CHAPTER-II

TAXES/VAT ON SALES, TRADE etc.

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Taxes/VAT on Sales, Trade etc.

2.1 Tax administration

The Commercial Taxes Department is under the purview of Principal Secretary to Revenue Department. The Department is mainly responsible for collection of taxes and administration of AP Value Added tax (VAT) Act (Changed to Telangana VAT Act vide G.O.Ms. No. 32 dated 15 October 2014), Central Sales Tax (CST) Act, AP Entertainment Tax Act, AP Luxury Tax Act[5] and rules framed thereunder. Commissioner of Commercial Taxes (CCT) is the Head of Department entrusted with overall supervision and is assisted by Additional Commissioners, Joint Commissioners (JC), Deputy Commissioners (DC) and Assistant Commissioners (AC). Commercial Tax Officers (CTOs) at circle level are primarily responsible for tax administration and are entrusted with registration of dealers and collection of taxes. The DCs are controlling authorities with overall supervision of the circles under their jurisdiction. There are 104 offices (12 Large Tax Payer Units (LTUs) headed by ACs and 92 Circles headed by CTOs) functioning under the administrative control of DCs. Further, there is an Inter State Wing (IST) headed by a Joint Commissioner within Enforcement wing, which assists CCT in cross verification of interstate transactions with different States.

2.2 Internal audit

The Department did not have a structured Internal Audit Wing that would plan and conduct audit in accordance with a scheduled audit plan. Internal audit is organized at Divisional level under the supervision of Assistant Commissioner (CT). There are 12 Large Tax Payers Units (LTUs) and 92 circles in State. Each LTU/circle is audited by audit teams consisting of five members headed by either CTOs or Deputy CTOs. Internal audit report is submitted within 15 days from the date of audit to DC (CT) concerned, who would supervise rectification work giving effect to findings in such report of internal audit.

2.3 Results of audit

In 2014-15, test check of the assessment files, refund records and other connected documents of the Commercial Taxes Department showed underassessment of Sales Tax/VAT and other irregularities involving ₹ 308.10 crore in 773 cases which fall under the following categories as given in **Table 2.1.**

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[5] AP Entertainment Tax Act and AP Luxury Tax Act and Rules have not been formally adopted by Government of Telangana, however, by virtue of Sections 100 and 101 of the Andhra Pradesh Reorganisation Act 2014, these are applicable in the State of Telangana.

Table 2.1 : Results of audit

(₹ in crore)

Sl. No.	Categories	No. of cases	Amount
1	Performance Audit on Implementation of VAT (including IT Audit of VATIS)	1	104.83
2	Excess Input Tax allowed	107	29.54
3	Non-levy/Short levy of Interest and Penalty	136	12.75
4	Short levy of tax on works contract	43	10.44
5	Excess authorisation of refunds	7	1.18
6	Incorrect exemption of taxable turnover	71	18.84
7	Short levy of tax due to application of incorrect rate of tax	137	51.03
8	Under-declaration of VAT	73	33.03
9	Other irregularities	198	46.46
	Total	**773**	**308.10**

During the year, Department accepted under-assessments and other deficiencies in 172 cases involving ₹ 57.85 crore. An amount of ₹ 1.29 crore in 57 cases was realised during the year 2014-15.

Performance Audit of "Implementation of VAT (including IT Audit of VATIS)" involving ₹ 104.83 crore, and a few illustrative cases involving ₹ 85.93 crore are discussed in the following paragraphs:

2.4 Performance Audit on "Implementation of VAT (including IT Audit of VATIS)"

2.4.1 Introduction

The Andhra Pradesh Value Added Tax Act (AP VAT Act) was introduced in the erstwhile combined State of Andhra Pradesh (AP) in 2005 to provide for and consolidate the laws relating to levy of value added tax on sale or purchase of goods in the State. It replaced Andhra Pradesh General Sales Tax Act, 1957 (APGST Act). Rules supporting AP VAT Act, known as Andhra Pradesh Value Added Tax Rules (AP VAT Rules) were also introduced in the same year. The Commercial Taxes Department uses an IT system known as Value Added Tax Information System (VATIS) to aid the implementation of the Act in the State.

2.4.2 Organisational setup

Commercial Taxes Department (CTD) is under the purview of the Principal Secretary, Revenue Department at the Government level. At Commissionerate level, Commissioner of Commercial Taxes (CCT) is the head of the Department and is assisted by Additional Commissioners, Joint Commissioners (JC), Deputy Commissioners (DC) and Assistant Commissioners (AC). Divisional offices at field level are headed by the DCs and are assisted by the ACs, Commercial Tax Officers (CTO), Deputy

Commercial Tax Officers (DCTO) and Assistant Commercial Tax Officers (ACTO).

There are 104 assessing offices functioning under the administrative control of the DCs consisting of 12 Large Taxpayer Units[6] (LTUs) headed by ACs and 92 circles headed by the CTOs.

2.4.3 Audit Objectives

The Performance Audit was conducted to

- assess the adequacy of systems in place to ensure compliance with legal provisions relating to registration, scrutiny of records and cancellation of registration of the dealers;
- assess the effectiveness of the system of assessments; and
- evaluate adequacy of IT Policy and relevant controls.

2.4.4 Scope, Sources of Audit Criteria and Methodology

Performance Audit on Implementation of Value Added Tax (including IT Audit of VATIS) covers the period from 2011-12 to 2013-14 and was conducted from September 2014 to June 2015.

The performance of the Department was benchmarked against audit criteria derived from the following:

- APVAT Act and Rules, 2005
- VAT Audit Manual[7] issued by the Government of Andhra Pradesh
- Orders/notifications issued by the Government/Department from time to time
- Citizen's Charter 2012

For conducting this Performance Audit, out of the 12 LTUs and 92 circles, LTU Abids and Punjagutta and 13 circles[8] were selected by simple random sampling method. IT audit of VATIS for the period from April 2011 to March 2014 was also conducted as part of the Performance Audit. Data related to selected sample (15 units) was extracted from the centralized data provided by the CCT and was analysed using IDEA software. The general controls and application controls were evaluated with reference to audit objectives.

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6 Large Taxpayer Units have under their jurisdiction 25-50 dealers of each Division selected on the basis of criteria like tax payments, complexity of transactions, etc. as decided by the CCT.

7 Commercial Tax Department revised Manual during 2012.

8 Begumpet, Gadwal, General Bazar, Hydernagar, Jeedimetla, Kothagudem, Mahankali Street, Malkajgiri, Nacharam, Punjagutta, Somajiguda, Siddipet and Warangal.

2.4.5 Acknowledgment

Audit acknowledges the co-operation extended by the Department in providing server data, records and other necessary information. The entry conference was held on 2 December 2014 with the CCT and departmental officers in which the Department was apprised of the scope and methodology of audit. An exit conference was held on 23 November 2015 in which the audit results and recommendations were discussed with the representatives of the Department and the Government. The Government was represented by the Principal Secretary while the Department was represented by the CCT. Responses of the Government and Department have been suitably incorporated in the report.

Audit Findings

Adequacy of systems for compliance

CTD is responsible for ensuring that eligible dealers in the State are registered and paying appropriate tax. Provisions have been made in the VAT Act, Rules and Manuals to protect the interest of Government revenue as well as to streamline the processes. Registration of dealers provides the basis for controlling the VAT dealers.

The registered dealers are mandatorily required to submit their returns and supporting documents. These form the basis for calculation of the tax liability/ITC of the dealers by CTD.

Cancellation of registration can be done on the request of the dealer or by CTD if certain legal provisions have been violated by the dealer. In such cases, audit is to be conducted by the CTD to ensure that Government revenues are protected.

2.4.6 Non-conducting of street surveys for identifying new dealers

Section 17 of the APVAT Act, 2005 provides that every dealer, other than a casual dealer shall be liable to be registered in accordance with the provisions of the Act. It further provides that dealers having turnover more than ₹ 7.5 lakh but less than ₹ 50 lakh should get registered as 'Turnover Tax' (TOT) dealer and dealers with turnover more than ₹ 50 lakh should invariably be registered as VAT dealers. With a view to identify such dealers who are liable to be registered and pay tax but have remained unregistered, street survey is an important tool. Appendix V of the VAT Audit Manual prescribes to conduct street surveys to identify and ensure registration of dealers. However, neither any procedure nor a periodicity has been prescribed.

Audit observed that street surveys had not been conducted in any of the 13 selected circles during the period covered under audit. In the absence of any such surveys CTD deprived itself of the opportunity of detecting the eligible unregistered dealers and bringing them under the tax net. However, there is no other enabling provision in this regard. The matter had earlier been raised by

Audit in the Report of the Comptroller and Auditor General of India (Revenue Receipts) for the year ended 31 March 2009.

The matter was referred to the Government in October 2015. The Government stated (November 2015) that street surveys were being conducted regularly and a special drive was conducted in the month of September 2015. However during the course of audit the CTOs had stated that no street surveys conducted during the period covered under audit and DC(CT)s had also stated that no circular instructions were issued in this regard.

2.4.7 Absence of penal provisions resulted in non-compliance

2.4.7.1 Non-filing of VAT 200A and VAT 200B returns

According to Section 13(6) of APVAT Act, ITC for transfer of taxable goods outside the State otherwise than by way of sale was to be allowed for the amount of tax in excess of four *per cent*/five *per cent*[9]. As per Section 13(5), no ITC was to be allowed if inputs are used for manufacture of exempt goods. As per Rule 20 of AP VAT Rules, dealers to whom Sections 13 (5) or (6) apply, are to file VAT 200A returns monthly and VAT 200B returns annually. These returns give the breakup of the transactions which are required for correct calculation of ITC eligibility in the case of interstate transfer of goods/manufacture of exempt goods. However, there was no provision for imposing any penalty for non-submission of these returns.

During the course of audit, in 10 circles[10], it was noticed (September 2014 to March 2015) from VATIS data analysis that in 8,227 cases[11] dealers had effected transfers of taxable goods to their branches outside the State or sold exempt goods within the State and claimed ITC amounting to ₹ 1549.29 crore during the period 2011-14. Unlike VAT 200, there was no provision in VATIS for online submission of VAT 200A and VAT 200B returns and the manual copies were also not made available to audit. In the absence of these returns, correctness of ITC claims could not be checked. The AAs could not insist on compliance as there was no penal provision in the Act/Rules.

On this being pointed out (September 2014 to May 2015) the CTOs in the test checked circles replied that notices would be issued to these dealers for submission of returns in VAT 200A and VAT 200B. However, in the absence of any penal provisions, non-compliance with the provisions resulted in allowing of ITC amounting to ₹ 1549.29 crore without checking the correctness of the claims.

The matter was referred to the Government in October 2015. The Government stated that online submission of returns would be implemented from 15 December 2015.

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[9] Tax rate revised from four to five *per cent* from 14 September 2011 vide Act No. 11 of 2012.

[10] Begumpet, Gadwal, Jeedimetla, Kothagudem, Mahankali Street, Malkajgiri, Nacharam, Siddipet, Somajiguda and Warangal.

[11] One case means one financial year for which the returns were to be submitted.

2.4.7.2 Non-filing of financial statements

Para 5.12 of VAT Audit Manual prescribes mandatory basic checks on figures reported by VAT dealers in their monthly VAT returns, and comparison of the figures with those recorded in certified financial statements to detect under-declaration of tax, if any. As per Rule 25(10) of AP VAT Rules, every VAT dealer whose annual total turnover is more than ₹ 50 lakh shall furnish, for every financial year the financial statements certified by a Chartered Accountant, on or before 31 December subsequent to the financial year to which the statements relate.

During the course of audit, in five circles[12] it was noticed from the data available in VATIS (November 2014 to March 2015), that in all 5057 cases[13], VAT dealers (who had a turnover of more than ₹ 50 lakh during that financial year) did not submit the audited financial statements during the period 2011-14. Neither had the dealers complied with the provisions under rules nor had AAs insisted on submission of financial statements. In the absence of certified financial statements, CTD cannot check whether the turnover disclosed in the returns are correct unless the dealers are selected for audit.

There was a provision under Section 14(1-B) of Andhra Pradesh General Sales Tax Act 1957, to levy penalty on non-submission of financial statement duly certified by the Chartered Accountant. In the AP VAT Act these provisions were dispensed with, owing to which the AAs could not insist on compliance.

After audit pointed this out, the AAs replied that notices would be issued to the dealers.

The matter was referred to the Department in August 2015. The Government agreed (November 2015) that there were no penal provisions in the Act to ensure filing of financial statements. No specific reply has been received on how the Government would ensure compliance with the Rules.

Effectiveness of the system of assessment

During the course of audit of the two DC(CT) offices and 13 circles, test check of files and VATIS data analysis, cases of short/non levy of taxes due to incorrect allowance of ITC, adoption of incorrect rate of tax, incorrect declaration of taxes and non-levy of penalty and interest on belated payment of taxes etc. were noticed. The cases are discussed in the following paragraphs.

2.4.8.1 Non-levy of interest and penalty on belated payments

As per Section 22 (2) of APVAT Act, in case of delayed payment of taxes, dealers have to pay interest at 1.25 *per cent*[14] per month on tax due for the period of delay from the prescribed or specified date for its payment. Further

[12] Kothagudem, Mahankali Street, Malkajgiri, Siddipet and Warangal.
[13] One case means one financial year for which tax was to be assessed.
[14] One *per cent* of tax due up to 14 September 2011 and 1.25 *per cent* from 15 September 2011 per month.

according to Section 51(1) of AP VAT Act, where a dealer who fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, he shall pay penalty of 10 *per cent* of the amount of tax due.

During the course of audit it was noticed in DC(CT) Abids office and nine circles[15] (September 2014 to February 2015) that the AAs had not levied interest and penalty in respect of 68 dealers though they had paid tax with the delay ranging from one day to 487 days. The total non-levy of interest and penalty works out to ₹ 3.38 crore.

2.4.8.2 Adoption of incorrect rate of tax

As per Section 4(1) of AP VAT Act, every VAT dealer shall pay tax on each sale of goods, at the rates specified in the Schedules. As per Section 4(7)(b), every dealer executing works contract and opting to pay tax under composition[16] shall pay tax at five *per cent*[17] on the total amount. According to Section 4(9)(d), dealers selling food and beverages, if their annual total turnover is more than ₹ five lakh but less than ₹ 1.5 crore, shall pay tax at the rate of five *per cent* on the taxable turnover of the sale or supply of goods, being food or drink served in restaurants, sweet-stalls, clubs, any other eating house or anywhere, whether indoor or outdoor or by a caterer.

During the test check of records, in CTO General Bazar circle, it was noticed (March to April 2015), that a dealer had been incorrectly declaring sales for the period 2013-14 of Rexine under exempted sales, though the commodity was listed under Schedule IV and taxable at five *per cent*. The AA did not check the returns and registration records of the dealer. This resulted in short payment of tax of ₹ 5.89 crore**.**

Similarly, in CTO, Siddipet Circle, Audit noticed (February 2015) from the online data in VATIS that a works contractor during the period 2011-13, continued to pay tax at four *per cent* under composition, instead of the revised rate of five *per cent*. There was short payment of tax of ₹ three lakh.

