

Chapter–II Taxes/VAT on Sales, Trade, etc.

2.1 Tax Administration

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

2.2 Internal Audit

As per the information furnished by the Department, the Internal Audit Wing (IAW) is functioning from the year 2011-12. During the year 2017-18, 378 Offices were due for audit, of which, 351 Offices were audited. The shortfall in coverage of Offices was due to the preparation for implementation of Goods and Services Tax. Year-wise details of the number of objections raised, settled and pending along with tax effect, as furnished by the Department, are given in **Table 2.1**.

				2	(₹	in crore)	
	Observat	tions raised	Observatio	ns settled	Observations pending		
Year	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount	
2013-14	9,841	227.31	4,231	72.46	5,610	154.85	
2014-15	3,043	23.31	1,007	8.34	2,036	14.97	
2015-16	1,814	35.65	146	3.32	1,668	32.33	
2016-17	1,599	105.02	21	1.84	1,578	103.18	
2017-18	1,305	2.31	39	0.36	1,266	1.95	
Total	17,602	393.60	5,444	86.32	12,158	307.28	

Table 2.1Year-wise details of observations raised by IAW

As seen from the table, 12,158 observations involving ₹ 307.28 crore were pending for settlement as on 31 March 2018. Early action may be taken to settle pending observations.

2.3 Goods and Services Tax (GST)

The Goods and Service Tax Act was passed in the Parliament on 29 March 2017. The GST Act came into effect on 1 July 2017 and GST Law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition.

The Central and State taxes that are subsumed into the GST are listed below:

Central taxes subsumed in the GST	State taxes subsumed in the GST
 Central Excise Duty Additional duties of Excise Excise Duty levied under Medicinal and Toilet Preparations Act Service Tax 	 VAT (including CST and Purchase Tax) Entertainment tax (other than the tax levied by Local Bodies)
 Additional Customs Duty (countervailing duty) and Special Additional Duty of Customs Surcharge and Cess related to supply of goods/services 	 Entry Taxes Luxury Tax, Taxes on lottery, betting and gambling, and all Cesses and Surcharges by the States

Components of GST: Three taxes are applicable under this system viz. Central GST (CGST), State GST (SGST) and Integrated GST (IGST).

- CGST: Collected by the Central Government on an intra-State sale
- SGST: Collected by the State Government on an intra-State sale
- IGST: Collected by the Central Government for inter-State sale

Advantages of GST: GST will mainly remove the cascading effect on the sale of goods and services. Removal of cascading effect will directly impact the cost of goods. Since tax on tax is eliminated in this regime, the cost of goods decreases.

GST is mainly technologically driven and the activities like registration, return filing, application for refund and response to notices need to be done online on the GST Portal.

GST Registration: In the GST regime, businesses whose turnover exceeds ₹ 20 lakh in a year (₹ 10 lakh for North Eastern (NE) and hilly States) are required to register as a normal taxable person. The number of registered dealers under pre-GST regime (VAT) in Commercial Taxes Department was 5,84,775.

Division of taxpayers between the Central Government and the State Government of Karnataka:

As per the guidelines⁵ issued by the GST Council Secretariat, with respect to the division of taxpayer base between the Central Government and State Governments, the taxpayers registered in the State of Karnataka have been allocated in the following manner:

- Taxpayers whose turnover is ₹ 1.5 crore and above 50 *per cent* to the Centre and 50 *per cent* to the State; and
- Taxpayers whose turnover is less than ₹ 1.5 crore 10 *per cent* to the Centre and 90 *per cent* to the State.

According to the criteria mentioned above, dealers in the State have been divided between the Centre and State as shown in **Table 2.2**.

⁵ Vide Circular No.01/2017, issued vide F.No.166/Cross Empowerment/GSTC/2017 dated 20.09.2017.

Number of dealers coming under the jurisdiction of State and Centre						
Annual Turnover of Dealers	Number o	Total				
	State	Centre				
₹1.5 crore and above	43,829	43,829	87,658			
Less than ₹ 1.5 crore	4,08,750	45,418	4,54,168			
Total	4,52,579	89,247	5,41,826			

 Table 2.2

 Number of dealers coming under the jurisdiction of State and Centre

Transitional Credit: Provisions have been made for the smooth transition of Input Tax Credit (ITC) available under VAT, Excise Duty or Service Tax to GST in the form of Transitional Credit. A registered dealer opting for Composition Scheme will not be eligible to carry forward ITC available in the previous regime.

2.4 Trend of Revenue under Pre-GST and GST regimes

A comparison of revenue earned under pre-GST and GST regime is as presented in **Table 2.3**.

