

Chapter–II

Taxes/VAT on Sales, Trade etc.

2.1 Tax Administration

Sales Tax/Value Added Tax (VAT) laws and Rules framed thereunder are administered at the Government level by the Principal Secretary, Finance Department. The Commissioner of Commercial Taxes (CCT) is the head of the Commercial Taxes Department (CTD) who is assisted by 14 Additional Commissioners. There are 13 Divisional VAT Offices (DVO), 13 Appeal offices, 13 Enforcement/Vigilance offices and one Minor Acts Division in the State managed by 42 Joint Commissioners (JCCTs). There are 123 Deputy Commissioners (DCCT), 321 Assistant Commissioners (ACCT) and 526 Commercial Tax Officers (CTO) in the State. At the field level, VAT is being administered through 118 Local VAT Offices (LVOs) and VAT Sub Offices (VSOs) headed by ACCTs and CTOs respectively. The DCCTs, ACCTs and CTOs head 266 Audit Offices where assessments/re-assessments are finalised by the Department.

2.2 Internal audit

The Department has an Internal Audit Cell under the charge of the JCCT (Internal Audit & Inspection). This cell is required to conduct test check of cases of assessment as per the approved action plan and in accordance with the criteria decided by the Steering Committee to ensure adherence to the provisions of the Act and Rules as well as Departmental instructions issued from time to time.

As per the information furnished by the Department, the Internal Audit wing is functioning from the year 2011-12. During the year 2014-15, pendency in coverage of offices was furnished as 150 and the total number of offices to be audited was not furnished. The Department raised 1609 objections involving ₹ 176.99 crore during 2014-15. As at the end of 31 March 2015 there were 1,271 objections pending, involving ₹ 162.01 crore.

2.3 Results of audit

In 2014-15, test check of the records of 168 offices of the CTD relating to VAT, Sales Tax, Entry Tax, Professions Tax, Entertainment Tax and Agricultural Income Tax showed underassessment of tax and other irregularities involving ₹ 67.69 crore in 846 cases, which fall under the following categories.

Table 2.1
Results of audit

Sl. No.	Category	No. of cases	(₹ in crore)
			Amount
	Value Added Tax		
1.	Non/short levy of tax	206	31.10
2.	Non/short levy of penalty	209	10.13
3.	Non/short levy of interest	154	4.53
4.	Incorrect / excess carry forward of credit	83	4.53
5.	Non/short payment of output tax	44	1.31

(₹ in crore)			
Sl. No.	Category	No. of cases	Amount
6.	Incorrect / excess allowance of input tax credit	26	2.22
7.	Unacknowledged returns	13	2.80
8.	Incorrect allowance of TDS	9	6.52
9.	Other irregularities	37	3.45
	Total	781	66.59
	Tax on Entry of Goods		
10.	Non/short levy of tax under entry tax	16	0.31
11.	Other irregularities	35	0.50
	Total	51	0.81
	Tax on Professions		
12.	Non/short payment of tax	4	0.03
13.	Other irregularities	4	0.03
	Total	8	0.06
	Agricultural Income Tax		
14.	Non/short levy of tax	3	0.20
15.	Other irregularities	3	0.03
	Total	6	0.23
	Grand Total	846	67.69

During the course of the year, the Department accepted underassessment and other deficiencies of ₹ 4.77 crore in 84 cases which were pointed out in audit during 2014-15 and recovered ₹ 2.22 crore in 57 cases. An amount of ₹ 10.47 crore was realised in 278 cases pointed out during earlier years. A few illustrative cases involving ₹16.07 crore are discussed in the following paragraphs.

2.4 Non/short payment of tax

According to Section 31(4) of the Karnataka Value Added Tax (KVAT) Act 2003, every dealer whose total turnover in a year exceeds a prescribed amount¹ shall have the accounts audited by a Chartered Accountant or a Cost Accountant or a Tax Practitioner (Auditor) and shall submit to the prescribed authority a copy of the audited statement of accounts in Form VAT-240 and other documents as prescribed in the Act.