In CTO Hydernagar circle (September 2014) Audit noticed that a dealer had paid tax by incorrectly adopting the rate of tax on sale of food and claimed ITC though his turnover was less than ₹ 1.5 crore, tax at five *per cent* was payable without claiming ITC. This had resulted in under declaration of output tax of ₹ two lakh.

2.4.8.3 Variations between the figures of returns and financial statements

In Nacharam Circle, Audit observed (January to February 2015) that AAs failed to notice that there were variations between the sale turnover as per the

[15] Begumpet, Gadwal, General Bazar, Kothagudem, Nacharam, Punjagutta, Siddipet, Somajiguda and Warangal.

[16] Under said Section, the dealer can opt to pay tax by way of composition at the prescribed rate on the total value of the contract.

[17] Prior to 14 September 2011 the rate of tax was four *per cent*, rates revised vide Act No.11 of 2012.

financial statements and those reported in VAT returns by four dealers for the years 2012-13 and 2013-14. In all the cases the sales turnover as per financial statements were more than those reported in VAT returns. There was under-declaration of turnover by ₹ 4.63 crore resulting in short payment of tax of ₹ 23 lakh. This indicates absence of proper scrutiny and cross linking between the financial statements and monthly returns submitted by the dealers.[18]

2.4.8.4 Non-declaration of VAT on taxable turnover

As per the Government orders issued in July 2011[19], the commodity "textiles and fabrics" was added to Schedule IV to AP VAT Act and hence its sales were to be taxed at five *per cent*. Later in June 2013 this commodity was included[20] in Schedule-I making its sales exempt. In General Bazar Circle, Audit observed (March to April 2015) that 21 dealers, during the period 2012-14, declared the sales of this commodity as exempted from tax while the commodity was added in Schedule IV and made taxable at five *per cent*. Although details were available in the VAT returns, AA failed to detect incorrect declaration of tax which resulted in non-payment of tax amounting to ₹ 1.10 crore.

2.4.8.5 Incorrect claims of ITC

As per Section 13(1), no ITC shall be allowed on tax paid on the purchase of goods specified in Schedule VI. Provisions under Sections 13(5) and 13(6) stipulate restrictions on claiming ITC. As per Rule 20 of the AP VAT Rules, a VAT dealer making taxable sales, exempted sales and exempt transactions of taxable goods shall restrict his ITC as per the prescribed formula[21].

Audit noticed in two DC(CT) offices[22] and four circle offices[23] (November 2014 to April 2015) from VAT 200 returns, Forms 200A and 200B returns of 12 dealers for the years from 2010-11 to 2013-14, that these dealers were making exempt sales, taxable sales and/or exempt transactions of taxable goods and Schedule VI goods but ITC was claimed without applying the prescribed formula for restrictions. This resulted in excess claim of ITC of ₹ 41.01 crore.

2.4.8.6 Incorrect ITC claimed by works contractors

As per Section 4(7)(b) of AP VAT Act read with Rule 17(2) of AP VAT Rules, the works contractors who opt to pay tax under composition scheme shall not be eligible to claim ITC. Further as per Section 13(7) of the Act,

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[18] As per Section 2(35) of Act, 'Tax period' means a calendar month. As per Section 20 of the Act read with Rule 23 of AP VAT Rules, every VAT dealer shall file a return within 20 days after the end of the tax period. Further, the return so filed shall be subject to scrutiny to verify the correctness of calculation, application of correct rate of tax and input tax credit claimed therein and full payment of tax payable.

[19] G.O.Ms.No.932, Revenue (CT-II) Department, dated 08 July 2011.

[20] G.O.Ms.No.308, dated 07 June 2013.

[21] A*B/C, where A is the input tax for common inputs for each tax rate, B is the taxable turnover and C is the total turnover.

[22] Abids and Punjagutta.

[23] Kothagudem, Mahankali Street, Malkajgiri and Nacharam.

where any works contractor pays tax on the value of goods incorporated in the works as per Schedules (if accounts are maintained properly), the dealer shall be eligible to claim 75 *per cent* of the taxes paid on such purchases.

Audit noticed (November 2014 to April 2015) in CTO, Begumpet and Siddipet that six works contractors in their VAT 200 returns claimed ITC of ₹ 1.51 crore on the total purchase turnover for the period 2013-14. These dealers were works contractors and hence were either not eligible to claim ITC or eligible only for 75 *per cent* of tax paid on the goods purchased and incorporated in works. The excess claim of ITC claimed works out to ₹ 38 lakh.

2.4.8.7 Under-declaration of turnover by Bar and Restaurants (Hoteliers)

As per Section 4(9)(c) of AP VAT Act, 2005, every dealer, whose annual total turnover is ₹ 1.5 crore and above shall pay tax at the rate of 14.5 *per cent* of the taxable turnover of the sale or supply of goods, being food or drink, served in restaurants, sweet-stalls, clubs, any other eating houses or anywhere whether indoor or outdoor or by caterers. Section 2(39) defines 'Total Turnover' as the aggregate of sale prices of all goods, taxable and exempted, sold at all places of business of the dealer in the State.

Audit noticed (January to March 2015) in seven[24] CTOs that 13 dealers running bar and restaurants declared the turnover in 26 cases[25] during the period from 2011-12 to 2013-14, less than ₹ 1.5 crore and paid VAT at five *per cent* on the sale of food only. However, annual total turnover of the dealers including the liquor sales as per the data obtained by Audit from Andhra Pradesh Beverages Corporation Limited was more than ₹ 1.5 crore per annum and the dealers were liable to pay tax at 14.5 *per cent.* Under-declaration of turnover resulted in under-declaration and short payment of VAT to the tune of ₹ 18 lakh. The AAs failed to check the correctness of turnover declared by the dealers though they had been registered as 'bar and restaurant'.

These observations were brought to the notice of the Department (June 2015 to September 2015) and Government (October 2015). The Government stated that in most of the cases either show cause notices were issued or demands raised and assured that action would be taken in the remaining cases.

2.4.9 Non-recovery of deferred sales tax and interest

Under 'Target 2000 sales tax incentives scheme' promulgated by the State Government in 1996, industrial units were allowed deferment of sales tax to the extent of incentive limit as mentioned in Final Eligibility Certificate (FEC). When AP VAT Act was introduced, all industrial units availing tax holiday or tax exemption on the date of commencement of the Act were to be treated as units availing tax deferment under Section 69 of this Act. As per Rule 67 of AP VAT Rules, the repayment of deferred tax was to commence

[24] Begumpet, Hydernagar, Kothagudem, Nacharam, Punjagutta, Siddipet and Warangal.
[25] One case means one financial year for which tax was to be assessed.

after the completion of the deferment period. In case of non-remittance of deferred sales tax on the due dates under the 'Target 2000 sales tax incentives' scheme, interest at 21.5 *per cent* per annum was payable as per the conditions mentioned in the FECs.

Audit observed that there is no effective mechanism to ensure recovery of dues in the case of units which had been allowed deferment as is evident from the following:

In CTOs, Kothagudem and Nacharam, a scrutiny of the files dealing with the incentives schemes revealed (January to February 2015) that 13 dealers had availed the facility of deferment of tax amounting to ₹ 5.93 crore which was recoverable after completion of the deferment period during 2010-2014. Neither had the dealers had made any payment, nor did the Department take any action to recover the same. This had resulted in non-recovery of deferred sales tax of ₹ 5.93 crore, besides applicable interest at the rate of 21.5 *per cent*.

In four CTOs[26] (September 2014 to February 2015) it was noticed from tax deferment records that nine dealers had paid deferred tax amounting to ₹ 2.15 crore with delay ranging from 50 to 2229 days for which they were liable to pay interest at the rate of 21.5 *per cent* per annum as required. Department did not levy interest of ₹ 76 lakh on belated payments.

On this being pointed out, AAs replied (September 2014 and February 2015) in respect of non-recovery cases and five cases of non-levy of interest that matter would be examined and notices would be issued. In the remaining four cases, CTO Nacharam stated (January 2015) that matter would be examined and final action taken intimated in due course.

The matter was referred to the Department in July 2015. The Government stated (November 2015) that show cause notices had been issued to the dealers.

VAT Audits

As per para 5.12 of the VAT Audit Manual, every Audit Officer shall exercise the basic checks prescribed such as verification of the purchase particulars, comparison with the financial statements, verification of payment of Output tax etc., and enclose these particulars along with the audit files. Para 5.12.4 and Appendix VIII of the VAT Audit Manual on "examination of annual accounts" prescribes for verification of the financial statements of the dealers so as to review any disparities between the details available in the VAT returns submitted by the dealer and his financial statements for that period.

VAT audits cover only around 10 *per cent* of dealers every year which may not be sufficient to prevent leakage of revenue. No norms have been prescribed for conducting minimum number of VAT audits in VAT Audit Manual. The details of VAT audits conducted during the period from 2011-12 to 2013-14 in the erstwhile combined State of AP are as follows:

[26] Jeedimetla, Kothagudem, Nacharam and Punjagutta.

Year	Total no. of registered dealers	Audits completed	Percentage of audits with respect to dealers	Revenue from VAT audits (₹ in crores)
2011-12	189945	18947	9.97	493.78
2012-13	230381	23468	10.19	823.55
2013-14 (upto Dec. 2013)[27]	278693	14080	3.05	863.67

Audit reviewed VAT Audit files and observed the following system and compliance deficiencies which reflect on the quality/insufficient checks being carried out in VAT audits:

2.4.10.1 Non-completion of VAT audit before cancellation of registration

As per Rule 14(4) of AP VAT Rules 2005, every VAT dealer whose registration has been cancelled under this rule shall pay back ITC availed in respect of all taxable goods on hand on the date of cancellation. In the case of capital goods on hand on which ITC has been received, the ITC to be paid back shall be based on the book value of such goods on that date. The VAT Audit Manual clearly prescribes several guidelines for selecting units for audit. It is one of the conditions laid down in the VAT Audit Manual that if a dealer applies for cancellation, an audit should be conducted to ascertain the correctness of ITC availed of by the dealer and only after completion of audit the cancellation was to be done.

During the course of audit it was noticed (November 2014 to February 2015) in five circles[28] from for the period 2011-12 to 2013-14 that CTD did not audit 1844 dealers before the cancellation of their registrations, owing to which the correct ITC to be recovered from such dealers could not be checked and protection of revenue could not be ensured. For example, in Nacharam circle in the case of a dealer Audit found that he had claimed ITC of ₹ 1.41 lakh in the VAT 200 return for September 2012. Though the registration of the dealer was cancelled (October 2012), Audit noticed that ITC was not reversed by the dealer nor did the AA insist on its payment from the Payments Status Report. As no audit was conducted before cancellation of the registration of the dealer, the dealer could get away without payment of ITC claimed on inputs.

After Audit pointed out the cases, the AAs of five circles stated that the matter would be brought to the notice of the DC (CT) for further necessary action. The CTO Nacharam stated that VAT audit would be taken up and action taken intimated to Audit in due course.

The matter was referred to the Department in August 2015. The Government replied (November 2015) that conducting audit in all cases of cancellation is difficult. They promised to examine the issue. Suitable guidelines are to be framed for audit of dealers whose registration is cancelled, in the interest of revenue.

[27] Department provided information for the period upto December 2013.
[28] General Bazar, Kothagudem, Mahankali Street, Malkajgiri and Siddipet.

2.4.10.2 Non-receipt of records after audit

The CCT issued circular instructions[29] to DCs to authorize audits to any officer of the Division not below the rank of DCTO. After completion of audits, audit files were to be transferred to the circles where the dealers were registered for further action to collect taxes, penalty and interest. Further, CCT issued instructions[30] to DCs to ensure that the demands raised according to the audits were taken into account by the relevant circle.

During the course of audit of 13 circles (November to April 2015), VAT audit records in respect of 1935 cases in respect of 2011-14 were called for by Audit, but the Department could produce only 1517 audit files. For the remaining 418 audit files, it was observed that those were not received in the respective jurisdictional circle offices after completion of VAT Audit. Due to non-receipt of the audit files, the compliance of the assessments finalized could not be ensured. Monitoring of the demands raised cannot be done by the respective CTOs in the absence of documents. After Audit pointed out the cases, the AAs stated that the matter would be brought to the notice of DCs for necessary action.

Matter was referred to the Department in August 2015. The Government stated (November 2015) that a check memo would be prepared at DC(CT) level and watched periodically to ensure timely receipt of records.

2.4.10.3 Improper maintenance of VAT audit files

It was observed (between September 2014 and April 2015) during test check of 1517 cases in DC(CT) Abids office and 13 circles that there were several omissions in the audit files as indicated below.

Sl. No.	Type of omission	No. of cases
1	Audit officers did not enclose the checklist	452 files (29.80 *per cent* of the test checked cases)
2	P&L account was not enclosed	193 cases (12.72 *per cent*)
3	Purchase particulars were not enclosed	675 cases (44.50 *per cent*)
4	Returns were not available	678 cases (44.69 *per cent*)
5	Details of G.I.S data were not available	1316 cases (86.75 *per cent*)
6	Non-verification of filing of statutory forms	1281 cases (84.44 *per cent*)

Due to the above mentioned omissions, Audit could not verify the accuracy of the assessment/penalty orders.

The issues were brought to the notice of the assessing authorities (between September 2014 and May 2015). They replied that the matter would be brought to the notice of concerned DCs(CT).

[29] CCTs Ref. No. B.II(2)/122/2006 dated 04 October 2006.
[30] No.BV(3)/120/2008 dated 16 April 2008 (Appendix XVIII of VAT Audit Manual).

The matter was referred to the Department (between June 2015 and September 2015) and to the Government (October 2015). Their reply has not been received (January 2016).

2.4.10.4 Leakage of revenue due to non-compliance with provisions

As per para 5.12 of the VAT Audit Manual, every AO shall exercise the basic checks prescribed such as verification of the purchase particulars, comparison with the Financial statements, verification of payment of output tax etc. and results to be recorded as a checklist in the audit files.

VAT audit is the final stage of scrutiny for finalization of assessment. A scrutiny of VAT audit files revealed that due to deficient exercise of checks during VAT audit resulted in short levy of tax due to incorrect adoption of rate tax, incorrect restriction/allowance of ITC, incorrect determination of taxable turnover, short/non-levy of penalties and interest as discussed below.

- In nine circles[31], it was noticed (September 2014 to January 2015) from VAT audit files of 19 dealers that turnovers reported in their VAT 200 returns were not tallying with those reported in financial statements. During the course of VAT audit, the AOs did not notice this issue. This resulted in short levy of tax of ₹ 2.95 crore that could have been prevented if the audit checks had been mandatorily followed.

- In Mahankali Street circle it was observed (November to December 2014) from a VAT audit file that the AO issued two assessment notices on the same date, first demanding tax of ₹ 9.08 lakh stating that the dealer had not produced books of accounts and second demanding a tax of ₹ 7,171, stating that the dealer had produced the books of account which however, were not available in the records. The reasons for such drastic revision of the demand was thus not supported by any document warranting the steep downward revision of assessed tax within hours. The assessment was finalized for ₹ 7,171 only.

- In DC(CT) Abids office and Punjagutta circle, it was noticed (September 2014 to February 2015) from VAT audit files of six dealers that they had paid tax after due date i.e., 20th of succeeding month. However, during the course of audit, the AOs did not levy interest on belated payment. This resulted in non-levy of interest of ₹ 34 lakh.

