against the actual eligible exemption of ₹ 3.20 crore. Availing of excess exemption resulted in short payment of tax and interest of ₹ 29.42 lakh and ₹ 8.53 lakh during 2011-12 and 2012-13.

Government stated (July 2015) that the assessment for the year 2012-13 had been completed (June 2015) creating additional demand of ₹ 9.68 lakh and the amount is under collection. Further report for the remaining period had not been received (January 2016).

➤ M/s Crompton Greaves Limited, Kochi, was a dealer in electrical goods, pump sets and parts etc. During 2012-13, they self assessed to tax at five *per cent* turnover of AMC amounting to ₹ 57.66 lakh after availing deduction under Rule 10(2) (b) for ₹ 60.54 lakh from the total turnover of ₹ 118.19 lakh. Since the turnover was arrived at under Rule 10(2) (b), the deduction admissible is ₹ 59.10 lakh (50 *per cent*) only and the balance turnover should have been assessed at 13.5 *per cent*. Failure to do this resulted in short payment of tax and interest of ₹ 6.06 lakh.

Government stated (July 2015) that assessment had been completed (June 2015) creating additional demand of ₹ 17.89 lakh. Further report had not been received (January 2016).

## **2.12. Short payment of tax due to incorrect claim of input tax credit/special rebate allowed**

Excess input tax credit/special rebate was availed resulting in short payment of tax

**2.12.1** Section 11(m) of KVAT Act, 2003, read with Rule 58(10)(i) of KVAT Rules, 2005, stipulates that no input tax credit shall be allowed for the purchases of goods where tax invoice in form No.8 is not available with the

**dealer or there is evidence that the same has not been issued by the selling dealer.**

- **CTO, II Circle, Ernakulam**

M/s Sreeragh General Finance Limited, Kochi, a dealer in motor vehicles and computer products, availed input tax credit of ₹ 1.09 crore during 2012-13, on the purchase of goods for ₹ 8.13 crore. Audit found from the KVATIS that this included input tax credit of ₹ 16.15 lakh on the purchase of goods for ₹ 1.20 crore from two dealers; but not supported by proper invoices issued to the assessee. The invoices filed by the assessee were issued by these two dealers in Form 8B applicable to end customers. Availing input tax credit without proper invoice was not in order. The incorrect availing of input tax credit had resulted in short payment of tax and interest of ₹ 19.21 lakh.

Government stated (October 2015) that necessary instructions had been given (August 2015) to the DC, Ernakulam to re-examine the case. Further report had not been received (January 2016).

**2.12.2 Under proviso 3 to Section 11(3) of KVAT Act, 2003, where any goods purchased in the State are subsequently sent outside the State or used in the manufacture of goods and the same are sent outside the State otherwise than by way of sale in the course of inter- State trade or export, input tax credit shall be limited to the amount of input tax paid in excess of five *per cent* on the purchase turnover of such goods sent outside the State.**

- **CTO, II Circle, Palakkad**

M/s Mascon Tillers and Tractors, Palakkad, was a dealer in tillers, tractors etc. During 2010-11, 2011-12 and 2012-13, the assessee purchased tillers and tractors for ₹ 6.48 crore, ₹ 4.15 crore and ₹ 9.42 crore respectively and availed input tax credit of ₹ 27.68 lakh, ₹ 33.23 lakh and ₹ 47.08 lakh respectively. Audit found that out of the total disposal of goods for ₹ 9.09 crore, ₹ 10.06 crore and ₹ 12.61 crore, 9.41 *per cent*, 6.23 *per cent* and 9.39 *per cent* respectively were stock transferred outside the State during the above period. As such four/five *per cent* input tax credit proportionate to interstate stock transfer to outside the State had to be reversed which was not done. Availing of excess input tax credit resulted in short payment of tax and interest of ₹ 10.57 lakh.

Government stated (July 2015) that assessment for the year 2012-13 had been completed (February 2015) and the assessee had remitted the amount of ₹ 5.26 lakh. Further report for the remaining period had not been received (January 2016).

- **CTO, Tirurangadi**

M/s Classic Foot Care (India) Private Limited, Malappuram, was a manufacturer of footwear. During 2012-13, they availed input tax credit of ₹ 41.02 lakh on a local purchase of ₹ 5.78 crore. They reversed input tax of ₹ 7.43 lakh against stock transferred to outside the State, goods for ₹ 3.29 crore. Audit found that five *per cent* input tax credit to be reversed proportionate to inter-State stock transfer would come to ₹ 13.42 lakh. Availing of excess input tax credit resulted in short payment of tax and interest of ₹ 7.07 lakh.

Government stated (July 2015) that assessment had been completed (January 2015) creating total additional demand of ₹7.12 lakh. The assessee had remitted (between March 2015 and May 2015) an amount of ₹4.50 lakh. Further report had not been received (January 2016).