								(< in crore)
Year	Budget	Receipts	Receipt under GST		Total	Percenta	Compensa	Protected
	estimates	under Pre- GST taxes	SGST	IGST Apportio nment	receipts under Pre- GST and GST	ge of increase	tion received	Revenue
2013-14	33,590.00	33,719.35	Not appl	icable	33,719.35	-	-	-
2014-15	37,250.00	38,286.03	Not applicable		38,286.03	13.54	-	-
2015-16	41,329.00	40,448.63	Not applicable		40,448.63	05.64	-	-
2016-17	46,504.10	46,105.17	Not applicable		46,105.17	13.98	-	-
2017-18	24,485.68	25,093.16	14,572.67	9,609.51	49,275.34	06.87	7,535.00*	35,229.69

Table 2.3Revenue earned under Pre-GST and GST regime

*including ₹ 1,289 crore for March 2018 sanctioned vide Order F.No.31011/3/2014-SO(ST) dated 29 May 2018.

Protected revenue for nine months' period from July 2017 to March 2018 was $\[earline] 35,229.69$ crore while the actual revenue received was $\[earline] 27,560.12$ crore, which pegged the eligible compensation at $\[earline] 7,669.57$ crore. After considering compensation of $\[earline] 7,535$ crore, received for the year deficit of compensation to be received stood at $\[earline] 134.57$ crore.

During the year, Audit has commenced the checking of migration of dealers from VAT to GST, Transitional Credit and Refunds under GST and the Compensation allotted to the State by the Central Government. The comments on these will appear in the subsequent Audit Reports.

2.5 **Results of Audit**

There are 430 auditable units in the Commercial Taxes Department. Out of these, audit selected 104 units for test-check wherein 1.87 lakh assessments were finalised. Out of these, audit test-checked records of 42,998 dealers (23.00 *per cent*) during the year 2017-18 and noticed 2,620 cases (6.09 *per cent* of audited sample) of non/short-levy of tax, non/short-payment of tax as per VAT 240, non-levy of tax on sale of liquor, non/short-levy of tax on works contract receipts, non/short-levy of penalties and interest, non-follow-up on payments, incorrect/excess allowance of input tax credit and non-observance of provisions of Acts/Rules etc. involving an amount of ₹ 196.74 crore. These cases are

illustrative only as these are based on test-check of records. The observations broadly fell under the following categories as detailed in **Table 2.4**.

		(₹ in crore)		
SI. No.	Category	No. of Paragraphs	Amount	
	Value Added Tax			
1.	Non/short-payment of tax as per VAT- 240	31	8.89	
2.	Non/short-levy of tax	46	104.29	
3.	Non-levy of tax on sale of liquor	39	26.88	
4.	Non/short levy of penalties (under Sections 72 (1), 72(2), and 74(4))	145	24.65	
5.	Non/short-levy of interest	53	1.81	
6.	Not-Acknowledged returns	29	8.13	
7.	Non/short-levy of tax on purchases from un-Registered Dealers	15	1.54	
8.	Incorrect/excess allowance of input tax credit	46	4.40	
9.	Non-levy of tax on works contract receipts from KREIS	35	6.73	
10.	Other irregularities	48	5.98	
	Total	487	193.30	
	Entry Tax			
11.	Non-levy of Entry Tax /interest	16	0.76	
	Entertainment Tax (KET)			
12.	Short-collection of security deposit/non-levy of interest	6	1.76	
	Profession Tax (PT)			
13.	Short-demand of Professions Tax/interest	7	0.16	
	Luxury Tax (LT)			
14.	Non-collection of Luxury Tax/interest	2	0.06	
	Expenditure Audit			
15.	Undue benefit of payment towards PF, ESI and Service Tax contribution to Contract Agency providing DEOs/Attenders in the absence of documentary proof whether remitted or not, non-deduction of TDS under Income Tax Act, Irregular drawal of charge allowance, Excess pay drawn due to incorrect fixation, etc.	13	0.70	
	Grand Total	531	196.74	

Table 2.4 Results of Audit

During the course of the year, the Department had accepted under-assessment and other deficiencies involving $\overline{\mathbf{x}}$ 18.71 crore in 75 paragraphs. An amount of $\overline{\mathbf{x}}$ 9.18 crore was recovered in 193 paragraphs that were pointed out in the earlier years.

A few illustrative cases of non/short-realisation of VAT, penalty and interest involving ₹ 74.30 crore are discussed in the following paragraphs.

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

According to Section 35 (1) of the Karnataka Value Added Tax Act, 2003, every registered dealer shall furnish a return and shall pay tax due on such return within twenty days (or fifteen days⁶) after the end of the preceding month or any other tax period as may be prescribed.

⁶ In case of dealers opted for paying tax under Composition Scheme.