- In DC(CT) Abids office and nine circles[32] it was noticed (September 2014 to February 2015) from VAT audit files of 33 dealers that AOs had not/short levied penalty of ₹ five crore on under-declaration of tax though tax had been levied in all cases.

[31] Hydernagar, Jeedimetla, Mahankali Street, Malkajgiri, Nacharam, Punjagutta, Siddipet, Somajiguda and Warangal.

[32] Begumpet, Gadwal, Hydernagar, Jeedimetla, Kothagudem, Malkajgiri, Punjagutta, Siddipet and Somajiguda.

- In DC(CT) Abids office it was noticed (January to February 2015) from an audit file that the dealer had effected purchases from unregistered dealers during 2011-13 and utilised them for dispatch of goods outside the State otherwise than by way of sale in the course of interstate trade. The dealer was thus liable to pay purchase tax on purchases from unregistered dealers. However, the AO did not levy purchase tax of ₹ four lakh.

- In four circles[33] it was noticed (September 2014 to February 2015) from VAT audit files of four dealers that they had received an amount of ₹ 1.28 crore towards hire charges/transport receipts of automobiles. AOs, while finalising the assessment, did not levy tax on hire charges received. This resulted in non-levy of tax of ₹ 18 lakh.

- In DC(CT) Abids office and five circles[34] it was noticed (September 2014 to March 2015) from VAT audit files of 15 dealers that they were engaged in exempt sales/exempt transactions along with taxable sales and were to claim ITC proportionately. However, they claimed full/excess ITC. This was not observed in VAT audit by AOs which resulted in short levy of tax of ₹ 1.97 crore.

- In General Bazar circle, it was noticed (March to April 2015) from the VAT audit files of two dealers of textiles and fabrics (to be taxed at five *per cent* or at one *per cent* if dealer opted to pay under composition) for the years 2012-13 and 2013-14 (April and May 2013), that one dealer did not pay any tax and the other paid tax at one *per cent* without opting for composition. In both cases, these were to be taxed at five *per cent*. AO, instead of assessing the tax at five *per cent* treated both dealers under composition and allowed tax at one *per cent* though neither had opted to pay tax under composition. This resulted in non/short levy of tax of ₹ 2.95 crore.

- During the course of audit, in DC(CT) Abids office and Punjagutta circle, Audit noticed (September 2014 to February 2015) from VAT audit files of four dealers that the dealers had purchased and sold used vehicles during 2009-13 and claimed ITC of ₹ 5.83 crore. Although the purchases were made from customers who were not VAT dealers and the claimants were not in possession of tax invoices as provided in Section 13(1) and 13(3) of AP VAT Act, the AO while finalising the assessments allowed ITC. This resulted in short levy of tax amounting to ₹ 5.83 crore.

- In DC(CT) Abids office and five circles[35] it was noticed (September 2014 to April 2015) from VAT audit files and other records of the eight dealers that they declared output tax at four/five *per cent* instead of at the rate of 12.5 *per cent*/14.5 *per cent* (rate on Schedule V commodities) on commodities which were falling under Schedule V.

[33] Hydernagar, Kothagudem, Nacharam and Somajiguda.
[34] Kothagudem, Mahankali Street, Nacharam, Punjagutta and Somajiguda.
[35] Jeedimetla, Mahankali Street, Punjagutta, Kothagudem and Nacharam.

Misclassification and incorrect rate of tax was not noticed by the AOs which resulted in short levy of tax of ₹ 21.22 crore.

- As per Section 4(7) of APVAT Act read with Rule 17(3) of APVAT Rules, any dealer engaged in construction and selling of residential apartments, houses, buildings or commercial complexes may opt to pay tax by way of composition at the rate of four *per cent*/five *per cent* of 25 *per cent* of the consideration received or receivable or the market value fixed for the purpose of stamp duty whichever is higher. Further as per Section 4(7)(h) of APVAT Act, amounts paid to sub-contractors are exempted from tax if the main contractors are paying tax under composition. In Punjagutta circle, Audit noticed (September 2014 and October 2014) from the VAT audit file of a dealer that he had claimed exemption of tax under Section 4(7)(h) on receipts from the sub-contract. The claim of exemption was allowed by the AO during the course of VAT Audit. However, on cross verification of the turnovers of the main contractor, Audit observed that he was not engaged in construction and selling of apartments. Hence, the dealer was not eligible for exemption. Incorrectly allowing exemption resulted in short levy of tax of ₹ 15 lakh.

- In Punjagutta circle it was observed (September 2014 to October 2014) from the VAT audit file of a dealer, who was engaged in construction and selling of apartments and paying tax under Section 4(7)(d) of the Act, that he recovered the cost of the material supplied to the sub-contractor who was exempted from tax as per the provisions mentioned above. As the dealer recovered cost of the material, it was to be treated as sale and was taxable in his hands. During the course of audit, the AO did not levy tax on the cost of the material recovered. This resulted in short levy of tax of ₹ 48 lakh.

- As per Section 4(7)(e) of APVAT Act, any dealer, having opted for composition, purchases any goods from outside the State and uses such goods in the execution of the works contracts, shall pay tax at the rates applicable to the goods under the Act and the value of such goods shall be excluded (from the turnover) for the purpose of computation of turnover on which tax by way of composition at four *per cent* is to be paid. In DC(CT), Abids office and Punjagutta circle it was noticed (September 2014 to February 2015) from VAT audit files that two dealers had opted to pay tax under composition and purchased goods from outside the State. They incorporated the goods in their works for which they were liable to pay tax at the rates applicable. However, during the course of audit, the AOs did not levy the differential rate of tax on the value of goods purchased from outside the State. This resulted in short levy of tax of ₹ 32 lakh.

- Audit noticed (September 2014 to February 2015) in DC(CT), Abids office and four circles [36] from VAT audit files of eight works

[36] Hyderanagar, Kothagudem, Punjagutta and Somajiguda.

contractors that AOs arrived at taxable turnovers under works contract incorrectly by allowing ineligible deductions[37], resulting in short levy of tax of ₹ 1.43 crore.

- As per Section 13(7) of AP VAT Act, where any VAT dealer pays tax under Section 4(7)(a) (one who has not opted to pay under composition), he shall be eligible to claim ITC at 90 *per cent* (75 *per cent* from15 September 2011) of the related input tax. During the course of audit, in DC(CT), Abids office and three circle offices[38]it was noticed (November 2014 to February 2015) from VAT audit files of five works contractors that AOs while finalising the assessment allowed ITC at 100 *per cent,* though the dealers had not opted to pay tax under composition. This resulted in allowing of excess ITC of ₹ 28 lakh.

- In DC(CT) Abids office Audit noticed (January 2015 and February 2015) from VAT assessment file of a dealer for the year 2010-11 that the AA arrived at tax due of ₹ 1.17 crore under composition. However, TDS credit taken against the composition works was ₹ 1.53 crore which was in excess of ₹ 35 lakh over the tax due. The excess amount was to be forfeited under Section 57 of the Act. No action was initiated by the AO for forfeiture of excess TDS amount retained.

- It was noticed from VAT audit files of another works contractor for the years 2010-11 and 2011-12 that he had awarded works to sub-contractors on back to back basis and was paying tax under non-composition. The TDS amounts retained by him were not forfeited though required under Section 57. This resulted in non-forfeiture of ₹ 2.43 crore.

From the cases mentioned above it is clear that the VAT audits conducted did not ensure compliance with rules.

The issues were brought to the notice of CTD in July and August 2015. The Government stated (November 2015) that in most of the cases either show cause notices have been issued or demands were raised and action has been assured in the remaining cases.

2.4.11 Internal audit

Department does not have a structured Internal Audit Wing that would plan and conduct audit in accordance with a scheduled audit plan. Internal audit is organised at Divisional level under the supervision of Assistant Commissioner (CT). Internal Audit Report is to be submitted within 15 days from the date of audit to the DC(CT) concerned, who would supervise rectification work.

[37] While arriving taxable turnover, certain expenditure such as finance charges, excess profit and administrative expenses relatable to supply of labour were incorrectly deducted from gross turnover etc.

[38] Begumpet, General Bazar and Punjagutta.

2.4.11.1 During the course of test check of the two DC(CT) offices and 13 circles (September 2014 to May 2015), it was observed in one circle[39] that internal audit was not conducted for the last three years. In three circles[40] internal audit was not conducted for last two years and in two DC(CT)[41] offices and nine circle offices[42] internal audit was not conducted for the year 2013-14. Further in all the cases where internal audits were completed, reports were not issued. From the above it is evident that the internal audit mechanism was not effective.

2.4.11.2 As per para 4.9.6 of VAT Audit Manual, allocation of audits should be recorded as computerized listings in divisions and circles mentioning dates of allocation, audit and finalization. Watch registers are to be maintained for monitoring the details of audit in offices.

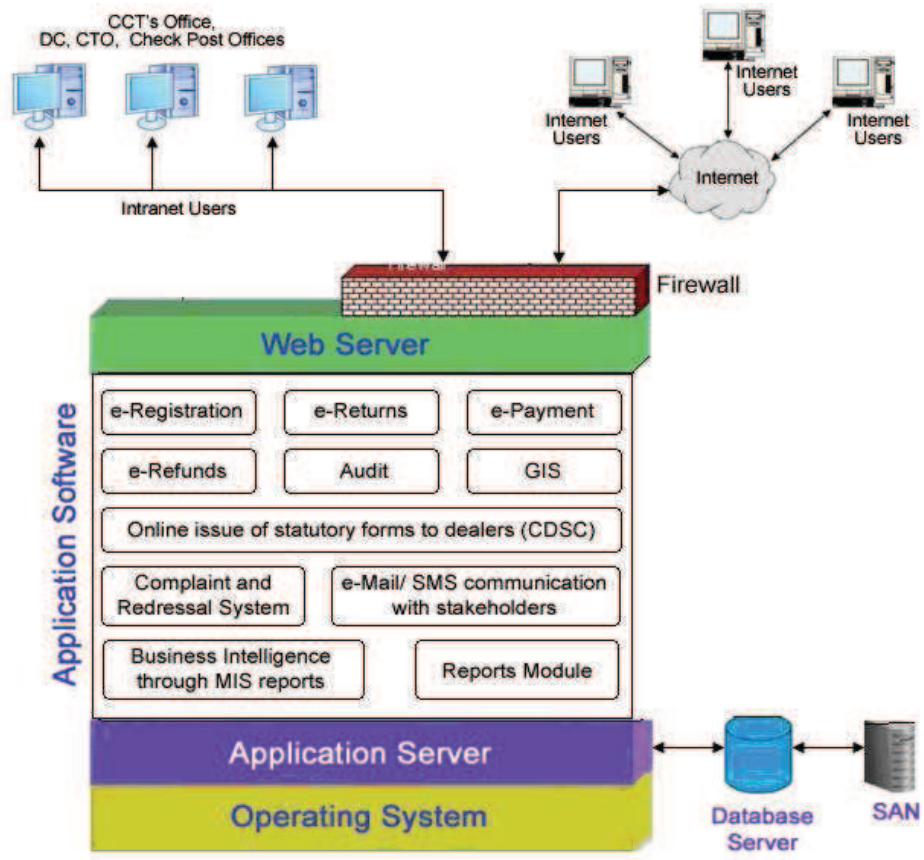
It was noticed that the watch registers and details were not maintained in DC(CT) Abids office and four circle offices[43], without which the information on the status of audits authorised and completed could not be verified. There is a risk of duplicate or erroneous allocation of audits in the absence of watch registers.

IT Audit of VATIS

2.4.12 Adequacy of IT policy and controls

CTD has been using Information Technology (IT) since 1989 and VATIS came into existence along with introduction of AP VAT Act in 2005. The original VATIS was developed in centralized architecture by Tata Consultancy Services Limited (TCS) and field offices were connected to the Central Data Centre located at the office of CCT. Processes relating to dealer registration, VAT/TOT returns, VAT audit and assessment and Goods Information System (GIS) that monitors interstate transactions etc., were computerized under this. To improve the response time of the system as a part of the realigned focus of the CTD, reengineering of VATIS was conceived. It was to extend departmental services (Service Oriented Architecture) to the dealers through multiple media like Internet, e-Seva and citizen service centres (CSC). The re-engineered VATIS has modules like e-Return, e-Registration, online issue of Statutory Forms and Complaint/Feedback system. The functional architecture of VATIS is as shown:

[39] Siddipet.
[40] Kothagudem, Punjagutta and Somajiguda.
[41] Abids and Punjagutta.
[42] Begumpet, Gadwal, General Bazar, Hydernagar, Jeedimetlaand Mahankali Street, Malkajgiri, Nacharamand Warangal.
[43] Kothagudem, Mahankali street, Punjagutta and Siddipet.



FUNCTIONAL ARCHITECTURE

The application has been built using Windows servers (database and application servers) with SQL Server and .NET framework. All the offices are inter-connected through intranet using AP State Wide Area Network (APSWAN) and other stakeholders get connected to the application via internet for obtaining services.

Audit conducted IT audit of Registration, Return, Audit, Payments, Refunds and Complaint / Feedback modules of VATIS application for the period April 2011 to March 2014. Data related to selected sample (15 units) were extracted from the centralized data provided by the CCT and was analysed using 'Interactive Data Extraction and Analysis (IDEA)'. The general controls and application controls were evaluated with reference to audit objectives.

The audit revealed deficiencies in the system relating to planning and use of IT application, mapping of business rules, access controls, data capture and validations, data integrity and system security issues etc. as mentioned in the succeeding paragraphs.

2.4.12.1 Lack of documented IT policy

Information Technology Policy ensures support of computing and communication resources to the Department in order to achieve compliance with requirements and effective use of resources, duly addressing the risks in

the best possible way. The IT policy needs to be prepared without ambiguity and approved by Senior Management. It has to meet the needs of CTD.

CTD does not possess an IT Policy that addresses the issues of using IT resources in accordance with applicable rules and objectives. Implementation of VATIS with the objectives of developing single core application was embarked upon[44] (August 2010) to take care of all the core tax functions, providing functionality as per the guidelines of the Government, offering quality service to the departmental staff as well as the dealers and to facilitate interface with other Government Departments. However, due to the lack of a documented policy addressing the alignment of requirements and implemented services, Audit could not check if the objectives had been completely achieved. The Government stated (November 2015) that the Department did not have an IT policy exclusive to it; however, such a policy including document retention policy would be formulated.

2.4.13 VATIS Implementation

The implementation of VATIS began in February 2012 and the system switched over to maintenance mode from May 2013. Though CTD has accepted all the modules after testing, Audit found some deficiencies relating to data migration and processes covered under VATIS including lack of mapping of business rules, data inconsistencies etc., which have not been addressed even after two years of implementation. These are given below:

2.4.13.1 Piecemeal approach adopted in developing the new VATIS software

An agreement was concluded with LGS Global Ltd in April 2011. LGS was to start project implementation within 230 days of entering into contract. Requests for proposal (RFP) for the purpose of re-engineering VATIS was issued in August 2010 by the Government and upon evaluation of the bids received. The implementation, however, began 10 months after agreement i.e. from February 2012. The timeline was extended initially up to September 2012 and then to April 2013. The new software (re-engineered VATIS) development model was changed from originally planned waterfall approach (all changes at once) to iterative (module wise replacement) to save cost. Meanwhile, a module for registration of dealers was developed in parallel by Centre for Good Governance (CGG) which as per the orders of CCT (March 2011) was implemented in all divisions by June 2011. This was replaced by the registration module of the reengineered VATIS (February 2012).