**2.12.3 Under Section 12(2) of KVAT Act, 2003 dealer paying compounded tax under Section 8 shall not be eligible for rebate under Section 12(1).**

- **CTO, Chalakudy**

M/s Institute of Indian Therapies, Annamanada was a dealer in medicine paying tax under Section 8(e) of the Act. Audit found that during 2010-11, the assessee availed special rebate of ₹ 5.19 lakh corresponding to the purchase turnover of ₹ 119.06 lakh. Incorrect availing of special rebate resulted in short payment of tax, cess and interest of ₹ 6.44 lakh.

Government stated (August 2015) that assessment had been revised disallowing special rebate of ₹ 4.86 lakh. Special rebate of ₹ 0.32 lakh was allowed for the raw materials for the manufacturing of medicine. Further report had not been received (January 2016).

**2.13. Non-imposition of penalty**

Penalty leviable as per CST Act, 1956 was not levied.

- **CTO, Chittur**

As per Section 8 of the CST Act, 1956, goods purchased by issuing declaration in Form C should be intended for re-sale or for use in the manufacturing or processing of goods for sale or in mining or in the generation or distribution of electricity or any other form of power. Under Section 10A read with Section 10(d) of the Act, for the misuse of C form, penalty not exceeding one and a half times of the tax which would have been levied under sub-section (2) of Section 8 should be levied.

M/s Five Star Metals (P) Ltd., Pallavur, a metal crushing unit purchased (December 2010) an electric generator set for ₹ 31.21 lakh. The assessee in response to a notice issued by the Intelligence officer declared (January 2011) that the generator set with accessories purchased by them was for own use and had no direct connection to their business. Though the generator was purchased for purposes other than that connected with the manufacturing or processing of goods, the assessee issued Form - C declaration for the above purchase (March 2011) which would attract penalty under Section 10(d) of the CST Act, 1956. Amount of penalty that could be imposed comes to ₹ 5.85 lakh.

Government stated (July 2015) that assessment of the dealer had been completed (November 2013) creating additional demand of ₹5.85 lakh. The appeal filed by the dealer had been allowed (February 2014) by the AC (Appeal) Palakkad. The second appeal filed by the State was dismissed (March 2015) by the Appellate Tribunal. Further report had not been received (January 2016).

Audit found that most of the cases mentioned above are cases pointed out in earlier Reports. The defects could have been detected and addressed, had the monthly/annual returns were scrutinised by the assessing officers.

## **Sales Tax**

### **2.14. Short levy of turnover tax due to non revision of assessment order**

The revision of turnover tax for the previous year was not reckoned while computing the compounded tax for subsequent years.

- **CTO, Special Circle I, Kozhikode**

**Under Section 7 of the KGST Act, 1963, bar attached hotel of and below two star, situated in municipal area, may, pay turnover tax on the turnover of foreign liquor calculated at (a) one hundred and forty *per cent* of the purchase value of such liquor, or (b) one hundred and fifteen *per cent* of the highest turnover tax payable by him as conceded in the return or accounts or the turnover tax paid for any of the previous consecutive three years, whichever is higher. The Commissioner of Commercial Taxes, vide Circular No. 44/2006 had issued directions that if on a subsequent date the tax payable by a dealer who had opted for payment of tax under compounding scheme is revised by virtue of an appellate order or an assessment order, the compounded tax payable shall be based on the revised tax liability fixed as per such orders.**

M/s Sea Queen Hotel, Kozhikode, was a bar attached two star hotel situated in municipal area, who opted for compounding scheme for payment of turnover tax. The turnover tax assessment for 2009-10 was completed (March 2014) and



turnover tax was fixed as ₹ 30.43 lakh at 115 *per cent* of ₹ 26.46 lakh, the turnover tax assessed for previous year 2008-09. Turnover tax assessment for 2010-11, 2011-12 and 2012-13 were completed based on the turnover tax for previous years and fixed as ₹ 34.99 lakh, ₹ 40.24 lakh and ₹ 46.27 lakh respectively. Subsequently based on the suppression detected by the Intelligence Officer, the assessment for the year 2008-09 was revised (March 2014), fixing the turnover tax as ₹ 37.24 lakh. However, assessments for 2009-10 to 2012-13 were not revised by the assessing authority based on the revised assessment order for 2008-09. The omission on the part of the assessing officer resulted in short levy of tax, cess and interest of ₹ 66.90 lakh.

Government stated (July 2015) that the assessments had been revised creating additional demand of ₹ 26.21 lakh. The assessee had filed appeal before DC (Appeal). Further report had not been received (January 2016).

### **2.15. Short levy of tax due to incorrect computation of compounded tax**

While computing the compounded tax, rate was applied on incorrect turnover tax reckoned for previous year.