Section 72(1) of KVAT Act, 2003, states that a dealer who fails to furnish a return or who fails to pay the tax due on any return furnished as required under the Act shall be liable to pay together with any tax or interest due, a penalty equal to:

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

Audit test-checked returns of 5,768 assessees out of 1,62,352 (3.55 *per cent*) in 26 LVOs/VSOs in nine⁷ Districts (out of 35 LVOs/VSOs in 13 Districts) between January 2017 and October 2017. In 169 cases (2.93 *per cent* of the audited sample) it was noticed that the assessees had filed returns for the years 2012-13 to 2015-16 and paid tax of ₹ 248.72 crore belatedly, i.e. beyond 20 days/15 days as the case may be, after the expiry of the applicable tax period. Though all these cases attracted penalty under Section 72(1) of the Act, they were neither paid by the assessees nor any effort made by the Officers concerned to impose the same. This has resulted in non-levy of penalty of ₹ 14.46 crore⁸.

It is pertinent to note here that basic checks on the returns filed by the dealers were not exercised by the Department and hence the belated payments went unnoticed, escaping levy of penalty.

After these cases were brought to the notice of the Department and the Government between January 2018 and May 2018, an amount of ₹ 2.59 crore was recovered in 49 cases, notices were issued in eight cases, and orders were passed levying penalty in 14 cases. Reply is awaited in the remaining 98 cases (December 2018).

Audit had pointed out similar lapses on non-levy of penalty under Section 72(1) of the KVAT Act worth ₹ 23.98 crore in 651 cases in the previous four Audit Reports⁹. However, the Department failed to devise suitable checks to prevent the recurrence of the same.

2.7 Short-levy of tax on sale of liquor

According to Section 4 (1) (a) (ii) of the KVAT Act, 2003, every registered dealer shall be liable to pay tax on his taxable turnover at the rate of five and one half *per cent* on sale of goods mentioned in the Third Schedule of the Act. Under Section 5 (1) of the KVAT Act, 2003, tax shall be exempt for the sale of goods specified in First Schedule of the said Act. As per First Schedule of the KVAT Act, 2003, tax payable on sale of liquor including beer, fenny, liqueur and wine was exempted.

⁷ Bengaluru, Belagavi, Bidar, Chamarajanagara, Dharwad, Kolar, Koppal, Tumakuru and Vijayapura.

⁸ Includes penalty on ₹ 207.72 crore @ five *per cent* and on ₹ 41.00 crore @ 10 *per cent*, on which ₹ 0.02 crore was already paid.

⁹ Paragraph Nos. 2.9, 2.5, 2.6 and 2.6 of Audit Reports for the year ended 31 March 2014 (Report No.7 of 2014), 31 March 2015 (Report No.3 of the year 2015), 31 March 2016 (Report No.5 of the year 2016) and 31 March 2017 (Report No.7 of the year 2017) respectively.

The Government vide Notification¹⁰ of 28 February 2014 removed exemption of tax payable on sale of liquor and introduced VAT at the rate of five and one half *per cent* on sale of liquor by CL-9 licences¹¹ i.e. Bar and Restaurants situated in areas coming under Bruhat Bengaluru Mahanagara Palike, City Municipal Corporation, City Municipal Council and Town Municipal Council or Town Panchayat with effect from 1 March 2014. The aforesaid Notification was amended on 21 April 2014¹², where tax on sale of liquor by CL-9 licences situated in rural areas was exempted.

Audit checked the returns of all the 706 assessees (100 *per cent*) (Bar and Restaurants situated in urban areas) in 26 LVOs in 13^{13} Districts (out of 35 LVOs/VSOs in 13 Districts) between February 2017 and December 2017. In respect of 94 assessees out of the 706 checked (13.31 *per cent* of the audited sample), tax was not fully paid on the turnover of ₹ 226.19 crore on sale of liquor for the period from March 2014 to March 2016. Tax payable at the rate of five and one half *per cent* amounted to ₹ 12.43 crore, of which only ₹ 1.54 crore was paid. This resulted in non-payment of tax of ₹ 10.89 crore. Further penalty and interest under Sections 72(2) and 36 of KVAT Act, 2003, amounted to ₹ 1.09 crore and ₹ 3.40 crore respectively.

Thus, total non-payment of tax including penalty and interest worked out to ₹ 15.38 crore. Though the tax on sale of liquor by bars and restaurants situated in urban areas was to be levied with effect from 1 March 2014, the Department did not take effective action in raising timely demands for collection of tax.

After these cases were brought to the notice of the Department and the Government between January 2018 and February 2018, an amount of \gtrless 0.05 crore was recovered in three cases. Orders were passed levying tax and penalty in seven cases. Replies were awaited in the remaining 84 cases (December 2018).

2.8 Non-follow-up of pending tax liabilities declared in the returns

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

Audit checked the returns of all the 1,116 assessees (100 *per cent*) which showed a status of 'Not acknowledged' in the e-VARADI system, in 20 LVOs in eight¹⁴ Districts (out of 35 LVOs/VSOs in 13 Districts) between May 2017 and January 2018. In respect of 491 returns filed by 152 assessees (13.62 *per cent* of the audited sample) pertaining to tax periods between April 2011 and March 2016, the respective tax liabilities amounting to ₹ 6.42 crore were not discharged. Penalty and interest, as applicable, worked out to ₹ 0.64 crore and ₹ 2.77 crore respectively. Total amount realisable worked out to ₹ 9.83 crore.