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

During test check of records in 27 LVOs in 13² districts between January 2014 and January 2015, we noticed that 59 dealers in their audited accounts in Form VAT 240 had declared additional tax liability of ₹ 3.37 crore compared to the tax liability declared in the monthly returns for the years 2010-11 to 2013-14. As per the Act, this additional liability declared was to be paid by the dealers along with penalty (at 10 per cent) and interest (at 1.5 per cent per month).

¹ ₹ 40 lakh till 31 March 2010, ₹ 60 lakh from 1 April 2010 to 31 March 2011 and ₹ 100 lakh thereafter

² Belagavi, Bengaluru, Chikkamagaluru, Chitradurga, Davanagere, Haveri, Kalaburgi, Kodagu, Kolar, Mangaluru, Mysuru, Raichur and Uttara Kannada (Karwar)

However, the dealers concerned neither paid the dues on their own on filing the audited accounts, nor were the dues demanded by the LVOs concerned. This resulted in non/short payment of tax of ₹ 4.78 crore including penalty of ₹ 30.75 lakh and interest of ₹ 1.10 crore.

Audit is of the opinion that the enabling of the automatic calculation of the computed fields and ensuring referential integrity between the documents like VAT returns, annual statements and VAT-240 in the e Filing System (EFS) would mitigate this problem of non/short payment to a greater extent by automatically showing up such cases.

After these cases were brought to the notice of the Department between March and May 2015 and referred to Government in July 2015, ₹ 14.95 lakh was collected in 11 cases. Reply was awaited in the remaining cases (November 2015).

2.5 Non- levy of penalty under section 72(1) of the KVAT Act

According to Section 35 (1) of the KVAT Act, every registered dealer shall furnish a return in such form and manner, including electronic methods, and shall pay tax due on such return within twenty days after the end of the preceding month or any other tax period as may be prescribed.

Further, as per Section 72(1) of KVAT Act, a dealer who fails to furnish a return or who fails to pay the tax due on any return furnished as required under the Act, shall be liable to pay, together with any tax or interest due, a penalty equal to:

- a) five *per cent* of the amount of tax due or ₹ 50 whichever is higher, if the default is not for more than 10 days, and
- b) ten *per cent* of the tax due, if the default is for more than 10 days.

During test check of records of 26 Offices in 13³ districts between April 2014 and March 2015, Audit noticed that 54 assesseees had filed returns and paid tax of ₹ 45.51 crore belatedly, i.e., beyond 20 days after the expiry of the applicable tax period. Though all these cases attracted penalty u/s 72(1) of the Act, it was neither paid by the assesseees nor was any effort made by the officers concerned to impose the same. This has resulted in non-levy of penalty of ₹ 3.68 crore.

After these cases were brought to the notice of the Department between March and April 2015 and referred to Government in July 2015, ₹ 1.15 crore was collected in 22 cases and demand notice for ₹ 40.28 lakh was issued in one case. In another case, it was replied that the observation may be dropped based on the assesseees' reply that, according to the judgement passed by the Hon'ble High Court of Karnataka, penalty under Section 72(1) can be relaxed by the officer concerned. The reply is not acceptable as the competent authority has not examined the case for waiver of penalty.

Reply was awaited in the remaining cases (November 2015).

³ Belagavi, Bengaluru, Bidar, Chikkaballapura, Chikkmagaluru, Chitradurga, Dharwad, Kolar, Madikeri, Mangaluru, Udipi, Uttara Kannada and Yadgir.

2.6 Non/short levy of interest

Under Section 36(2) of the, KVAT Act 2003, every dealer who fails to pay any amount of tax or additional tax declared in the returns or furnishes a revised return more than three months after the tax becomes payable, shall be liable to pay simple interest. The rate of interest was 1.25 *per cent* per month up to 31 March 2011 and 1.5 *per cent* per month with effect from 01 April 2011 under Section 37(1) of the above Act, leviable from the date on which any amount payable under this Act was due.