**Section 7 of the KGST Act, 1963 stipulates that any bar attached hotel not being a star hotel of and above three star hotel, heritage hotel or club, situated in Municipal area, may at its option pay turnover tax on the turnover of foreign liquor calculated at (a) one hundred and forty *per cent* of the purchase value of such liquor, or (b) one hundred and fifteen *per cent* of the highest turnover tax payable by it as conceded in the return or accounts or the turn over tax paid for any of the previous consecutive three years, whichever is higher for the year 2009-10 and at (a) one hundred and eighty *per cent* of the purchase value of such liquor, or (b) one hundred and twenty five *per cent* of the highest turnover tax payable by him as conceded in the return or accounts or the turnover tax paid for any of the previous consecutive three years, whichever is higher for the year 2010-11.**

- **CTO, II Circle, Tripunithura**

M/s Polakulathu Tourist Home, Vyttila, was an assessee engaged in the business of running a bar attached hotel. The turnover tax assessment of the assessee for 2009-10 was completed by the assessing authority (December 2012) taking the turnover as 140 *per cent* of the purchase value of liquor and turnover tax was fixed at ₹ 16.01 lakh. Audit found that 115 *per cent* of the turnover tax payable for 2008-09 amounted to ₹ 48.79 lakh which was higher than the turnover tax fixed by the assessing authority. Incorrect computation of turnover tax resulted in short levy of tax, cess and interest of ₹ 37.74 lakh.



Government stated (June 2015) that assessment had been completed (June 2014) creating additional demand of ₹ 38.07 lakh and revenue recovery efforts had been initiated for recovery of the dues. Further report had not been received (January 2016).

- **CTO, Special Circle I, Kozhikode**

M/s Kalyan Residency, Koyilandy, was a bar attached hotel of three star category. The turnover tax assessment of the assessee for 2010-11 was completed (May 2014) by the assessing authority taking the turnover as 180 *per cent* of the purchase value of liquor during the year and the turnover tax was fixed as ₹ 29.99 lakh. However, Audit found that the turnover tax of the assessee for 2009-10 fixed by the assessing authority was ₹ 16.90 lakh. Since the assessee started business from October 2009 only, the turnover tax payable for a financial year would be ₹ 33.80 lakh. Hence, 125 *per cent* of the turnover tax payable for 2009-10 amounted to ₹ 42.26 lakh. Incorrect computation of compounded tax by the assessing officer resulted in short levy of tax, cess and interest of ₹ 17.47 lakh.

Government stated (July 2015) that assessment had been completed (March 2015) creating additional demand of ₹ 20.11 lakh. Further report had not been received (January 2016).

## **2.16. Short levy of tax due to incorrect assessment**

Incorrect reckoning of turnover tax resulted in short levy of compounded tax.

As per Section 5(2) of the KGST Act, 1963, bar attached hotels are liable to pay turnover tax at 10 *per cent* on turnover of foreign liquor sold by them. However, as per Section 7 of KGST Act, 1963 bar hotels of below three star can opt for payment of such tax at compounded rate. For bar hotels, the rate effective from 1 July 2006 is higher of (a) the turnover tax on the turnover of foreign liquor calculated at 135 *per cent* of purchase value of liquor, for hotels situated in *panchayat* area and at 140 *per cent* of purchase value of liquor for bar hotels situated in municipal corporation area or (b) 115 *per cent* of highest turnover tax payable by it as conceded in the return or accounts or the turnover tax paid, for any of the previous consecutive three years. As per Rule 13(3) of Foreign Liquor Rules, 1953 (FL Rules, 1953) from 1 April 2007, only three star hotels and above are eligible for bar license but existing licensees not having above classification and functioning on 31 March 2007 shall be regularised.

- **CTO, Ettumanoor**

The turnover tax assessment of M/s Palakkunnel Tourist Hotel, Ettumanoor, a bar hotel, which opted payment of tax at compounded rate, was finalised accepting the claim of the assessee that their business was transferred as a whole to the new

partnership firm with effect from 1 October 2008 and hence a new business. The turnover tax for 2009-10 was assessed to ₹ 33.69 lakh being 135 *per cent* of purchase turnover of liquor. Consequently, the turnover tax for 2010-11 and 2011-12 were also fixed based on the turnover tax fixed for 2009-10. Audit found that the business was done in the name and style M/s Palakkunnel Tourist Home upto 30 September 2008 and the business was continued with effect from 1 October 2008 under the name and style M/s Palakkunnel Tourist Hotel. The assessee cannot be considered as a separate entity from the existing one on the fact that if they were new entities, Rule 13(3) of FL Rules, 1953 ought to have prevented it from grant of bar license as the hotel had no three-star status. Hence, the compounded tax to be fixed for the year 2009-10 was ₹ 38.88 lakh being 115 *per cent* of the tax paid during 2008-09 (highest turnover tax paid, of three preceding years). Incorrect fixation of compounded tax for the year 2009-10 resulted in consequent short fixation of tax for the years 2010-11 and 2011-12 also. Total short levy of tax, cess and interest amounted to ₹ 22.70 lakh.

Government stated (October 2015) that based on the audit observation, the assessment was reopened under Section 19 of the KGST Act, 1963. While deciding the appeal filed by the dealer, the Deputy Commissioner (Appeals) Kottayam quashed the assessment. Government had issued necessary direction to the DC, Kottayam to file second appeal in the case. Further report had not been received (January 2016).