¹⁰ Notification No.FD 21 CSL 2014 (II) dated 28 February 2014.

¹¹ CL-9 licence is given by the Excise Department for sale of liquor in Bar and Restaurants.

¹² Notification No.FD 41 CSL 2017, Bengaluru dated 21 April 2014.

¹³ Bagalkote, Ballari, Bengaluru, Belagavi, Dharwad, Haveri, Kolar, Koppal, Mysuru, Ramanagara, Tumakuru, Udupi and Vijayapura.

¹⁴ Bagalkote, Belagavi, Bengaluru, Dharwad, Haveri, Kolar, Mangaluru and Tumakuru.

Even though the 'e-VARADI' system for online filing of returns clearly indicates a status of 'Not acknowledged' against all returns where the tax liability is not discharged in full, the Officers concerned failed to follow up these cases and ensure timely recovery.

After these cases were brought to the notice of the Department and the Government between January 2018 and March 2018, an amount of ₹ 0.18 crore was recovered in 16 cases. Orders were passed levying tax and penalty in five cases. Reply is awaited in the remaining 131 cases (December 2018).

2.9 Non/short-payment of differential tax liability declared in audited statement of accounts

According to Section 31(4) of the KVAT Act 2003, every dealer whose total turnover in a year exceeds a prescribed amount¹⁵ shall have the accounts audited by a Chartered Accountant or a Cost Accountant or a Tax Practitioner (Auditor) and shall submit to the prescribed authority a copy of the audited statement of accounts in Form VAT-240 and other documents as prescribed in the Act.

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

During test-check of returns of 3,824 dealers out of 23,515 (16.26 per cent) in 20 LVOs in six¹⁶ Districts (out of 35 LVOs/VSOs in 13 Districts) between January 2017 and December 2017, Audit noticed that 43 dealers (1.12 per cent of the audited sample) in their audited accounts in Form VAT 240 had declared additional tax liability of ₹ 5.09 crore over and above the tax liability declared in the monthly returns for the years from 2014-15 to 2015-16. Out of the additional tax liability declared, only $\gtrless 0.72$ crore was paid by 12 dealers. The remaining amount of ₹ 4.37 crore was neither paid by the dealers concerned on their own while filing the audited accounts, nor were the dues demanded by the LVOs concerned. Further, penalty (at 10 per cent) and interest (at 1.5 per cent per month) leviable amounted to ₹ 0.43 crore and ₹ 1.40 crore respectively. Total non/short-payment thus worked out to ₹ 6.20 crore.

The Department has failed to identify the cases of non-payment of additional tax declared by the dealers in the audited statement of accounts. The Offices concerned were not watching the unacknowledged status¹⁷ of Form 240 in eFS, which prevented detection of non-payment cases. Mismatch between the digital data sheet depicting summary of Form-240 and PDF files uploaded¹⁸ has added to the problem as in such cases, identification needs to be taken up case-wise. Thus, lack of a system for scrutinising the audited statement of accounts in the

¹⁵ ₹ 40 lakh till 31 March 2010, ₹ 60 lakh from 1 April 2010 to 31 March 2011 and ₹ 100 lakh thereafter.

¹⁶ Bagalkote, Bengaluru, Belagavi, Hubbali (Dharwad), Tumakuru and Udupi.

¹⁷ "Unacknowledged" status indicates non-payment of additional tax. 18

PDF formats of Form 240, Profit and Loss Account and Balance Sheet.

returns filed by the dealers resulted in non-collection of taxes declared by them as payable.

After these cases were brought to the notice of the Department and the Government between January 2018 and May 2018, an amount of ₹ 0.62 crore was recovered in nine cases and notices were issued in three cases. Orders were passed levying tax and penalty in other two cases while one case was referred to audit. Reply was awaited in the remaining 28 cases (December 2018).

Audit had pointed out similar lapses on non-collection of additional tax worth \mathbf{E} 22.62 crore, declared by 157 dealers in their audited statement of accounts, in the previous six Audit reports¹⁹. However, the Department failed to devise suitable checks to prevent the recurrence of the same.

2.10 Short-levy of tax in respect of works contractors

According to Section 4 (1) (c) of the KVAT Act, 2003, every registered dealer shall be liable to pay tax on his taxable turnover in respect of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract specified in the Sixth Schedule, subject to Section 14 and 15 of Central Sales Tax Act 1956, at the rates specified in the said Schedule to the Act.