Delivery of different modules took place on different dates from February 2012 (Registration module) to April 2013 (email/SMS to communication with Stakeholders). The developers were required to develop software in accordance with the System Requirement Specifications (SRS) and User Requirement Specifications (URS) which are to be frozen before implementation in order to ensure that development process is completed within timelines specified.

[44] Date of RFP.

Audit observations pertaining to the contract for reengineering VATIS and its implementation revealed the following:

- System Requirements Specifications (SRS) document was prepared by the developer after implementation of all the modules (April 2013). This shows that the project was started without identifying the requirements of CTD and involving user groups which resulted in the creation of a system which did not meet the requirements of the Department. For example, as stated earlier in para 2.4.7.1, additional returns of VAT 200A and VAT 200B required for restricting the ITC are not being obtained from the dealers. Neither is there any provision for online submission of these returns. Audit observed that no requirement was projected with regard to this in the RFP, though filing of these additional returns is mandatory. Absence of facilities to automatically generate notices/reports also corroborates the fact.

- CTD had supplied (January 2013) IT related infrastructure to its branch offices without conducting requirement study, which is essential as different circle and divisional Offices handle varying quanta of work and manpower. The nature of transactions dealt with by them are different. It was noticed in audit that the number of systems supplied to branch offices were not as per strength of operating ACTOs, DCTOs, CTOs and DC.

- Department conducted module-wise testing of the application internally and gave acceptance to the developer in a phased manner along with implementation of the modules from February 2012 to April 2013 (final acceptance). Out of all the tests conducted before acceptance of the system, documentation exists only for the validation tests conducted by the developer. Audit also noticed that validation tests were conducted after implementation of the modules like audit, payment and registration. A stable production environment requires appropriate testing infrastructure. Before going for implementation of computer application, test data needs to be removed from the production database. It is observed that test cases were not separated (August 2014) from production data even though final acceptance had been given more than a year ago. These show that standard software development and testing practices were not followed.

- Change management process enables improvement of organisation's performance in relevance to the changes brought in to the existing system. Change management documentation ensures chronological recording of the changes adopted and becomes knowledge base for future changes to be made. Audit observed that workflow issues have not been documented and change management documentation was not produced to Audit in spite of repeated requests. Also, no third party or security audit was conducted during the period 2011-2014 for VATIS.

The Government, while responding to observation of inadequacy of documentation at the stage of requirement study and implementation, stated (November 2015) that requirement study had been conducted for VATIS by

constituting a committee with officials, trade representatives and IT experts. Regarding test data being present along with production data, it was stated that the testing platform has been completely separated and testing is currently being done using only test data. On the observations relating to not conducting a security/third party audit, it was stated that third party audit was conducted and they had issued a certificate in April 2015.

However, as seen from the documents, SRS was finalised after implementation, test data was present along with production data for more than a year after final acceptance and third party audit certificate was obtained two years after completion of implementation and acceptance.

2.4.13.2 Incomplete data migration and inadequate data capture

In the case of tax Departments like CTD, maintenance of legacy data is critical. It was observed that the data that was ported from the previous version of the VATIS was not in line with the new table structures. It was found that after migrating the data to the re-engineered VATIS from old VATIS, the data columns of the re-engineered VATIS were left empty or filled with universal data values, as no corresponding data value or column existed in the old VATIS. Thus due to ineffective data migration, CTD has to simultaneously maintain two databases, portals and associated infrastructure. It also necessitates users to hop through different portals and databases for report generation which is cumbersome to users.

Audit also observed that though it is mandatory to capture PAN, it was not captured with registration data of 69 dealers out of 27095 active VAT dealers and 3121 dealers out of 6198 active TOT dealers in the period 2011-14. Therefore, the data migration and data capture was not effective.

In respect of incomplete integration of old VATIS data with new VATIS data the Government stated (November 2015) it is difficult because the technology and table structures are different; however, the data pertaining to the period after June 2011 was 100 *per cent* consistent.

The Department needs to ensure that the data it requires is easily available and is consistent in order to ensure proper monitoring of dealers.

2.4.13.3 Lack of portability of data from Debt Management Unit portal

Before reengineering of VATIS, the departmental users were obtaining details pertaining to the demands of arrears by accessing the data residing on a separate Debt Management Unit portal (DMU). An observation on lack of reliable data in DMU portal had featured in Para 2.5.4 of CAG's Audit Report on Revenue Sector for the year ended March 2014.

It was found in audit that the data of arrears from DMU portal was not directly ported to the re-engineered VATIS but was re-entered into the application manually. As the DMU data itself was not found reliable, re-entering of such data into new VATIS requires assurance that the data entered is rectified while re-entering. However, no certification was obtained either from the

departmental officers concerned or from any third party service provider. The officials now cross check data in old VATIS/DMU with the data entered in new VATIS and also manual records of demand, collection and write off pertaining to the period before 2006 to arrive at arrears. This again necessitates users to hop through three different data groupings. This reveals lack of planning in data migration and porting.

2.4.14 Processes covered under VATIS

An analysis of data and application of VATIS revealed that VATIS was not being fully utilized by CTD, either due to non-incorporation of Rules/procedures or due to lack of data/awareness. None of the processes have been completely automated. Business rules like advance rulings and court judgments are not being mapped into system. The observations made are mentioned below:

2.4.14.1 Registration

When a dealer is applying for registration with CTD, the application must have adequate provisions for capturing important details like PAN of the dealer, the address and contact details, principal activities of the dealer and principal commodities he deals with.

A study of the registration module of the reengineered VATIS revealed that though application forms for registration as VAT dealer (VAT 100) or TOT dealer (TOT 001) could be filed online during the audit period, all the supporting documents still needed to be sent through post along with print outs of filled application forms. VATIS also allowed dealers to mention a maximum of only five principal activities and five principal commodities while applying. An analysis of data in respect of the 15 sample offices for the period 2011-14 revealed that the commodity details captured was 'others' in 5992 cases (dealers registered before reengineered VATIS) out of 34663 total VAT dealers. 36 such cases were registered under reengineered VATIS. Commodity wise reports cannot be generated in the absence of proper commodity classification. The details of commodities being dealt with by dealers are necessary to calculate tax liability and to monitor the transactions relating to evasion prone commodities.

Besides, Audit also noticed anomalies in available data like registration effect date being prior to application date in 7499 cases out of 27095 VAT dealers who were active during the period 2011-14 in the sample offices and in 2325 cases out of 6198 TOT dealers. The same error was observed in 36 registrations done after implementing of the present system.

2.4.14.2 Returns

As stated earlier, VAT 200A and 200B returns could neither be filed online nor could the details be entered in VATIS during the audit period. The calculation of tax liability/ITC claim thus require the dealer to manually file the return and the AA to manually account for the adjustments to be made on exempt transactions/sales.

VAT 200 returns also do not have commodity-wise data and details of sales/purchases (e.g. TIN of the dealer to whom a commodity was sold or from whom a commodity was purchased) but only tax rate-wise data.

Currently, from the data in VAT 200 returns, it is possible to check only if tax had been paid on the amounts declared by the dealer under each rate. There is no mechanism to capture commodity wise sales or purchases to verify whether the dealer was dealing only in goods for which he was registered, whether the commodity was classified under the correct Schedule and whether the taxes were paid accordingly. There is no mechanism to verify if there is any disparity in sales claimed to be made by a dealer, say A to another dealer B as neither A nor B has to disclose the buyer/seller details in their monthly returns. Thus, eReturns module of VATIS does not support cross checking of sales and purchases.

It was also observed that wherever revised returns were filed and payments made, the ledgers of the dealer and the payment status reports were showing a mismatch due to the Returns module not being updated even if Payment module was being updated.

Government stated (November 2015) that system of online submission of VAT 200A and VAT 200B would be implemented from 15 December 2015. However, it was checked and found that it was not implemented till the end of December 2015.

2.4.14.3 Implementation of automatic notice and report generation

VATIS does not alert users to convert TOT dealers to VAT dealers based on turnover. Though it was part of RFP, automatic notice and reminder generation, and their delivery through email and SMS is not fully implemented. Interest and penalty on belated/non-filing of returns or belated payment of tax is not automatically calculated. It is left to the assessing authority to manually scrutinise the returns and related documents and levy the demand.

An analysis of payment and dealer details available in VATIS package revealed that in 45728 cases of delayed submission of returns in Telangana, penalty and interest amounting to ₹ 104.13 crore was not realised during the period 2011-14. This could have been avoided by automating notice generation at least in cases of belated payment/filing of returns.

It was also observed that 1175 out of 13381 active dealers who were registered before March 2011 in the sample offices did not file monthly returns and total number of such pending returns is 9252 as on August 2014. Penalty at the rate of ₹ 2500 for each instance of non-filing is to be charged.

Analysis of data in VATIS package also revealed that both mobile and telephone numbers were not captured for 1206 out of 27095 active VAT dealers. For 1033 out of 27095 active VAT dealers and 1285 out of 6198 TOT dealers records, bank account number was not captured. For 325 out of total 34663 VAT dealers and 19 out of 27095 active VAT dealers email-id was not

captured. Lack of these data will hamper the efforts of CTD to automate notice and reminder generation.

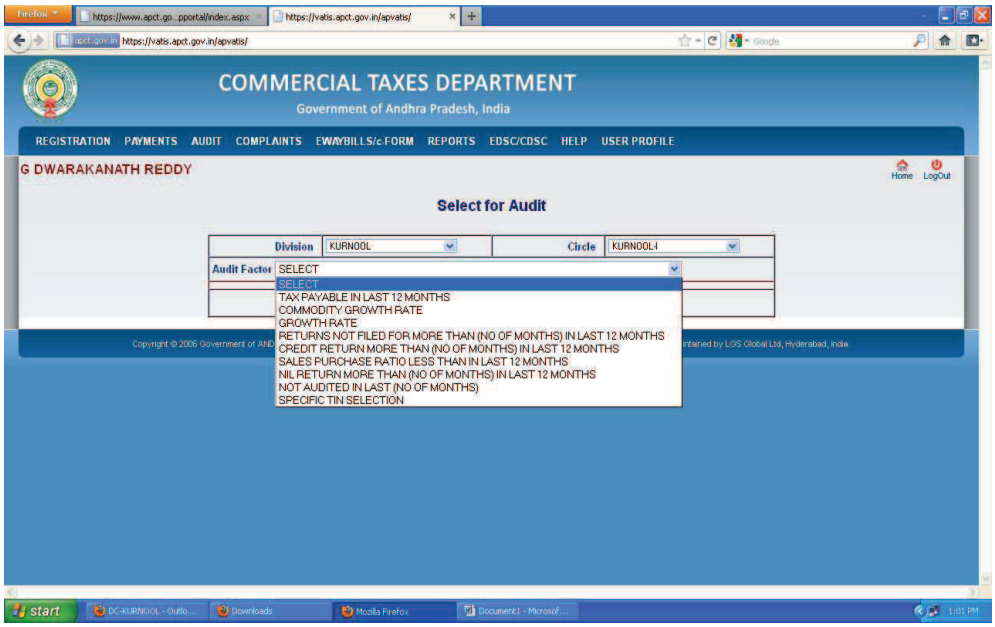
The Government stated (November 2015) that automatic generation of penalty notices was available in VATIS initially, but due to huge number of notices generated by the system even in the cases of small amounts, to avoid burden on the system the provision was consciously removed.

Since the Act provides for levy of penalty in the case of belated payments, automatic generation of demand and penalty is required.

2.4.14.4 Audit

VAT Audit Manual being currently used by CTD was brought out in June 2012 five months after the implementation of reengineered VATIS which began in February 2012. Audit module was accepted and implemented from September 2012. A comparison between the Manual and the Audit module revealed the following:

- While the VAT Audit Manual gives 15 criteria for selection of dealers for general audit, only four of these have been mapped to VATIS Audit module.



In fact, while the Audit Manual clearly stipulates that top six *per cent* of the VAT dealers excluding LTU VAT dealers are to be audited every 12 months in each Division, data available in VATIS package clearly shows that in 13 circles covered under the sample that nearly 83 *per cent* of top 100 dealers who came under jurisdiction of the offices were not audited during 2013-2014.

Selection-parameter wise breakup (as available in VATIS) of 1583 audit authorizations in sample offices for the period April 2013 to March 2014 as recorded in VATIS is tabulated below:

Selection parameter	Audit cases
Nil return more than (no. of months) in last 12 months	2
Commodity growth rate	7
Returns not filed for more than (no. of months) in last 12 months	1
Sales purchase ratio less than in last 12 months	50
Credit return more than (no. of months) in last 12 months	166
Not audited in last (no. of months)	982
Growth rate	18
Specific TIN selection	164
Tax payable in last 12 months	193

This table clearly shows that audits were not selected based on parameters provided in the Manual. Selection of 164 dealers based on 'Specific TIN selection' (total 10.36 *per* cent of audit selections) shows that discretionary powers were exercised for selection of dealers for audit.

- VAT Audit Manual also calls for Specific Audit in (a) cases resulting from other audits where audit officers have identified evidence of serious fraud or based on information provided by intelligence and other agencies which require in-depth investigation and (b) cases where there is evidence of inter-state fraud or international fraud or investigation involving more than one division should be passed on to CIU / Enforcement Wing at Headquarters.

  In VATIS audit module, data captured/processed pertaining to tax declared, waybills usage, check post data, belated registrations, revised returns and interest amounts payable are not furnished as inputs for selection for specific audit. Thus business requirements have not been mapped to implement in VATIS package for specific audits.

- Only active user_ids with designation of DC or above can authorize VAT Audits as per business rules. An analysis of data relating to authorizations in VATIS package revealed that in four cases, authorization of audit of dealers coming under the sample offices was done by users whose user-ids were not present in user_master table. In 1542 cases out of 3123 audits conducted (September 2012 to March 2014) of dealers in the sample offices it was observed that audit inspection details had been entered by junior assistants instead of the officers who conducted audit. These show that logical access controls are not in place in case of audit authorizations and entry of data relating to audit inspections.

- In 19 cases among the cases where audit inspection conducted during the period September 2012 to March 2014 in the sample offices resulted in additional demand. However, the additional demand amounts were posted to tables but no specific reason was assigned to the additional demand. VAT audit inspection details were also not available in another 19 cases (for the three month period from January to March 2014) in audit inspection table indicating inspection details

were not uploaded. These show that the Audit module is not being utilized by effectively by CTD.

- VATIS also does not provide results of VAT audit to CST assessment. Thus, a dealer can escape declaring his true turnover by declaring certain turnovers as relating to CST during VAT assessment and not declare it at the time of CST assessment, leading to loss of revenue to the Government.

- It was observed that in case of 334 out of 821 cases where additional demand was raised due to audit during September 2012 to March 2014 in the sample offices, it took more than 90 days to complete assessment after serving notice. This delay may result in assessments getting time-barred.