During test check of monthly returns filed in Form VAT-100, annual audited statements filed in Form VAT-240 and re-assessment orders passed under the Act in 33 offices (19 Audit Offices and 14 Local VAT Offices / VAT Sub-Offices) in eight⁴ districts between January 2014 and January 2015, it was noticed that there was a delay in payment of tax either against original returns or against additional tax liabilities arising from re-assessments/ revised returns, in respect of 54 dealers. Though interest was leviable in these cases under Section 36(2) of the Act, it was either not levied or levied short. The total non/short levy of interest for the tax periods between April 2005 to March 2013 worked out to ₹ 2.33 crore.

After these cases were brought to the notice of the CCT between April 2014 and February 2015, and referred to Government in July 2015, ₹ 23.06 lakh was collected in respect of 13 dealers.

Reply in respect of remaining cases was awaited (November 2015).

2.7 Excess adjustment of credit amount

According to Section 10 of the KVAT Act 2003, the tax payable by a dealer under the Act on sale is called 'Output tax' while the tax paid by the dealer on purchases is called 'Input tax'. A dealer is liable to pay the net tax⁵ after setting off input tax paid against output tax payable.

The said provision of the KVAT Act also stipulates that "where the input tax deductible by a dealer exceeds the output tax payable by him, the excess amount shall be adjusted or refunded together with interest, as may be prescribed". Rule 127 of the KVAT Rules, 2005, provides for the dealer to adjust the excess amount towards the tax payable by him for any other month or quarter.

Test check of VAT-100 returns, annual audited accounts filed in VAT-240 and re-assessment orders in 31 Offices (29 -LVOs and two -VSOs) in 15⁶ districts were conducted between November 2013 and December 2014. Audit cross verified the credit amounts brought forward and adjusted against the output tax liability by the dealers in their returns with respect to returns/revised returns filed by them for previous tax periods, advices given by auditors in

⁴ Bengaluru, Bengaluru Rural, Chikkamagaluru, Chitradurga, Dharwad, Haveri, Mysuru and Raichur

⁵ Net tax = Output tax – Input tax

⁶ Belagavi, Bangalore Rural, Bangalore Urban, Chikkamagaluru, Chitradurga, Dakshina Kannada, Davanagere, Hassan, Haveri, Kolar, Mysuru, Raichur, Shivamogga, Uttara Kannada and Yadgir

Form VAT-240 and re-assessments concluded by the prescribed authorities. The cross verification revealed in the case of 54 dealers that against the admissible credit of ₹ 34.31 crore from the earlier tax periods, credit of ₹ 36.62 crore had been adjusted by the dealers concerned. However, no action was taken by the LVOs/VSOs to reverse the adjustment made by the dealers or to demand and recover the same. This has resulted in excess adjustment of credit amount of ₹ 2.31 crore. The details are as under:

Table .2.2
Excess adjustment of unit amount

(₹ in lakh)				
Sl. No.	Description	Credit amount adjusted	Admissible credit	Excess amount adjusted
1.	Amounts adjusted in excess of the amounts shown as carried forward in returns for previous tax periods.	59.82	30.51	29.31
2.	The dealers adjusted credits in the returns as per the excess amounts available to them in their previous returns. Subsequently, the auditors of the dealers reduced the excess amounts claimed in those previous returns, or, in audit it was noticed that credit claimed in previous returns were in excess though the auditors did not advise the dealers to reduce the credit. The dealers concerned, however, did not revise the returns in which the excess amount was adjusted. No action was taken by the LVOs/VSOs to reverse the adjustment made by the dealers or to demand and recover the same.	3579.13	3400.59	178.54
3.	The dealers adjusted credits in the returns as per the excess amounts available to them in their previous returns. Subsequently, the prescribed authorities of the Department, in the re-assessment orders, reduced the excess amounts carried forward by the dealers. No action, however, was taken to reverse the adjustment already availed of by the dealers in their subsequent returns.	22.90	Nil	22.90
	Total	3661.85	3431.10	230.75

After these cases were brought to the notice of the CCT between April 2014 and March 2015, and referred to Government in July 2015, ₹ 5.77 lakh was collected in respect of three dealers, the excess adjustment of credit was adjusted/rectified in the re-assessment orders in respect of two dealers, the excess adjustment of credit was demanded in the re-assessment orders in respect of two dealers and three dealers rectified excess adjustment of credit in VAT-100 return for the month of November 2014. Reply in respect of remaining cases was still awaited (November 2015).