Test-check of re-assessment²⁰ Orders in respect of works contractors in three²¹Audit Offices (out of 69 Audit Offices) of the Commercial Tax Department revealed the following deficiencies which resulted in short-levy of tax, penalty and interest of ₹7.74 crore due to suppression of turnover, application of incorrect rate of tax and incorrect allowance of Gross Profit. Details of the cases are as below:

a. Suppression of turnover under works contract receipts

As per the re-assessment Order passed by the Deputy Commissioner of Commercial Taxes (Audit)- 2.1, Divisional VAT Office-2, Bengaluru, under Section 39(1) of the KVAT Act, 2003, for the year 2014-15 in respect of M/s.Good Earth Eco Development Private Limited (TIN²²-29640621624), (the purchaser), the assessee had made purchases worth ₹ 34.41 crore from M/s.Good Earth Eco Futures Private Limited (TIN-29260808170) (the seller) and was allowed input tax credit of ₹ 4.99 crore. However, on cross-verification by Audit of VAT 240 (audited statement of accounts)/VAT Returns of the seller, it was found that the assessee had declared taxable turnover of only ₹ 26.56 crore and paid output tax of ₹ 3.85 crore. Thus, it was evident that the seller had

¹⁹ Paragraph Nos 2.9.1, 2.10.7, 2.4.4.5, 2.4, 2.7 and 2.7 of Audit Reports for the year ended 31 March 2012 (Report No.3 of 2013), 31 March 2013 (Report No.1 of the year 2014), 31 March 2014 (Report No.7 of the year 2014), 31 March 2015 (Report No.3 of the year 2015), 31 March 2016 (Report No.5 of the year 2016) and 31 March 2017 (Report No.7 of the year 2017) respectively.

²⁰ Reassessment is the process of verification conducted by the Department in which the correctness of returns filed by the dealers are checked with respect to the books of accounts and other related documents maintained by the dealer.

²¹ Deputy Commissioner of Commercial Taxes, (Audit)- 2.1, Divisional VAT Office-2, Bengaluru, Assistant Commissioner of Commercial Taxes (Audit)- 3-Hubballi and Assistant Commissioner of Commercial Taxes (Audit)- 1-Vijayapura.

²² TIN is Tax Payers Identification Number.

suppressed contract receipts to the extent of ₹ 7.85 crore. The consequent shortlevy of tax works out to ₹ 1.14 crore²³. Besides, penalty of ₹ 0.11 crore²⁴ and interest of ₹ 51.25 lakh²⁵ were also leviable for short-declaration of tax. The total liability thus worked out to ₹ 1.76 crore.

In this connection, it appears that the Officer concerned had failed to crossverify the input tax claim made by the purchaser vis-a-vis the taxable turnover declared by the seller and the tax paid by him in the returns filed by him. This had resulted in non-detection of suppression of turnover by the seller and nonprotection of Government revenue by way of possible leakage of revenue in the form of input tax credit without realising corresponding output tax.

After the case was brought out by Audit to the notice of the Department during October 2017 and April 2018, the Department conducted a re-assessment of the seller (M/s Good Earth Eco Futures Pvt. Ltd) and passed a re-assessment Order under section 39(1) of the KVAT Act rectifying the suppression of turnover and raising a demand of ₹ 1.76 crore for the short-levy of tax (April 2018).

b. Application of incorrect rate of tax for Ductile Iron Pipes under works contract receipts

Component materials consumed under a works contract are levied tax at the rate prescribed under Sixth Schedule appended to the KVAT Act, except the declared goods²⁶, for which the rate of tax²⁷ is prescribed under Section 15 of the Central Sales Tax Act,1956.

The Commissioner of Commercial Taxes (CCT), Karnataka vide two clarifications²⁸ in May 2013 and January 2016 had clarified that the goods, Ductile Iron Pipes (D I Pipes), are covered under Entry No.70 of III Schedule to the KVAT Act. Hence, DI pipes were not classified as declared goods and the rate of tax applicable for DI pipes was the rate prescribed under the Sixth Schedule and not the rate applicable for declared goods.

M/s.Pragati Constructions (TIN: 29230787574) as a civil works contractor had, during the years 2012-13 and 2013-14, undertaken works contract of pipeline work of multi-village water supply projects in various Gram Panchayats and Municipal Corporations. Audit checked the re-assessment records of M/s.Pragati Constructions in the Office of ACCT (Audit)-1-Vijayapura, in October 2017 and noticed that the Assessing Officer had levied tax at five *per cent* on the turnover of DI pipes, considering them as Steel Pipes (declared goods), for the years 2012-13 and 2013-14 vide re-assessment Order dated 28 May 2016.

²³ At the rate of 14.50 *per cent* on ₹ 7.85 crore.

²⁴ 10 per cent of ₹ 1.14 crore.

²⁵ Calculated at 1.5 *per cent* per month for 30 months from May 2015 to October 2017, i.e. till date of Audit.