- In 13 cases relating to the sample offices in the period from September 2012 to March 2014, it was observed that VAT audit of dealers were done by same officers consecutively against the instructions[45] of CCT.

- It was observed that cancelled dealers are not being audited as per VAT Act and only 154 out of 3804 cancelled cases (from September 2012 to March 2014) in the sample offices were audited.

2.4.14.5 Refund

Currently, a dealer who is eligible can apply for refund of ITC while filing the monthly returns. Audits are usually conducted before authorization of refunds to verify the claims. This is done manually as it involves cross-verification of sales/purchase particulars with CTOs under whom the dealers having business transactions with the dealer claiming the refund are registered. Details are entered in Refund module only after refund is authorized. Even the voucher for refund payment is also generated manually. There is no provision for capturing voucher number and date of generation of voucher in the module. Audit test checked the data relating to refunds of the 15 sample offices where refunds had been authorized as per the VATIS package. A cross-verification of the manually maintained refund registers with VATIS data revealed that in three sample offices[46] there was mismatch in the number of refunds. There were three cases in two offices where corresponding register entries were not available though entries had been made in VATIS and 34 cases in which there were no corresponding entries in VATIS though refunds had been made as per refund registers.

2.4.14.6 Grievance redressal

An analysis of entries of the table 'CCRS_FEEDBACK' in VATIS package relating to complaints received revealed that in 58 out of 445 complaints entered in VATIS from January 2013 to March 2014 relating to erstwhile combined State of AP, complaint details like the officer to whom complaint was addressed was not captured. Due to the faulty design of the form which

[45] CCT's Ref.No. B.II(2)/122/2006 dated 4 October 2006.
[46] Begum Bazar, Punjagutta and Somajiguda.

allows such critical data to be omitted, these complaints could not be allocated to anyone for resolution.

2.4.15 Data validation problems

Audit observed while test-checking the data relating to sample offices that data validation checks that were supposed to be incorporated in the system were either not incorporated or incorrectly incorporated resulting in the following inconsistencies:

- For 27 out of 27095 active VAT dealers of sample offices, starting date of tax liability (first tax period date) was not within 30 days from approved registration date (RC-effect date).

- An analysis of data in the table relating to the details of quarterly returns filed by TOT dealers in VATIS showed that in 191 out of 986743 records available for the erstwhile combined State of AP for the period covered under audit, though details of returns were available, returns themselves were not available.

- It was also observed that there were five records in 'PAYMENT_DTL' relating to the sample offices in the period covered under audit where 'tax period_from' was later than 'tax period to'.

2.4.16 Inadequate data capture

Registration data of VATIS indicate status of the dealer as 'REGD' (Registered) and 'CNCL' (Cancelled) basing on the status of the dealer's registration. Dates of Registration or Cancellation were also captured to indicate change in dealer's status from active status to cancelled status. Audit observed in cases of cancelled dealer's data that the 'registration effective to' date was not recorded in 3803 out of 8733 cancelled dealers among 15 sample offices during the period covered under audit. Out of these cases, 917 cancellations were done after the introduction of re-engineered VATIS. This indicates that data capture is incomplete.

2.4.17 Non-compliance with Citizen's charter

The timeframe fixed for issue of registration certificate to the applicants (when pre-registration visit is required) is 24 days from application date excluding application date. In two cases of new registrations (out of 122 in sample offices in 2013-14) done with pre-visit requirement, Audit noticed that registration took more than 24 days.

As per Citizen's Charter of CTD, registration of dealers not requiring pre-visits is to be completed within six days of application. Audit observed from VATIS package that during the year 2013-14, registration of 126 VAT dealers not requiring pre-visit by the registering authority (out of 5993 registrations in sample offices) took more than six days which is not in line with the Citizen's charter.

2.4.18 IT Security, monitoring of outsourced services and business continuity

Security policy defines how an organisation plans to protect physical and information Technology (IT) assets that include servers, systems, software and data. For any IT system, it is important that sufficient measures be taken to ensure smooth functioning of critical functions even if disasters occur. This is especially so for a system like VATIS, which supports the CTD, the main revenue-earning wing of the State.

It is observed that risks associated with data and content management are not being adequately addressed. Outsourced service providers facilitate services of portal, and backup recovery issues and facility management services and CTD has not yet evolved a mechanism to maintain and manage data as per required retention period of CTD. There is no security policy drafted but for the items listed in System Requirement Specifications.

RFP 7.2 of annual maintenance contract (AMC) and facility management (FM) services prescribes maintenance of details of problems and issues related to application/ database/network failures and time taken to resolve them at branch offices/data centre chronologically through an automated tracking solution implemented by service providers. However CTD is yet to furnish details to Audit. In the same R.F.P, clause 3.2.1.1 stipulates virus protection services to IT infrastructure of the Department. However log of antivirus updating on client machines in branch offices was not available, leaving Audit with no assurance as to whether they were being updated. This indicates that performance of outsourced technical team (HCL) is not being monitored.

Backup activity of reengineered VATIS data and related information is being done at central office. However, Audit found in all the sample offices backup of branch office's assessment documents, notices, vakalat filings and other important documentation was neither done locally (CTO office) nor at central office as VATIS does not have a mechanism to backup these orders and documents. Thus, VATIS has only a superficial amount of data when compared to the physical documents available in unit offices.

Presence of disaster recovery site in the same city or geographical proximity does not address risks like earthquakes. It was observed that only one disaster recovery site is located that too within three km radius of main site which is not sufficient to ensure business continuity. From these, it is clear that the disaster preparedness of CTD is not adequate.

The Government accepted (November 2015) the audit observation of disaster recovery site being in the same city and promised to take action.

2.4.19 Training and change management

Training policy and implementation of the same is critical to inculcate awareness among users of IT infrastructure when new systems are introduced to ensure smooth transition. It is observed that CTD has no training policy. Audit also observed that user manuals have not been provided to local offices.

RFP stipulates change requests maintenance. However it was found that Change Management documentation was not available either with CTD or developers. Lack of change management documentation can cause problems with business continuity.

The Government stated (November 2015) that training was imparted to most of the officials in 2015 and help documentation was available online.

2.4.20 Conclusion

Audit found that CTD is not insisting on filing of returns and that the level of scrutiny of records is inadequate as was evidenced by non-levy of penalty/interest on non-filing of returns and belated payments. The selection of dealers for audit remains mostly discretionary. The checks prescribed are not completed and the documentation is inadequate in assessment files. Integration of various modules in and with VATIS is still incomplete. There is no assurance regarding integrity of data as there are problems associated with data migration as well as logical access controls. Filing of returns has not yet fully been made available online and a lot of critical data is still maintained at local offices which have no backup.

2.4.21 Recommendations

- Built in provisions for automatic scrutiny of returns when they are filed, and generation of penalty/demand notices in cases of non-filing and belated payment be introduced.
- Audit file tracking system may be integrated with VATIS so that the progress can be monitored. The checklist for the checks prescribed may also be integrated.
- Data in VATIS should be purged of inconsistencies and module integration taken up in a time-bound manner.

Audit observations

During scrutiny of records of the Offices of the Commercial Taxes Department relating to assessment and revenue collection towards VAT and CST, Audit observed several cases of non-observance of provisions of Acts/Rules, resulting in non/short levy of tax/penalty and other cases as mentioned in the succeeding paragraphs in this Chapter. These cases are illustrative and are based on a test check carried out by Audit. Such omissions are pointed out in audit every year, but not only do the irregularities persist; these remain undetected till an audit is conducted again. There is a need for improvement of internal controls so that repetitions of such omissions can be avoided or detected and rectified.

2.5 Under-declaration of tax due to adoption of incorrect rate of tax

Under Section 4(1) of the AP VAT Act, 2005[47] (VAT Act) tax on sales is to be levied at the rates applicable to the goods as prescribed in the Schedules to the VAT Act. Commodities not specified in any of these schedules fall under Schedule V and tax is to be levied at the rate of 14.5 *per cent*[48]. Works contractors who opt to pay tax under composition[49] are liable to pay tax at the rate of five *per cent*[50].

Audit noticed (between January 2012 and January 2015) during the test check of VAT records of 26 dealers in 14 circles[51] for the assessment period from 2008-09 to 2013-14 that 11 works contractors who opted to pay tax under composition paid tax at the pre-revised rate of four *per cent* instead of five *per cent*. In two cases, the Assessing Authorities (AAs) while finalising assessments during April 2012 and February 2014 incorrectly exempted the sale turnover of stone ballast and alburel which were to be taxed at Schedule IV rates for the period 2008-09 to 2013-14. In 13 other cases, on the sale of commodities, viz., battery scrap, roofing material like purlin, galvalume galvanized coloured coated sheets, empty gas cylinders, electric meter, cables and scrap, ready to cook food, rubber scrap etc., which fall under Schedule V to the VAT Act, the AAs either levied tax at lesser rates or the dealers under-declared tax in their monthly VAT returns for the period 2009-10 to 2013-14. The application of incorrect rates of tax resulted in under-declaration/short levy of tax of ₹ 38.59 crore on the turnover of ₹ 428.41 crore.

[47] Changed to Telangana VAT Act vide G.O.Ms. No. 32 dated 15 October 2014.
[48] Rate was revised from 12.5 *per cent* to 14.5 *per cent* with effect from 15 January 2010.
[49] Works contractors can pay tax in two ways – if they are under composition, they pay tax at a uniform rate on the entire value of the works contract. Otherwise they have to maintain accounts and pay tax on goods incorporated at the rates applicable.
[50] Four *per cent* before 14 September 2011.
[51] Afzalgunj, Ashoknagar, Basheerbagh, Fort Road, Gandhinagar, Hyderguda, IDA Gandhinagar, Marredpally, M.J.Market, R.P Road, S.D. Road, Special Commodities, Sultan Bazar and Vanasthalipuram.

After Audit pointed out the cases, the concerned AAs replied as follows:

Assessing Authority	No. of cases	Reply to audit observation	Audit's opinion
CTO Ashoknagar (June 2015)	One	DC (CT), Secunderabad dropped revision proposals after comparison with financial statements.	Reply is not relevant to the objection raised as the dealer had included supply of ballast under labour charges which cannot be verified from P&L Accounts.
CTO Gandhinagar (September 2014)	One	Levy of tax was correct as per STAT orders.	Neither reference to the STAT order nor a copy of the same was furnished.
CTO Hyderguda (November 2014)	Two	Tax at four *per cent* rate was being collected as per the Advance Ruling [52] that over the counter sales of sweets are covered under Schedule IV.	Reply is not tenable in light of the latest advance ruling in the case of 'Sweet magic' Vijayawada[53], wherein it was clarified that counter sales of sweets are taxable at the rate applicable to schedule V of the VAT Act.
CTO M.J. Market (January 2015)	Two	Empty gas cylinders come under packing material (covered in Entry 90 of Schedule IV)	Entry 90 specifically excludes storage tanks. Punjab High Court has ruled[54] that in the case of dealers manufacturing LPG cylinders, the cylinders cannot be treated as 'packing materials'.
CTO Basheerbagh (May 2015)	One	VAT audit file was submitted to the DC (CT) Abids Division for revision.	
CTO, IDA Gandhinagar and S.D. Road (December 2012 to March 2015)	Ten	Demand notices were issued to the dealers.	
Seven CTOs [55] (February 2012 to November 2014)	Eight	The matter would be examined.	
CTO M.J. Market	One	No reply was furnished.	

The matter was referred to the Department between October 2012 and May 2014. Their reply has not been received (January 2016).

[52] PMP/P&L/AR.Com/10/2009 dated 30 July 2009.
[53] A.R.com/72/2012, dated 5 July 2013.
[54] W.P No. 16 of 2007 IOCL vs. State of Punjab dated 19 May 2009.
[55] Afzalgunj, Fort Road, Marredpally, R.P. Road, Special Commodities, Sultan Bazar and Vanasthalipuram.

2.6 VAT on works contracts

2.6.1 Payment of VAT under non-composition method

2.6.1.1 Short levy of tax due to incorrect determination of taxable turnover under works contract

Under Section 4(7) (a) of the VAT Act, tax on works contract is to be paid on the value of goods incorporated in the work at the rates applicable to such goods. To determine the value of goods incorporated, deductions prescribed under Rule 17(1) (e) of VAT Rules are to be allowed from the total consideration and the remaining turnover is to be taxed in proportion to the goods purchased at the rates applicable to them.

Audit noticed (between January 2013 and November 2014), during test check of the VAT assessment files of two DC(CT)s and three circles[56], that the AAs while finalising the assessments in six cases for the years from 2008-09 to 2012-13 between February 2012 and February 2014, incorrectly determined the taxable turnover by allowing inadmissible deductions like bank interest, computer maintenance, advertising, office expenditure, books etc., from gross turnovers which were not prescribed under the rules. In three of the above cases, profit earned on labour charges was incorrectly determined. This resulted in short levy of tax of ₹ 8.24 crore.

After Audit pointed out the cases, in one case, DC(CT) Abids contended (February 2013) that profit earned on labour is to be calculated by applying the formula "profit x labour/material and labour". The contention of the Department is not tenable as administrative and other expenses are also to be included in the denominator in the calculation. In one case, DC(CT) Secunderabad contended (April 2014) that the dealer while computing labour charges for claiming exemption, forgot to add charges incurred towards salaries of site staff, bonus and over time allowance paid to staff etc. The reply is not acceptable as expenditure on salaries paid to staff cannot be attributed to labour charges. In one case, CTO Srinagar colony stated (February 2015) that the audit file was submitted to DC(CT) Secunderabad Division for revision and in the remaining three cases two CTOs[57] stated (between March 2014 and September 2014) that the matter would be examined and report submitted in due course.

The matter was referred to the Department between October 2014 and June 2015. Their reply has not been received (January 2016).

2.6.1.2 Short levy of tax on works contractors who did not maintain detailed accounts

As per Rule 17(1) (g) of VAT Rules, if a works contractor has not maintained detailed accounts to determine the correct value of the goods at the time of

[56] DC(CT)s-Abids, Secunderabad CTOs-Gandhinagar, Srinagar Colony and Tarnaka.
[57] Gandhinagar and Tarnaka.

incorporation, he shall pay tax at the rate of 14.5 *per cent*[58] on the total consideration after allowing permissible deductions. As per Government Orders[59], printing and developing photographic films are to be treated as works contracts.

Audit noticed (between June 2014 and December 2014) during the test check of VAT audit files of three circles[60]that in three cases, for the period from 2009-10 to 2012-13, detailed accounts were not maintained by the dealers. Though assessments were to be done as per Rule 17(1)(g), the AAs exempted turnover of ₹ 15.48 crore incorrectly. This resulted in short levy of tax of ₹ 98.91 lakh.

After Audit pointed out the cases, all the CTOs stated (between June 2014 and December 2014) that the matter would be examined and report submitted in due course.

The matter was referred to the Department between December 2014 and June 2015. Their reply has not been received (January 2016).

2.6.2 Payment of VAT under composition method

2.6.2.1 Short levy of tax on works contract under composition

As per the provisions of Section 4(7) (b) of the VAT Act, under the scheme of paying tax under composition, any works contractor may opt to pay tax on the total consideration for works contract at five *per cent*[61]. As per Section 4(7)(e) of VAT Act, if any dealer who opts to pay tax under composition, procures goods from outside the State for using them in execution of works contracts, he shall pay tax on the goods at the rates applicable to them in the State. The value of such goods shall be excluded from the total turnover under composition on which tax at five *per cent* is payable.