2.8 Non levy of penalty under Section 72(2) of the KVAT Act

Under Section 72(2) of the KVAT Act, 2003, a dealer, who for any prescribed tax period, furnishes a return which understates his liability to tax or overstates his entitlement to a tax credit by more than five *per cent* of his actual liability

to tax or his actual tax credit, as the case maybe, shall, after being given an opportunity of showing cause in writing against the imposition of a penalty, be liable to a penalty equal to 10 per cent of the amount of such tax under or overstated.

During test check of VAT-100 returns, annual audited accounts filed in VAT-240 and re-assessment orders in 19 Offices (17 LVOs and 02 Audit Offices) in ten⁷ districts between January and December 2014, we noticed that in respect of 28 assesseees, tax liability was understated in original returns which were rectified either by filing revised VAT-100 returns or by filing of Annual Audit Accounts in Form VAT-240. We also noticed that in respect of two assesseees, re-assessment orders were passed by the Department in which additional tax liability was raised. The understatement of tax in monthly returns and additional tax liability created in re-assessment orders in these cases amounted to ₹ 12.97 crore. Though penalty was leviable under Section 72(2), the same was not levied by the officers concerned and the non-levy worked out to ₹ 1.29 crore.

After these cases were brought to the notice of the CCT between May 2014 and February 2015, and referred to Government in July 2015, ₹ 84.89 lakh was collected in nine cases. Reply in respect of the remaining cases was awaited (November 2015).

2.9 Non-discharge of tax liability declared in the returns

Under Section 35(1) of the KVAT Act 2003, every registered dealer shall furnish a return in the prescribed form and shall pay the tax due on such return within 20 days (or 15 days⁸) after the end of the preceding month.

The CTD introduced (April 2010) online e-Filing System (EFS) for filing of returns, payment of taxes, issue of Forms and Transit Pass, etc.

Returns filed under EFS are assigned one of the following status:

Table 2.3
Status of refunds under EFS

Sl. No.	Status	Meaning
1.	Deemed acknowledged	Dealer files his return after making e-payment of tax liability declared in the return or has credit to be carried forward with no net tax liability for payment. This status is automatic.
2.	Acknowledged	Dealer files return online with details of cheque for payment of net tax liability. The return is acknowledged by the LVO on receipt of the cheque.
3.	Not acknowledged	Dealer files return online but is yet to discharge liability fully/partially.

When the return is acknowledged by the LVO, the cheque is posted to the bank statement in EFS and then sent for realisation. Status of 'Not acknowledged' implies that the dealer has not handed over the cheque to the

⁷ Belagavi, Bengaluru Rural, Bengaluru Urban, Chikkamagaluru, Dakshina Kannada, Haveri, Madikeri, Mysuru, Udupi and Uttara Kannada

⁸ 20 days for regular VAT dealers and 15 days for dealers who have opted for composition of tax.

LVO or that there is an omission on the part of the LVO to update the status of the return in EFS even after receipt of the cheque. All realised payments of the dealer are reflected in the EFS against the TIN⁹ of the dealer.

During test check of returns filed in two LVOs¹⁰ in Bangalore district between May and November 2014, Audit noticed that 38 returns filed for the tax periods between April 2011 and January 2013 by 20 assesseees were under the category of 'not acknowledged' in the EFS. Scrutiny of the payment details of these assesseees in EFS also showed that the respective liabilities were either not fully discharged or were only partially discharged. Thus, it indicates that the dealers had not made the payments to the LVOs concerned.

The total amount of tax realizable from such dealers worked out to ₹ 87.54 lakh. No action had been taken by the officers concerned to follow up these cases and ensure recovery.

These cases were brought to the notice of the Department in May 2015 and referred to Government in July 2015. Reply was awaited (November 2015).

2.10 Incorrect refund of tax

According to Rule 127 read with 128 of the KVAT Rules, 2005, any dealer in whose case the input tax deductible exceeds the output tax payable by him on the basis of the returns for any tax period, such dealer may claim refund of such amount or adjust such amount towards the tax payable by him for any other tax period.