²⁶ Goods declared under Section 14 of the Central Sales Tax Act, 1956, as goods of special importance in inter-state trade or commerce.

²⁷ Five *per cent* from 01.04.2011.

²⁸ Clarification No. CLR.CR.236/12-13 dated 24 May 2013 and Clarification No. CLR.CR.85/2014-15 dated 23 January 2016.

Incorrect adoption of a lesser rate of tax applicable to declared goods instead of the applicable rate of 14.50 *per cent* vide Entry no.23 of the Sixth Schedule to the KVAT Act, 2003, resulted in short-levy of tax (₹ 1.49 crore), penalty (₹ 0.14 crore) and interest (₹ 0.72 crore) aggregating to ₹ 2.35 crore²⁹.

After the case was pointed out to the Department and the Government between October 2017 and May 2018, rectification orders were passed and an amount of ₹ 2.35 crore was demanded.

c. Inadmissible apportionment of Gross Profit towards labour charges and other like charges

Rule 3(2) (1) of KVAT Rules, 2005, provides for deduction, from the total work contract receipts, of all amounts actually expended towards labour charges and other like charges in connection with the execution of works contract. Besides, when labour and like charges are not ascertainable from the books of accounts maintained by the dealer, Rule 3(2) (m) of KVAT Rules provides for deduction of such charges as a percentage of the value of the contract. The table included under the Rule ibid prescribes different percentages, ranging from 10 to 40 *per cent*, for labour and other like charges for different types of contracts.

Further, gross profit margin earned by a dealer shall be apportionable³⁰ to the labour and other like charges involved in the execution of works contract only if labour and like charges were ascertainable from the books of accounts maintained by the dealer. In other cases, when it is allowed as percentage of the value of the contract, no further deduction could be claimed towards profit margin.

Audit checked re-assessment records of M/s.Megha Engineering and Infrastructures Limited (TIN: 29670757747) in the Office of the ACCT (Audit)-3-Hubballi, in February 2018, for the tax period 2013-14. In the re-assessment Order dated 18 May 2015 passed under Section 39(1) of the KVAT Act, labour charges and other like charges aggregating to ₹ 154.97 crore were allowed at standard rate of 25 *per cent* of the value of the contract as per Rule 3(2) (m) of KVAT Rules, 2005. In addition, gross profit of ₹ 34.87 crore was also allowed

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Description	2012-13	2013-14	Total	Remarks	
	(₹ in	(₹ in	(₹ in		
	crore)	crore)	crore)		
Turnover of Ductile Iron (D I) pipes (including Gross Profit) used in the works contract as declared in P & L Accounts	9.50	6.10	15.60	*37 months from May 2013 to May	**25 months from May
Tax leviable at 14.5 <i>per cent</i> as applicable under entry no. 23 of sixth schedule	1.38	0.88	2.26	2016, i.e. date of	2014 to May 2016,
Less : Tax levied at 5 <i>per cent</i> as applicable to declared goods	0.47	0.30	0.77	Order.	i.e. date of Order.
Short-levy of tax (difference in rate of tax at 9.5 <i>per cent</i>)	0.91	0.58	1.49		
Add: penalty leviable at 10 <i>per cent</i> under Section 72(2)	0.09	0.05	0.14		
Add: Interest leviable under Section 36(2)	0.50*	0.22**	0.72		
Total tax, penalty and interest	1.50	0.85	2.35		

⁰ As per the Explanation III under the Rule 3 of the KVAT Rules read with the instructions of the Commissioner of Commercial Taxes vide Circular No. 11/2009-10 dated 07 December 2009. as apportionment towards labour charges and other like charges which was incorrect. Thus, incorrect allowance of gross profit on labour charges and other like charges has resulted in short-determination of taxable turnover to the extent of ₹ 34.87 crore and consequent short-levy of tax of ₹ 2.40 crore. Besides interest of ₹ 1.23 crore was leviable under Section 36(2) of KVAT Act and the total liability aggregated ₹ 3.63 crore³¹.

After this case was brought to the notice of the Department and the Government between February 2018 and May 2018, the Government replied that gross profit was allowable as per the Judgement of Hon'ble High Court of Karnataka in the case of M/s Sobha Developers Private Ltd Vs. the Additional Commissioner of Commercial Taxes³².

The reply is not acceptable as the Judgement relates to the assessment years 2003-04 and 2004-05, when the Karnataka Sales Tax (KST) Act was in force. As per the Judgement, gross profit could be apportioned to labour charges under the KST Act even when it was not ascertainable from the books of accounts. The Judgement stated that Explanation II under Rule 6(4) of KST Act covered both the versions (ascertainable and non-ascertainable from books of accounts) of claim of labour charges. However, under KVAT Act, the position has changed and gross profit was allowable only in cases where it was ascertainable from the books of accounts.