During test check of VAT records of three circles[62] (between October 2013 and July 2014) for the period from 2009-10 to 2011-12 Audit noticed that in case of two works contractors who opted to pay tax under composition, the AAs while finalising the assessments (between May 2012 and January 2013) did not levy tax on the purchases of ₹ 36.11 crore made from dealers outside the State. In another case, the AA allowed exemption on an expenditure of ₹ 1.38 crore incurred towards labour charges though such exemption was not admissible if the dealer had opted to pay tax under composition. This resulted in short levy of tax of ₹ 4.76 crore.

After Audit pointed out the cases, in two cases, CTO Gowliguda and Madhapur stated (October 2013 and April 2014) that the matter would be examined and report submitted in due course. In the remaining case, CTO Vidyanagar stated (July 2014) that notice would be issued to the dealer.

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58 12.5 *per cent* before 26 April 2010.
59 Memo No. 47340/CT.II(i)/2006 dated 9 February 2007.
60 Nampally, Nizamabad III and Srinagar Colony.
61 Four *per cent* before 14 September 2011.
62 Gowliguda, Madhapur and Vidyanagar.

The matter was referred to the Department between May and September 2015. Their reply has not been received (January 2016).

2.7 Interstate sales

2.7.1 Incorrect grant of concessional rate of tax due to acceptance of invalid statutory forms

According to Sections 6A and 8 of Central Sales Tax (CST) Act, 1956 read with Rule 12 of CST (Registration & Turnover) Rules, 1957 every dealer shall file a single declaration in form 'C' covering all interstate sales, which take place in a quarter of a financial year between the same two dealers to claim concessional rate of two *per cent* tax and form 'F' to cover all interstate transfer of goods other than sales every month to claim exemption. As per Section 8(2) of the Act, interstate sale turnover not covered by proper declaration forms shall be taxed at the respective State rates as applicable to all goods.

Audit noticed (between August 2013 and March 2015) during the test check of the CST assessments of DC(CT) Adilabad and 13 circles[63] that the AAs while finalising assessments in 14 cases between January 2012 and March 2014 for the years 2008-09 to 2010-11 incorrectly allowed concessional rate of tax on the interstate sales turnover of goods belonging to Schedules IV and V amounting to ₹ 33.97 crore on the basis of invalid 'C' forms i.e. local 'C' forms, forms covering more than a quarter etc. In two other cases, AAs while finalising assessments for the years 2009-10 to 2011-12 between June 2012 and March 2014, incorrectly exempted turnover on the branch transfer turnover of cotton and its by-products and drugs and medicines amounting to ₹ 3.96 crore on the basis of invalid 'F' forms, i.e. 'F' forms not signed by principal officer of other State, outdated 'F' forms issued for the State of Mysore etc. This resulted in short levy of tax of ₹ 3.69 crore in 16 cases.

After Audit pointed out the cases, in nine cases, DC(CT) Adilabad and seven CTOs[64] stated (between August 2013 and March 2015) that the matter would be examined and report submitted in due course. CTO, IDA Gandhinagar in one case relating to acceptance of local 'C' forms contended (September 2013) that as per the documents filed by the dealer, there was transfer of documents of title to the goods during the course of movement of goods from one State to another and hence the 'C' forms could be accepted. The reply is not acceptable as there was no movement of goods from one State to another and the transactions took place between two local dealers. In five cases, five CTOs[65] stated (between November 2013 and November 2015) that the assessment files were submitted to DCs (CT) concerned for revision. In one case, CTO Basheerbagh stated (November 2014) that notice would be issued to the dealer to produce records for verification.

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[63] Basheerbagh, Begumpet, Hyderguda, Hydernagar, IDA Gandhinagar, Keesara, Kothagudem, Lord Bazar, Nacharam, Saroornagar, Tarnaka, Vengalraonagar and Vidyanagar.

[64] Basheerbagh, Begumpet, Hyderguda, Hydernagar, Lord Bazar, Nacharam, and Tarnaka.

[65] Keesara, Kothagudem, Saroornagar, Vengalraonagar and Vidyanagar.

The matter was referred to the Department between October 2013 and June 2015. Their reply has not been received (January 2016).

2.7.2 Incorrect exemption on interstate transactions not covered by documentary evidence

As per Sections 5, 6, 6A and 8 of CST Act read with Rule 12 of CST(R&T) Rules,

(i) export of goods and goods sold for export are not to be taxed on production of documentary evidence such as bill of lading, purchase order and 'H' form in support of the transaction;

(ii) sales during interstate transit are exempt from tax if they are supported by E1/E2 and C Forms;

(iii) interstate transfer of goods to branches of the dealer are exempted on production of form 'F' for each month;

(iv) interstate sales made to any unit located in SEZ is exempted from tax on production of Form 'I'.

If the dealer fails to file statutory forms, the transactions are to be treated as interstate sale not covered by 'C' form and tax levied under Section 8(2) of the Act at the rates applicable to such goods inside the State.

2.7.2.1 During the test check of the CST assessment files of seven circles[66] for the period 2009-10 to 2011-12, Audit noticed (between February 2014 and January 2015) that in 12 cases where the assessments were completed between June 2012 and March 2014, the AAs incorrectly allowed exemption on a turnover of ₹ 32 crore representing export sales, transit sales, interstate SEZ sales and stock transfer of goods though not supported by proper documentary evidence. The incorrect exemption resulted in non-levy of tax of ₹ 3.33 crore.

After Audit pointed out the cases, three CTOs[67] (between June 2014 and January 2015) stated in five cases that the matter would be examined and report submitted in due course. In five cases, four CTOs[68] stated (between February 2014 and November 2015) that the files were sent to DCs(CT) concerned for revision. In the remaining two cases, CTO Bowenpally contended (July 2014) that as per verdict of Supreme Court[69] read with Commissioner's orders, submission of foreign buyer's purchase order is not mandatory and Form 'H' declaration was taken into consideration for finalizing the assessment. The reply of the Department is not tenable because the order of Supreme Court related to case of deemed exports whereas the objection was on non-production of evidence to the commercial taxes office to prove that the sales were made for export.

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[66] Basheerbagh, Bowenpally, IDA Gandhinagar, Lord Bazar, Madhapur, Mehdipatnam and Saroornagar.
[67] Jeedimetla, Lord Bazar and Madhapur.
[68] Basheerbagh, IDA Gandhinagar, Mehdipatnam and Saroornagar.
[69] Consolidated Coffee Vs Coffee Board (1980), 46 STC 164 (SC).

The matter was referred to the Department between October 2014 and May 2015. Their reply has not been received (January 2016).

2.7.2.2 Audit noticed (between November 2011 and January 2015) during test check of the CST assessment files of two circles[70] that the AAs, while finalising the assessments in two cases for the years from 2007-08 to 2010-11 between January 2011 and March 2014, levied tax at concessional rate, on turnover relating to transit sale covered by local 'C' forms which were however not supported by "E" forms. As the dealers did not file "E" forms the turnover should have been treated as local sales and tax to be levied accordingly. Thus, there was a short levy of tax of ₹ 5.01 lakh.

After Audit pointed out the cases, CTO Begumpet in one case, stated (November 2011) that notice was issued to the dealer and in the remaining case, CTO M.J. Market contended (January 2015) that the dealer effected transit sales and the goods have evidently moved from the other State; the delivery was taken by another AP State dealer which was evidence for the transit sales. The reply is not tenable as the dealer could be entitled to pay tax at concessional rates only on presentation of proper statutory forms.

The matter was referred to the Department in April 2012 and May 2015. Their reply has not been received (January 2016).

2.7.3 Non-levy of penalty for misuse of 'C' forms in interstate purchases

As per Section 8(3)(b) of CST Act, a dealer registered under the Act shall mention the goods intended to be purchased from outside the State. These goods shall be included in the registration certificate. These goods are to be intended only for (i) resale; (ii) manufacture or processing of goods for sale; (iii) mining; (iv) generation or distribution of electricity or any other form of power; (v) packing of goods for sale/resale.

In Circular[71] dated 30 August 2012, CCT also clarified that works contractors are not entitled to issue C forms against the purchase of goods like plant and machinery, earth moving equipment etc. as works contracts cannot be treated as manufacturing or processing of goods.

Under Section 10A of CST Act, penalty not exceeding 1.5 times the tax which would have been levied is to be imposed if the dealer violates the provisions of Section 8(3)(b) of CST Act.

Audit noticed (between November 2013 and January 2015) during the test check of CST records of five circles[72] for the period from September 2007 to July 2013, that in six out of seven cases, dealers made interstate purchase of electrical goods, paints, colours, furniture, adhesive, timber and sizes, sanitary ware, batteries, drugs and medicines, refrigerators etc., which were not specified in their RCs. In the remaining case, a works contractor purchased

[70] CTOs Begumpet and M.J. Market.
[71] CCT's Reference No. AII(2)/292/2012 dated 30 August 2012.
[72] Hydernagar, Begumpet, Nacharam, Punjagutta and S.D. Road.

earth moving equipment and issued 'C' forms against the purchases. These dealers thus misused 'C' forms as these purchases were in violation of provisions of Section 8(3)(b)(ii) of CST Act. Penalty on the turnover of ₹ 19.03 crore could have been levied (₹ 2.56 crore) if penal action under Section 10A of the CST Act had been taken for misuse of 'C' forms.

After Audit pointed out the cases, AAs stated in four cases (between December 2013 and September 2014), that the matter would be examined and report submitted in due course. In two cases, CTO Begumpet stated (November 2014), that notice would be issued and penalty collected. In one case, CTO S.D. Road stated (July 2015) that show cause notice had been issued to the dealer.

The matter was referred to the Department between November 2014 and July 2015. Their reply has not been received (January 2016).

2.7.4 Short/ Non-levy of tax on interstate sales

If the dealer fails to file statutory forms, transactions which involve interstate transfer of goods are to be treated as interstate sale not covered by 'C' form and tax levied under Section 8(2) of the Act at the rates applicable to such goods inside the State.

As per Government orders[73] the excess demands raised over the concessional rate of *two per cent* on interstate sale of rice not covered by 'C' form may be waived if the dealer produced triplicate copies of way bills by mentioning the names of check posts through which goods had been transported and gives references of relevant entries in the Registers maintained at the check posts.

Audit noticed (between June 2014 and March 2015) during the test check of the CST assessment files of 16 circles[74] that in three cases the AAs, while finalising the assessments (between March 2012 and March 2014) for the years 2008-09 to 2010-11 incorrectly allowed concessional rate of tax on the interstate sales of rice not covered by 'C' forms though the dealers did not fulfill the requirements. In one of these cases, though the dealer had filed triplicate copies of way bills, the names of check posts through which goods were transported were not mentioned. Verification of Goods Information System (GIS) data of two other dealers revealed that they transported lesser quantity of rice to other States than the turnover assessed. In 24 cases, incorrect rate of tax was allowed on the interstate sales/stock transfer of goods though not supported by statutory forms. This resulted in non-levy of tax of ₹ 1.25 crore in these 27 cases.

After Audit pointed out the cases, in 17 cases, AAs stated (between June 2014 and March 2015) that the matter would be examined. In 10 cases, eight

[73] Memo No.20354/CT-II (1)/2011-12 dated 8 June 2011.

[74] Bodhan, Bowenpally, Charminar, Fatehnagar, Gadwal, IDA Gandhinagar, Jeedimetla, Keesara, Madhapur, Malkajgiri, Nacharam, Narsampet, Saroornagar, Somajiguda, Vanasthalipuram and Warangal.

CTOs[75] stated (between August 2014 and November 2015) that files were sent to DCs concerned for revision.

The matter was referred to the Department between April 2015 and July 2015. Their reply has not been received (January 2016).

2.7.5 Short levy of tax due to incorrect computation of taxable turnover under CST Act

As per Section 9 (2) of CST Act, the authorities empowered to assess and enforce payment of tax under general sales tax law of the respective State shall perform similar functions under CST Act as well.

During the test check of CST assessment files of five circles[76] for the period 2009-10 and 2010-11, Audit noticed (between October 2013 and February 2015) that in five cases, the AAs did not compute the taxable turnovers correctly due to non-comparison with Profit and Loss accounts, returns, allowing exemption on certain transactions like sale of software licences, etc. This resulted in short levy of tax of ₹ 62.31 lakh.

After Audit pointed out the cases, in one case, CTO Khammam - I stated (May 2014) that the matter would be examined and report submitted in due course. In one case, CTO Bhongir stated (July 2014) that the assessment would be revised. In one case, CTO Madhapur stated (October 2014) that the dealer was an exporter and filed clearance certificates issued by the Software Technologies Park of India (STPI) in support of the exemption. The reply is not tenable as the sale of licences was neither reported by the assessee nor assessed by the AA as exports. In the remaining two cases, CTOs Ferozguda and Tarnaka stated (April 2015 and August 2015) that the assessment file was submitted to DCs concerned.

The matter was referred to the Department between May 2014 and July 2015. Their reply has not been received (January 2016).

2.8 Non-levy of interest on belated payment of tax

According to Section 22(2) of the VAT Act, if any dealer fails to pay the tax due on the basis of return submitted by him within the time prescribed, he shall pay, in addition to the amount of such tax or penalty or any other amount, interest calculated at 1.25 *per cent*[77] per month for the period of delay.

Audit noticed (between May 2012 and February 2015) during the test check of the VAT records of three DC(CT)s[78] and 11 circles[79] that 22 dealers paid tax of ₹ 87.13 crore for the assessment period 2005-06 to 2013-14 as declared in

[75] Bowenpally, IDA Gandhinagar, Jeedimetla, Keesara, Saroornagar, Somajiguda, Vanasthalipuram and Warangal.
[76] Bhongir, Ferozguda, Khammam-I, Madhapur, and Tarnaka.
[77] One *per cent* before 15 September 2011.
[78] Adilabad, Begumpet and Hyderabad (Rural).
[79] Agapura, Basheerbagh, Fatehnagar, Hyderguda, Nalgonda, Narayanaguda, Punjagutta, Rajendranagar, Ramgopalpet, R.P. Road and Vanasthalipuram.

their monthly VAT returns with delay ranging from one day to 2002 days. In six of these cases, in six circles[80] where assessments were finalised, the AAs either did not levy or short levied interest on belated payment of tax. In one case, sales tax exemption sanctioned to a dealer for the period from March 2002 to March 2009 was cancelled by Director of Industries (August 2010) due to irregular sanction and the unit was asked to repay the amount availed. By the end of March 2013, the dealer paid back the amount of ₹ 11.68 crore availed during 2006-07 to 2007-08. However, AA did not levy any interest for the belated repayment. This resulted in non-levy/payment of interest of ₹ 4.14 crore in all 23 cases.