During a test check of the records in LVO - 40, Bengaluru in October 2014, we noticed that a civil works contractor, in his return for the month of April 2011 (submitted on 20 June 2011), had brought forward a credit of ₹ 18.11 lakh from the previous monthly return of March 2011. Re-assessment order dated 28 February 2012 passed by the Department for the period 2010-11, however, concluded that the credit available for refund at the end of the tax period of March 2011 was only ₹ 13.09 lakh. Thus, an excess amount of ₹ 5.02 lakh¹¹ had been carried forward by the dealer, which was neither rectified by the dealer nor was demanded by the Department. Further, it was noticed that the credit of ₹ 13.09 lakh arrived as per the reassessment order was refunded on 09 May 2012.

In addition, an amount of ₹ 18.11 lakh carried forward by the dealer from March 2011 was refunded again, along with the excess credit available for the year 2011-12, vide another order dated 19 April 2014. This included the excess amount of ₹ 5.02 lakh carried forward as well as ₹ 13.09 lakh already refunded in May 2012, thereby resulting in an excess refund of ₹ 18.11 lakh. Interest and penalty under the Act work out to ₹ 9.05 lakh¹² and ₹ 1.81 lakh¹³ respectively for overstatement of tax credit by the dealer.

⁹ Tax payers identification number.

¹⁰ LVOs-20 and 40

¹¹ ₹ 18.11 lakh (less) ₹ 13.09 lakh

¹² 1.5 per cent on ₹ 5.02 lakh (excess credit brought forward) from 20 May 2011 to 09 May 2012 (12 months) (+) 1.5 per cent on ₹ 18.11 lakh (excess credit availed) from 10 May 2012 to 19 April 2014 (24 months) (+) 1.5 per cent on ₹ 18.11 lakh (incorrect refund) from 20 April 2014 to 29 October 2014 (06 months)

¹³ 10% of ₹ 18.11 lakh

After this case was brought to the notice of the CCT in May 2015 and referred to Government in June 2015, ₹ 23.60 lakh was adjusted out of the amount refundable to the assessee for the tax period 2012-13. Balance of ₹ 5.37 lakh was yet to be recovered (November 2015).

2.11 Non-levy of interest on delayed payment of entry tax

Under Section 7(2) of the Karnataka Tax on Entry of Goods (KTEG) Act 1979, every dealer is required to pay the full amount of tax payable on the basis of turnover computed by him for the preceding month within 20 days after the end of that month. In case of default beyond 10 days after that period, the assessee is liable to pay interest at the rate of two *per cent* per month of the tax payable for every month or part thereof during which such default is continued.

Audit noticed between November 2014 and January 2015 that four dealers had brought goods valued at ₹ 16.83 crore into the local area. They were liable to pay advance tax of ₹ 39 lakh. However, the assessee filed incorrect returns and had paid only advance tax of ₹ 7.77 lakh. The mistake was detected by the Department while concluding the assessments but interest, though leviable, was not levied. This resulted in non levy of interest of ₹ 22.38 lakh.

After these cases were brought to the notice of the Department in April 2015 and referred to Government in July 2015, ₹ 4.90 lakh was collected in two cases. In one case, it was replied that a payment of ₹ 15.86 lakh made by the assessee for September 2006 was not considered while concluding the assessments. It was also mentioned that if the same were to be considered, there could not be any short levy and the question of levy of interest does not arise.

On verification of the return for the September 2006, Audit noticed that the payment mentioned was made against liability towards VAT and not KTEG. It was also noticed that the assessee had not declared any turnover under KTEG in that return. Hence, the reply in respect of that case cannot be accepted.

Reply was awaited in the remaining case (November 2015).

2.12 Non-levy of tax on warranty claims

According to Section 2 (29) of the KVAT Act, 2003, “sale” means every transfer of property in goods by one person to another in the course of trade or business for cash or for deferred payment or other valuable consideration.