2.11 Non-levy of tax due to non-declaration of works contract receipts from the Karnataka Residential Educational Institutions Society

According to Section 4 (1) (c) of the KVAT Act, 2003, tax shall be levied in respect of transfer of property (whether as goods or in some other form) involved in the execution of works contract at the rates specified in the Sixth Schedule of the Act. Section 15 (1) (b) of the KVAT Act, 2003, provides that a dealer who executes a works contract may elect to pay in lieu of the net amount of tax payable by him under this Act, by way of composition an amount specified at such rates on the total consideration for the works contract executed.

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Description	Turnover	Short-levy	Remarks
	(₹ in	oftax	
	crore)	(₹ in crore)	
Short-determination of turnover due to incorrect admission	34.87	-	* For 34
of apportionment of GP			months
Percentage of declared goods to other goods as worked out	80:20	-	
in the Re-assessment order			
Component of declared goods in the turnover short-	27.90	1.39	
determined (34.87*80/100), which attracts tax at the rate			
of five <i>per cent</i>			
Component of other goods in the turnover short-	6.97	1.01	
determined (34.87*20/100), which attracts tax at the rate			
of 14.5 per cent			
Total short-levy of tax		2.41	
Add: Interest leviable under Section 36(2) of KVAT Act	34 months	1.23*	
Total liability (tax and interest)		3.63	

³² STA. No. 4/2011 C/W STA. No. 3/2016 dated 2 April 2014.

Rate of tax on works contract for composition and regular dealer is four *per cent* and 14.50 *per cent* respectively for the year 2016-17. Further, Section 9-A of the KVAT Act, 2003, provides for deduction of tax at source (TDS) from the amounts payable to a dealer in respect of any works contract executed for the Central Government or State Government or an industrial, commercial or trading undertaking of the Central or State Government or local authority or a statutory body, etc.

The Karnataka Residential Educational Institutions Society (KREIS) was constituted by the Government of Karnataka in the year 2000³³ to establish, maintain, control and manage all residential educational institutions in the State. Since then, KREIS has been awarding works contracts to construct Schools/Colleges. As per the clarification³⁴ of the Commercial Taxes Department, KREIS being a "Society" is not authorised/required to deduct tax at source and hence, KREIS has not been deducting tax from payments made to the contractors in respect of the works executed.

During the year 2016-17, KREIS made payments towards works contracts worth ₹ 140.14 crore to 115 dealers. Cross-check of such payments (during May 2017 and March 2018) in all the 115 cases (100 *per cent*) by Audit with returns filed by the dealers revealed short/non-declaration of turnover in the returns filed in 24 LVOs/VSOs in 12 Districts³⁵ as mentioned below.

- (a) In respect of 23 dealers (under composition scheme) (20 per cent of the audited sample), consideration of works contracts received during 2016-17 from KREIS was ₹ 101.52 crore, of which only an amount of ₹ 64.85 crore was declared by these dealers, resulting in understatement of turnover of ₹ 36.67 crore. Non-levy of tax at the rate of four *per cent* on the turnover of ₹ 36.67 crore amounted to ₹ 1.47 crore. Besides, penalty of ₹ 0.14 crore and interest of ₹ 0.25 crore were leviable. Total liability worked out to ₹ 1.86 crore.
- (b) In respect of 12 dealers (under regular VAT) (10.43 *per cent* of the audited sample), the works contract consideration received from KREIS was ₹ 38.62 crore, of which only an amount of ₹ 0.78 crore was declared by these dealers, resulting in understatement of turnover of ₹ 37.84 crore. This resulted in non-levy of tax at 14.5 *per cent* (after allowing deduction of labour charges and other like charges at 30 *per cent*) of ₹ 3.84 crore. Besides, penalty of ₹ 0.38 crore and interest of ₹ 0.65 crore were leviable. Total liability worked out to ₹ 4.87 crore.

The total non-levy of tax including penalty and interest on works contract receipts from KREIS worked out to \gtrless 6.73 crore. The Commercial Tax Department's action of not authorising KREIS to deduct tax at source, though being a work executing agency like Public Works Department, Karnataka

³³ Government Order No. Saka E 532 S.E.W 96 dated 6 October 1999 and KRIES started its activities from 3 February 2000.

³⁴ Commercial Tax Department Letter No. KSA.CR.45/2007-08 dated 7 June 2007.

³⁵ Ballari, Belagavi, Bengaluru, Bidar, Dharwad, Hassan, Kolar, Koppal, Shivamogga, Tumakuru, Udupi and Vijayapura.

Housing Board, National Highway Authority of India, etc. resulted in non-levy of tax on the works contract receipts not declared by the assessees in the returns.

After these cases were brought to the notice of the Department and the Government between March 2018 and May 2018, re-assessment orders were passed in two cases levying tax, penalty and interest. Reply is awaited in the remaining 33 cases (December 2018).