After Audit pointed out the cases, three DC (CT)s and five CTOs[81] in 11 cases stated (between March 2014 and January 2015) that matter would be examined and report submitted in due course. CTOs Agapura, Narayanaguda and Punjagutta in nine cases stated (between December 2013 and August 2015) that notices were issued to the dealers. In one case, CTO Rajendranagar stated (November 2015) that interest was levied but copy of demand letter was not furnished. CTOs Basheerbagh and Nalgonda in two cases stated (June 2012 to June 2014) that the files would be transferred to DCs(CT) concerned for revision.

The matter was referred to the Department between July 2013 and July 2015. Their reply has not been received (January 2016).

2.9 Input tax credit

2.9.1 Under-declaration of tax due to incorrect claim of input tax credit

Under Section 13(1) and 13(3) of the VAT Act, input tax credit (ITC) shall be allowed for the tax paid on all purchases of taxable goods, if such goods are meant for use in the business of the VAT dealer and he is in possession of tax invoices. Rule 20(2) of VAT Rules gives the list of goods on which a VAT dealer cannot claim ITC.

Audit noticed (between February 2014 and November 2014), during test check of VAT records of DC(CT) Punjagutta and five circles[82]that in three out of six cases, the dealers incorrectly claimed ITC amounting to ₹ 35.21 lakh on purchase of coal, cement used for own consumption and on inputs used in construction or maintenance of buildings though the dealers were not works contractors, for the period from 2006-07 to 2011-12. The claim of ITC in these cases were in contravention of provisions under Rule 20(2). In one case, a dealer claimed ITC of ₹ 1.48 lakh for the year 2011-12 on purchase of used vehicles without valid tax invoices. In one case, the dealer claimed ITC of ₹ 5.56 crore for the tax period from August to November 2010 on the purchases made from a dealer whose registration was cancelled. In the remaining case, ITC of ₹ 2.44 lakh claimed by a dealer during September

[80] Agapura, Basheerbagh, Hyderguda, Nalgonda, Rajendranagar and Vanastalipuram.
[81] DC(CT)s-Adilabad, Begumpet, Hyderabad (Rural) CTOs- Fatehnagar, Hyderguda, Ramgopalpet, R.P. Road and Vanasthalipuram.
[82] Hyderguda, Malkajgiri, Nalgonda, Vanasthalipuram and Vidyanagar.

2012 to March 2013 did not match with the sale details of the selling VAT dealer during cross verification. This resulted in incorrect claim of ITC of ₹ 5.95 crore in all six cases.

After Audit pointed out the cases, the AC(LTU) Punjagutta, CTOs Hyderguda and Nalgonda stated (between July 2014 and November 2015) that the audit files of the dealers were forwarded to DC(CT)s concerned for revision. CTO Vanasthalipuram in one case stated (July 2014) that matter would be examined and report submitted in due course. CTO Malkajgiri in one case, stated (April 2014) that the point has been noted and further action would be initiated in due course. In the remaining case, CTO Vidyanagar stated (February 2015) that a revised show cause notice was issued.

The matter was referred to the Department between November 2014 and May 2015. Their reply has not been received (January 2016).

2.9.2 Incorrect allowance of input tax credit to works contractor

As per Section 13 of the VAT Act, no ITC is allowed if a works contractor opts to pay tax under composition scheme. If the works contractor is not paying tax under composition, the input tax credit shall be limited to 75 *per cent*[83] of the related input tax. As per Section 4(7)(i) read with amended provisions of Section 4(7)(d) of the VAT Act, the amount received as sub-contractor is exempt from tax if the main contractor opted to pay tax under composition.

Audit noticed (between June 2014 and January 2015), during test check of VAT records of six CTOs[84] that in four out of seven cases, for the period between April 2009 and October 2013, the AAs allowed 100 *per cent* ITC on purchases of works contractors instead of restricting it to 90 *per cent*/ 75 *per cent*. In one case, during the years 2010-11 to 2011-12, though there was no tax liability on sub-contractor, the main contractor transferred TDS to the sub-contractor and the sub-contractor claimed it as ITC. In another case, for the period between December 2010 and June 2012, the dealer executing works contracts, both under composition and non-composition, claimed ITC in full. In another case for the year 2013-14, a dealer who opted to pay tax under composition as per provisions of Section 4(7)(d) of the VAT Act claimed ITC. This resulted in incorrectly allowing excess ITC of ₹ 61.06 lakh in seven cases.

After Audit pointed out the cases, in three cases, CTOs General Bazar and Vidyanagar stated (November 2014 and July 2015) that revised show cause notices were issued to the dealers. In two cases, CTOs Gandhinagar and Vengalraonagar stated (July 2014 and September 2014) that the matter would be examined. In two cases, CTO Marredpally and Nizamabad II stated (November 2014 and December 2014) that the audit files would be submitted to DC concerned for revision.

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[83] It was 90 *per cent* before 15 September 2011.

[84] Gandhinagar, General Bazar, Marredpally, Nizamabad II, Vengalraonagar and Vidyanagar.

The matter was referred to the Department between October 2014 and June 2015. Their reply has not been received (January 2016).

2.9.3 Excess claim/allowance of input tax credit on exempt sales

As per Section 13(5) of the VAT Act, no input tax credit (ITC) shall be allowed on sale of exempted goods (except in the course of export), exempt sales and transfer of exempted goods outside the State otherwise than by way of sale. As per Section 13(6) of the VAT Act, ITC for transfer of taxable goods outside the State otherwise than by way of sale (exempt transactions) shall be allowed for the amount of tax in excess of five *per cent*[85].

VAT dealers making taxable sales, exempted sales and exempt transactions of taxable goods shall restrict the ITC claim as per Rule 20 of VAT Rules. As per entry 59 of Schedule I to the VAT Act, sales made to SEZ units is exempt from tax and no ITC is to be allowed on such sales.

During the test check of VAT records of DC(CT) Nalgonda Division and six circles[86] for the assessment period from 2008-09 to 2012-13, Audit noticed (between May 2011 and January 2015) that in VAT returns of four cases for the assessment period 2009-10 to 2010-11, though sale transactions involved taxable sales, exempt sales and also exempt transactions, the dealers had claimed ITC in excess, without proper restriction as per the formula prescribed. In five other cases, the AAs, while finalising the VAT assessments of the dealers between May 2012 to July 2013 for the assessment years 2008-09 to 2012-13 had not restricted ITC correctly as per provisions of Rule 20. This resulted in allowance of excess claim of ITC of ₹ 22.22 lakh in nine cases.

After Audit pointed out the cases, five CTOs[87] in seven cases, stated (between January 2014 and January 2015) that the matter would be examined and report submitted in due course. In one case, CTO Bhongir partially raised demand by revising the assessment. DC(CT), Nalgonda in one case, stated (November 2015) that assessment was revised duly levying tax but copy of revised assessment was not furnished.

The matter was referred to the Department (between November 2014 and July 2015). Their reply has not been received (January 2016).

2.9.4 Incorrect allowing of ITC on ineligible items

As per Section 13(4) of the VAT Act read with Rule 20(2)(r) of VAT Rules, a VAT dealer cannot claim input tax credit on furnace oil and other fuels like LPG etc., used in manufacture or processing units. CCT clarified in Advance Ruling[88] that usage of LPG in hotels should also be treated as manufacturing activity.

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85 It was four *per cent* before 15 September 2011.
86 Bhongir, Gandhinagar, Malkajgiri, Nacharam, Rajendranagar and S.D.Road.
87 Gandhinagar, Malkajgiri, Nacharam, Rajendranagar and S.D.Road.
88 Advance Ruling -A.R.Com/79/2012, dt.21 February 2013.

Audit noticed (between June 2014 and January 2015), during test check of VAT audit files of five circles[89] that in five cases, the AAs allowed ITC amounting to ₹ 22.63 lakh on purchase of LPG and furnace oil for the period from April 2009 to January 2013, though no ITC is allowable on these goods. This resulted in incorrect allowing of ITC of ₹ 22.63 lakh.

After Audit pointed out the cases, CTOs Malakpet and M.J.Market stated (June 2014 and January 2015) in two cases that the matter would be examined and report submitted in due course. In two cases, CTOs Marredpally and Srinagar Colony stated (January 2015 and February 2015) that the files would be submitted to DC(CT)s concerned. In the remaining case, CTO Basheerbagh stated (December 2014) that the records of the assessee would be called for and reply submitted on verification of facts.

The matter was referred to the Department (between October 2014 and April 2015). Their reply has not been received (January 2016).

2.9.5 Allowing of excess ITC on purchases

Section 13 provides for allowing of ITC to dealers for the tax paid on purchase of taxable goods. As per Section 38 (1) (d) of the VAT Act, a VAT dealer who paid tax in excess of the tax due for a tax period may claim credit in the next tax return. As per Para 5.11.4 of VAT Audit Manual 2005, the audit officer auditing the accounts of a VAT dealer is required to cross-verify the details given by the dealer in VAT returns with the financial statements for the period.

Audit noticed (between March 2011 and January 2015) during the test check of VAT Audit records of six CTOs[90] for the assessment period from April 2010 to March 2013 that four out of six dealers dealing in alloy steel castings; non-ferrous castings and general engineering; cement & PVC pipes and hardware items declared purchase turnover of ₹ 16.67 crore in their VAT 200 returns, whereas the purchases as per Profit and Loss accounts was ₹ 14.80 crore only. The dealer claimed ITC as per the declared turnover whereas AAs did not reconcile the difference while finalising the assessments. In two other cases, the dealers incorrectly carried forward ITC of ₹ 4.34 lakh, which was disallowed in the previous assessment and one dealer incorrectly adjusted it against his tax liabilities. This resulted in excess claim of ITC of ₹ 14.43 lakh in six cases.

After Audit pointed out these cases, in one case CTO Balanagar stated (April 2015) that show cause notice was issued to the dealer. In the other four cases, four CTOs[91] stated (between May 2011 and January 2015) that the matter would be examined and reply furnished in due course and in the remaining case CTO Keesara stated (September 2015) that file sent to DC for revision.

[89] Basheerbagh, Malakpet, Marredpally, M.J.Market and Srinagar Colony.
[90] Balanagar, Keesara, Khairtabad, Lord Bazar, Malkajgiri and Narsampet.
[91] Khairtabad, Lord Bazar, Malkajgiri and Narsampet.

The matter was referred to the Department between April 2015 and May 2015. Their reply has not been received (January 2016).

2.10 Levy of penalties under VAT

2.10.1 Non-levy of penalty on belated payment of tax

Under Section 51(1) of the VAT Act a dealer who fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, shall be liable to pay tax and a penalty of 10 *per cent* of the amount of tax due.

Audit noticed (between June 2012 and February 2015) during the test check of VAT records of two DC(CT)s and 14 circles[92] for the period 2005-06 to 2013-14 that in 48 cases the dealers paid tax of ₹ 16.06 crore as per the monthly returns submitted by them but after the last day of month in which it was due. The AAs did not levy penalty for belated payment of tax as required under Section 51(1) of the VAT Act. This resulted in non-levy of penalty of ₹ 1.61 crore.

After Audit pointed out the cases, in 14 cases, the AAs stated (between April 2014 and February 2015) that the matter would be examined and report submitted in due course. In nine cases, CTO Narsampet stated (June 2014) that action would be taken to collect the penalty. In 11 cases, four CTOs[93] stated (between June 2014 and November 2015) that notices were issued to the dealers. In three cases, three CTOs[94] stated (between June 2012 and June 2014) that files were sent to DC(CT) concerned. In 10 cases, four CTOs[95] stated (between May and November 2015) that penalty was levied. However, no documentary evidence was furnished by CTOs in proof of taking the demand to DCB Register. In the remaining case, CTO R.P.Road stated (January 2015) that penalty was levied but an appeal was pending before ADC.

The matter was referred to Department between November 2014 and July 2015. Their reply has not been received (January 2016).

2.10.2 Non/short levy of penalty for under-declaration of tax

As per Section 53(1) of VAT Act, where any dealer has under-declared tax, and where it has not been established that fraud or willful neglect has been committed, if under-declared tax is (i) less than 10 *per cent* of the tax, a penalty shall be imposed at 10 *per cent* of such under-declared tax; (ii) more than 10 *per cent* of the tax due, a penalty shall be imposed at 25 *per cent* of such under-declared tax. Under Section 53(3) of VAT Act, any dealer who has under-declared tax and where it is established that fraud or willful neglect has

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[92] DC(CT)s - Adilabad, Begumpet CTOs - Agapura, Basheerbagh, Bhongir, Fatehnagar, Gowliguda, Hissamgunj, Lord Bazar, Nalgonda, Nampally, Narsampet, Narayanaguda, Rajendranagar, Ramgopalpet and R.P.Road.

[93] Basheerbagh, Hissamgunj, Nampally and Narayanaguda.

[94] Basheerbagh, Bhongir and Nalgonda.

[95] Agapura, Bhongir, Gowliguda and Rajendranagar.

been committed, he shall be liable to pay penalty equal to the tax under-declared.

During the test check of the VAT audit files in 14 circles[96] during the period 2008-09 to 2012-13, Audit noticed (between October 2013 and November 2014) that in 11 out of 20 cases where the dealers under-declared tax of ₹ 1.1 crore which was more than 10 *per cent* of the total tax due, AAs levied penalty at less than 25 *per cent*. In one case, where a dealer under-declared tax of ₹ 7.62 lakh on which penalty at the rate of 10 *per cent* was leviable, AAs levied penalty of less than 10 *per cent.* In eight other cases, although the AAs recorded in their reports that the dealers under-declared tax of ₹ 5.70 crore willfully, AAs either did not levy or short levied penalty. This resulted in non/short levy of penalty of ₹ 3.27 crore.

After Audit pointed out the cases, in 13 cases, the AAs stated (between April 2014 and December 2014) that the matter would be examined and report submitted in due course. In four cases, four CTOs[97] stated (between June 2014 and November 2014) that the files would be sent to DC(CT)s concerned. In one case, CTO Kothagudem contented (June 2015) that the dealer paid tax by way of TDS and non-reporting of the turnover in VAT returns was due to non-receipt of TDS certificate (Form 501) at the dealer's end. The reply is not acceptable as there is no provision in VAT Act permitting dealers to declare their turnover only after TDS certificates have been received. In one case, CTO Agapura, did not furnish any specific reply to the audit query and in the remaining case CTO Saroornagar stated (November 2015) that the file was submitted to DC for revision.

The matter was referred to the Department between October 2014 and May 2015. Their reply has not been received (January 2016).

2.10.3 Non-levy of penalty for failure to register as VAT dealers

Under Section 49(2) of VAT Act, any dealer who fails to apply for registration before the end of the month subsequent to month in which he was to register as a VAT dealer shall pay penalty of 25 *per cent* of the amount of tax due.

Audit noticed (September 2014) during the test check of VAT records in CTO Keesara circle for the period 2011-12 to 2012-13, that the Vigilance and Enforcement (V&E) Department obtained details of lease rentals of ₹ 4.94 crore received by eight unregistered dealers. Based on the reports, they were assessed and levied with VAT of ₹ 71.67 lakh under VAT Act. However, penalty under Section 49(2) was not levied for failure to register as VAT dealers. This resulted in non-levy of penalty of ₹ 17.92 lakh.

After Audit pointed out the cases, the AA stated (November 2015) that notices were issued. Orders will be passed accordingly. Action taken report would be submitted.