Further, in *Md. Ekram Khan & Sons vs Commissioner of Trade*¹⁴, Uttar Pradesh, the Hon’ble Supreme Court held that the ‘transfer of property’ on the parts replaced under warranty constituted a ‘sale’ and hence is liable to be taxed.

During test check of the records of one Audit Office and one LVO in Bengaluru and Davanagere Districts during June 2014 and September 2014, Audit noticed that three dealers had received credits worth ₹ 37.33 lakh as warranty claims from the manufacturer. Though the same was taxable as per

¹⁴ Judgement (With CA No. 9619/2003) dated 21 July 2004

the judgement of the Hon'ble Supreme Court, it was not subjected to tax at the relevant rates prescribed under the KVAT Act. The resultant non-levy of tax aggregates to ₹ 6.60 lakh along with interest.

After these cases were brought to the notice of the CCT in May 2015 and referred to Government in June 2015, ₹ 2.94 lakh was collected in two cases. Reply was awaited in the remaining cases (November 2015).

2.13 Non-levy of tax on purchases from unregistered dealers

According to Section 3(2) of the KVAT Act 2003, "the tax shall also be levied, and paid by every registered dealer or a dealer liable to be registered, on the sale of taxable goods to him, for use in the course of his business, by a person who is not registered under this act".

Under Section 15(5)(e) of the Act *ibid*, a works contractor who had opted for composition of tax shall be liable to pay tax u/s 3(2) of the Act in respect of purchases from unregistered dealers (URDs) in addition to tax by way of composition on the total consideration of the works contract executed.

During test check of records of an Audit Office and an LVO in Raichur and Belagavi districts respectively during April 2014 and November 2014, Audit noticed that six works contractors who had opted for composition of tax had made purchases of sand, murrum and jelly worth ₹ 93.6 lakh from URDs during the years 2010-11 to 2012-13. Though such purchases were liable to tax at the rates prescribed in the Act, the same was not paid by the assesseees or levied by the assessing officers. The resultant non-levy of tax on such purchases works out to ₹ 7.94 lakh. The aforesaid understatement of tax also attracts penalty of ₹ 0.67 lakh and interest of ₹ 2.21 lakh. Total non-levy aggregates to ₹ 10.82 lakh.

After these cases were brought to the notice of the CCT in May 2015 and referred to Government in July 2015, ₹ 4.46 lakh was collected in six cases in which two cases were recommended for reassessment and one case for rectification. Action taken in the matter was awaited (November 2015).

2.14 Excess/incorrect allowance of Input Tax Credit

Under Section 10(3) of the KVAT Act, 2003, the tax payable by a registered dealer under the Act on sale is called 'Output Tax' while the tax paid by the registered dealer under the Act on purchase is called 'Input Tax'. A dealer is liable to pay the net tax¹⁵ after adjustment of input tax paid against output tax.

Audit conducted test check of monthly returns filed in Form VAT-100, annual audited statements filed in Form VAT-240 and re-assessment orders passed under the Act in five offices (four Audit Offices and one LVO) in two¹⁶ districts between June 2014 and February 2015. During cross-verification of the purchase statements filed by dealers with the returns filed by their supplying dealers, Audit found that in four cases, dealers had claimed Input Tax Credit (ITC) of ₹ 3.49 lakh in their monthly returns on purchases from five dealers whose registration was not current during the period of sale.

¹⁵ (Output tax – Input tax)

¹⁶ Belagavi and Bengaluru

Three supplying dealers had filed 'nil' returns or did not file returns for the tax periods in which ITC of ₹ 0.96 lakh was claimed. Audit also noticed that one dealer had claimed ITC of ₹ 2.37 lakh in excess due to arithmetical error in VAT-240 for the year 2012-2013. These resulted in excess/incorrect claim of ITC of ₹ 6.82 lakh. Besides, penalty of ₹ 0.68 lakh and interest of ₹ 2.50 lakh were leviable aggregating to ₹ 10.00 lakh.

After these cases were brought to the notice of the CCT between September 2014 and April 2015, and referred to Government in July 2015, ₹ 4.86 lakh was collected in three cases. Reply in respect of remaining two cases was still awaited (November 2015).