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[96] Agapura, Balanagar, Basheerbagh, Bhongir, Bowenpally, Khairatabad, Kothagudem, Madhapur, Nizamabad II, Nizamabad III, Rajendranagar,Saroornagar, Vanasthalipuram and Vengalraonagar.

[97] Bhongir, Nizamabad II, Rajendranagar and Vengalraonagar.

The matter was referred to the Department in January 2015. Their reply has not been received (January 2016).

2.10.4 Short levy of penalty for using false tax invoice

As per Section 55(2) of VAT Act, any dealer who issues false tax invoice or receives and uses a tax invoice knowing it to be false, shall be liable to pay a penalty of 200 *per cent* of tax shown on the false invoice.

Audit noticed (July 2014) during the test check of VAT assessments in CTO Vanasthalipuram circle that in one case, AA levied tax of ₹ 1.17 lakh for use of false tax invoice for the period February and March 2012. Penalty of ₹ 0.12 lakh at the rate of 10 *per cent* only was levied instead of ₹ 2.34 lakh at the rate of 200 *per cent* of tax shown on the false invoice. This resulted in short levy of penalty of ₹ 2.22 lakh.

After Audit pointed out the case, AA stated (July 2014) that the matter would be examined and report submitted in due course.

The matter was referred to the Department in October 2014. Their reply has not been received (January 2016).

2.11 Non-levy of VAT on transfer of right to use goods

As per Section 4(8) of VAT Act, every VAT dealer who leases out or licenses others to use taxable goods, for cash or consideration in the course of his business shall pay tax at the rates on the consideration as are applicable to the goods involved.

Audit noticed (between October 2013 and October 2014) during the test check of records of DC(CT) Hyderabad (Rural) and five circles[98] that in seven cases, the AAs while finalising the assessments for the years from 2007-08 to 2012-13 either did not levy or short levied tax on a turnover of ₹ 20.65 crore representing lease rentals of audio visual equipment, proclain, transport vehicles, machinery and concrete mixer. This resulted in non-levy of VAT of ₹ 2.54 crore.

After Audit pointed out the cases, the AAs in six cases replied (between February 2014 and October 2014) that the matter would be examined and result intimated in due course. In one case CTO Tarnaka replied (April 2015) that the audit file was sent to DC(CT) Secunderabad for revision.

The matter was referred to the Department between February 2014 and April 2015. Their reply has not been received (January 2016).

[98] Fatehnagar, Madhapur, Malakpet, Narasampet and Tarnaka.

2.12 Sales tax incentives

2.12.1 Non-levy of interest on belated repayment of sales tax deferment

As per the provisions of Section 69 of the VAT Act, all sales tax exemption cases sanctioned prior to the enactment of VAT Act were converted as sales tax deferment by doubling the period left over without change in monetary limit of the amount sanctioned. Further, as per the Government orders[99], repayment of deferred sales tax was to commence after the end of the period of deferment. In case of non-remittance of deferred tax on the due dates, interest at the rate of 21.5 *per cent* per annum was to be charged as per the guidelines of the sales tax deferment scheme.

Audit noticed (between June and November 2014) during test check of records of five circles[100] that in six cases, the dealers availed sales tax deferment but repaid the deferred tax amounting to ₹ 1.59 crore belatedly (delay of four to 730 days). The AAs however, did not levy any interest. This resulted in non-levy of interest of ₹ 18.72 lakh.

After Audit pointed out the cases, in two cases, CTO Ashoknagar stated (July 2015) that notices were issued to the dealers. In one case, CTO Bhongir stated (June 2014) that matter would be examined. In one case, CTO IDA Gandhinagar stated (February 2015) that notices would be issued to the dealer. CTO, Vanasthalipuram stated (November 2015) that interest was levied in one case. In the remaining case, CTO Marredpally stated (May 2015) that notice was issued to the dealer.

The matter was referred to the Department between November 2014 and July 2015. Their reply has not been received (January 2016).

2.12.2 Incorrect/excess availing of deferment

As per Rule 67(2) of VAT Rules, the units already availing tax deferment prior to commencement of the VAT Act, shall continue to avail the benefit up to the period as mentioned in their final eligibility certificates (FECs). The tax deferment should be availed only for the products mentioned in FEC of the respective dealer.

Audit noticed (between June and November 2014) during test check of deferment records in two circles[101] that in one of the two cases, the AA while finalising assessment in May 2013 for the year 2007-08 adjusted an amount of ₹ 27.67 lakh to deferment whereas the actual output tax for the commodity mentioned in the FEC was ₹ 14.19 lakh only. In another case, the unit availed sales tax deferment of ₹ 1.05 lakh after completion of deferment period. This resulted in incorrect/excess availment of deferred tax of ₹ 14.54 lakh.

[99] G.O.Ms.No.503, dated 8 May 2009.
[100] Ashoknagar, Bhongir, IDA Gandhinagar, Marredpally and Vanasthalipuram.
[101] Khammam I and Srinagar Colony.

After Audit pointed out these cases, in one case, CTO Srinagar Colony stated (February 2015) that the audit file was submitted to DC(CT) Punjagutta for revision and in the remaining case, CTO Khammam I stated (September 2015) that a demand of ₹ 1.05 lakh was raised and taken into Debt Management Unit (DMU) records and dealer paid partly an amount of ₹ 0.30 lakh. However, copy of DMU records was not furnished.

The matter was referred to the Department in November 2014 and January 2015. Their reply has not been received (January 2016).

2.12.3 Non/Short recovery of deferred sales tax

As per Rule 67(5) of VAT Rules, the repayment of deferred tax shall commence after the completion of the deferment period.

Audit noticed (October 2013 and July 2014) during test check of deferment records in Afzalgunj and Madhapur circles that in four cases, the dealers availed sales tax deferment of ₹ 75.06 lakh for the period 1996-97 to 2008-09 which was to be repaid from February 2010 onwards. In one case, AA partly recovered an amount of ₹ 4.13 lakh out of sanctioned amount of ₹ 29.77 lakh and no recovery was made in the remaining cases. This resulted in non/short recovery of deferred sales tax of ₹ 70.93 lakh.

After Audit pointed out the cases, AAs stated that matter would be examined and report submitted in due course.

The matter was referred to the Department in March 2015. Their reply has not been received (January 2016).

2.13 Short levy of tax due to incorrect determination of taxable turnover

As per Section 21 (4) of VAT Act, the authority prescribed may, based on any information available or on any other basis, conduct a detailed scrutiny of the accounts of any VAT dealer and where any assessment as a result of such scrutiny becomes necessary, such assessment shall be made within a period of four years from the end of the period for which the assessment is to be made.

Audit noticed (between June 2011 and December 2014) during the test check of VAT assessments and other VAT records of 17 circles[102] that in three out of 19 cases, the AAs for the years 2008-09 to 2011-12 under assessed the purchase turnover of bearings and receipts of royalty and warranty claims. In 13 cases, the AAs, assessed less sales turnovers than those reported in trading/profit and loss accounts. In one case, the dealer declared less sales turnover than those reported in trading/profit and loss accounts. In another case, SEZ sale turnover of ₹ 4.88 lakh as reported by the dealer for the year 2012-13 but not supported by documentary evidence was incorrectly

[102] Afzalgunj, Agapura, Begumbazar, Bodhan, Fatehnagar, Hyderguda, Jubilee Hills, Khairatabad, Malkajgiri, M.G.Road, Nampally, Saroornagar, Ramgopalpet, R.P.Road,Srinagar Colony, Tarnaka and Vidyanagar.

exempted. In the remaining case, for the year 2011-12 sale turnover of 'sugar' exempted by the AA was much higher than that of the turnover as per sales ledgers of the dealer. This resulted in short levy of tax of ₹ 96.50 lakh in 19 cases.

After Audit pointed out the cases, in eight cases, eight CTOs[103] stated (between September 2013 and January 2015) that the matter would be examined and report submitted in due course. In 10 cases, AAs stated (between March 2014 and November 2015) that the files were submitted to DCs(CT) concerned and revision was under process. In the remaining case, CTO Fatehnagar contended (November 2012) that the differential turnover related to high sea sales under CST Act. The reply is not tenable as the said turnover was not assessed under CST Act.

The matter was referred to the Department between March 2014 and May 2015. Their reply has not been received (January 2016).

2.14 Short levy of VAT due to incorrect exemption

As per Section 4(9)(c) of VAT Act, every dealer, whose annual total turnover is ₹ 1.5 crore and above shall pay tax at the rate of 14.5 *per cent* of the taxable turnover of the sale or supply of goods, being food or any other article for human consumption or drink. Sale of goods to any unit located in SEZ is exempted from tax as per entry 59 of Schedule I to VAT Act. However, supply of food to SEZ units does not qualify for such exemption.

Audit noticed (September 2014), during the test check of VAT assessment files in CTO Khairatabad that in one case, AA while finalising the assessment for the years 2011-12 to 2012-13 allowed exemption on a turnover of ₹ 3.69 crore being sale of food to a unit located in SEZ. This resulted in short levy of tax of ₹ 47.59 lakh.

After Audit pointed out the case, AA stated that the matter would be examined and report submitted in due course (January 2016).

The matter was referred to the Department in December 2014. Their reply has not been received (January 2016).

2.15 Non-forfeiture of excess collection of tax

As per provisions of Section 57(2) of the VAT Act, no dealer shall collect any amount by way of tax at a rate exceeding the rate at which he is liable to pay tax. If any tax is collected in excess of the liability, it shall be forfeited to the Government under Section 57(4) of the VAT Act.

Audit noticed (July 2014) during the audit of two circles[104] for the period from April 2011 to May 2013 that in two cases, tax of ₹ 14.19 lakh was collected in

[103] Afzalgunj, Agapura, Begum bazar, Bodhan, Jubilee Hills, Khairatabad, Malkajgiri and M.G.Road.
[104] Malakpet and Tarnaka.

excess of tax liability. However, the AAs did not forfeit the same. This resulted in non-forfeiture of excess tax collections of ₹ 14.19 lakh.

After Audit pointed out the cases, AAs replied that the matter would be examined and report submitted in due course.

The matter was referred to the Department in November 2014. Their reply has not been received (January 2016).

2.16 Non-levy/declaration of purchase tax

Under Section 4(4) of the VAT Act, purchase tax is to be levied on purchase of taxable goods made without paying tax (through purchase from unregistered dealers or if the selling dealer is not liable to pay tax) if the goods are used as inputs either for exempt products or for goods which are disposed of by any means other than by sale. Purchase tax is to be levied proportionately if the originally purchased goods are used as common inputs for products which separately necessitate and do not necessitate levy of purchase tax.

Audit noticed (September 2014) during the test check of VAT records of CTO Rajendranagar for the period from 2010-11 to 2012-13, that in one case, the dealer reported exempt transactions of gram and sale of exempted goods such as husk of pulses derived from taxable goods i.e., pulses. In this case, the dealer purchased taxable goods from unregistered dealers. Out of the total purchases of taxable goods worth ₹ 17.33 crore from unregistered dealers, the purchase price of ₹ 2.13 crore corresponding to the exempt transactions and exempt sales attracted purchase tax. However, neither had the dealer paid the tax nor was the same levied by the AA during VAT audit of the case (December 2013). This resulted in non-levy/declaration of purchase tax of ₹ 9.98 lakh.

After Audit pointed out the case, CTO Rajendranagar stated that the audit file would be submitted to DC(CT) Saroornagar for further verification.

The matter was referred to the Department in June 2015. Their reply has not been received (January 2016).

2.17 Short levy of tax due to arithmetical mistakes

Levy of taxes under VAT Act is governed by Section 4 of the Act and tax under CST Act is levied under the provisions of Section 8 of CST Act.

Audit noticed (between June and October 2014) during the test check of three CST assessment files and two VAT audit files in four circles[105] that in three out of five cases, the AAs while finalising the assessments between March 2013 and March 2014 for the period 2009-10 and 2010-11, worked out the tax to be levied as ₹ 3.92 lakh instead of ₹ 11.54 lakh due to arithmetical errors, resulting in short levy of tax of ₹ 7.60 lakh. In one case, excess credit of

[105] Bowenpally, Fatehnagar, Hydernagar and Malakpet.

₹ 0.53 lakh was arrived at erroneously and in the remaining case, penalty was short levied by ₹ 0.58 lakh. Thus there was total short levy of tax/penalty of ₹ 8.73 lakh due to arithmetical errors.

After Audit pointed out the cases, three CTOs[106] in three cases stated (between July and October 2014) that the matter would be examined and report submitted in due course. CTO Hydernagar in two cases stated (September 2014) that the assessments would be revised.

The matter was referred to the Department between November 2014 and June 2015. Their reply has not been received (January 2016).

2.18 Loss of revenue due to non-finalisation of assessment

As per Section 14 (3) of APGST Act, 1957, where any dealer liable to tax under the Act fails to (i) submit return before the due date prescribed, or (ii) produce the accounts, registers and other documents after inspection, or (iii) submit a return subsequent to the date of inspection, the assessing authority may, within a period of six years from the expiry of the year to which the assessment relates, issue a notice to the dealer and conducting enquiry assess to the best of his judgment, the amount of tax due from the dealer on his turnover for that year.

Audit noticed (April 2014), during test check of V&E records in CTO Narayanaguda circle that, in one case, the V&E Department had cautioned (January 2004) about the evasion of tax on works contract turnover not reported for the period 1997-98 to 1999-2000. However, the Department failed to take timely action and issued show cause notice (March 2008) after a lapse of four years from the date of receipt of information on evasion of tax. By the time, the assessments had become time barred. This resulted in loss of revenue of ₹ 7.40 lakh.

After Audit pointed out the case, the CTO Narayanaguda stated (November 2014) that the said reference of V&E was received from DC(CT) Abids in February 2008. When an attempt was made to finalise the assessment by issuing the show cause notices, the dealer's reply showed that the assessments were barred by limitation of time. There was no laxity on the part of CTO. The reply is not acceptable as the Department failed to ensure finalisation of assessment in time.

The matter was referred to the Department in December 2014. Their reply has not been received (January 2016).

2.19 Short levy of tax and penalty for failure to convert as VAT dealer

Under Section 17(3) of the VAT Act, every dealer whose taxable turnover exceeds ₹ 50 lakh in the preceding 12 months shall be liable to be registered as a VAT dealer.

[106] Bowenpally, Fatehnagar and Malakpet.

As per Section 49(2) of the VAT Act, any dealer who fails to apply for registration as required under Section 17 shall be liable to pay penalty of 25 *per cent* of the tax due prior to the date of registration.

Audit noticed (June 2014) during the test check of records of Turnover Tax (TOT) dealer of CTO Karimnagar-I that in one case, though the turnover of the dealer exceeded ₹ 50 lakh in preceding 12 months, AA did not convert the dealer to VAT dealer. On the turnover of ₹ 30.04 lakh that exceeded the threshold limit in this case, VAT of ₹ 4.05 lakh was not levied due to non-conversion as VAT dealer. The dealer was also to be levied with a penalty of ₹ 1.01 lakh for failure to register as a VAT dealer.

After Audit pointed out the case, the CTO Karimnagar-I stated (May 2015) demand had been raised against short payment of tax and notice was issued for non-payment of penalty. However, no documents were made available.

The matter was referred to the Department in November 2014. Their reply has not been received (January 2016).