2.12 Short-levy of tax due to incorrect allowance of sub-contractor payments

According to Section 4 (1) (c) of the KVAT Act, 2003, tax shall be levied in respect of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contracts at the rates specified in the Sixth Schedule of the Act. Section 15(1) of the KVAT Act, 2003, provides that a dealer who executes works contract may elect to pay, in lieu of the net amount of tax payable by him under this Act, by way of composition at the specified rate on the total consideration for the works contracts executed.

As per Rule 3(2) of KVAT Rules, 2005, the taxable turnover shall be determined by allowing the deductions from the total turnover as prescribed in clauses (a) to (m). Rule 3 (2) (i-1) of the KVAT Rules provides for deduction of all amounts paid or payable to sub-contractors as the consideration for execution of works contract whether wholly or partly, provided that no such deduction shall be allowed unless the dealer claiming deduction produces document in proof that the sub-contractor is a registered dealer liable to pay tax under the Act and that the turnover of the such amounts is included in the return filed by such subcontractor.

During test-check of returns filed by 164 dealers out of 3,227 (5.08 *per cent*) in nine LVOs/Audit Offices in Bengaluru and Ballari Districts (out of 35 LVOs/VSOs in 13 Districts) between April 2016 to January 2018, Audit noticed 14 cases (8.54 *per cent* of the audited sample) in which the civil works contractors had claimed deduction of ₹ 49.86 crore in turnover towards subcontractor payments for the period 2012-13 to 2014-15. Of these, 13 works contractors had opted for composition of tax (COT) while the remaining one had filed regular VAT returns.

On cross-verification of returns filed by the works contractors with those filed by related sub-contractors, it was noticed that a turnover aggregating $\overline{\xi}$ 11.32 crore only was declared in the returns filed by the sub-contractors as against $\overline{\xi}$ 49.86 crore claimed by the works contractors in their returns. This resulted in excess allowance of sub-contractor turnover of $\overline{\xi}$ 38.54 crore and consequent short-levy of tax of $\overline{\xi}$ 1.83 crore. Besides penalty of $\overline{\xi}$ 0.14 crore and interest of $\overline{\xi}$ 0.53 crore were also leviable. Total liability worked out to $\overline{\xi}$ 2.50 crore. It appears that absence of a system for verification of returns of the works contractors vis-à-vis the sub-contractors was responsible for the excess allowance of sub-contractor turnover. After these cases were brought to the notice of the Department and the Government between March 2018 and May 2018, an amount of \gtrless 0.19 crore was recovered in one case. Reply was awaited in the remaining 13 cases (December 2018).

2.13 Non-levy of penalty under Section 74(4) of KVAT Act for nonfiling of VAT-240

According to Section 31(4) of the KVAT Act, 2003, read with Rule 34(3) of KVAT Rules, 2005, every dealer whose total turnover in a year exceeds one hundred lakh rupees shall have his accounts audited by a Chartered Accountant or a Cost Accountant or a Tax Practitioner and submit a copy of the audited statement of accounts in Form VAT-240 and prescribed documents within nine months after the end of the relevant year.

Further, under Section 74(4) of the KVAT Act, any dealer who fails to submit within the time prescribed a copy of the audited statement of accounts, shall be liable to pay a penalty of five thousand rupees and, a further penalty of fifty rupees per day for so long as the failure to submit a copy of the audited statement of accounts continues.

Test-check of returns of 29,586 dealers out of 34,805 (85 *per cent*) in 38 LVOs/VAT Sub Offices (VSOs) in 14 Districts³⁶ (out of 38 LVOs/VSOs in 15 Districts)³⁷ between April 2016 and February 2018 revealed that 2,607 assessees (8.81 *per cent* of the audited sample) did not file Form VAT-240 for the years 2012-13 to 2015-16. Non-submission of Form VAT-240 implies that the assessees have not got their accounts audited by the authority concerned. Audit noticed that the Department had not taken any action to enforce compliance in this regard, either by issue of notice or by levy of mandatory penalty under Section 74(4). Consequently, the Department was not ensuring the audit of books of accounts maintained by those assessees and thereby the correctness of tax paid by such assessees. As monthly returns filed by the assesses are deemed to be assessed, failure to enforce such controls built into the system will result in leakage of revenue. Non-levy of penalty under Section 74(4) of the KVAT Act in respect of the above assessees worked out to ₹ 8.23 crore.

After these cases were brought to the notice of the Department and the Government between May 2018 and June 2018, an amount of \gtrless 0.36 crore was recovered in 157 cases and notices were issued in 86 cases. Orders were passed in 81 cases levying penalty and interest and 25 other cases were referred to audit. Reply was awaited in the remaining 2,258 cases (December 2018). Further, on a check of eFS, Audit found that filing of form-240 was not ensured by the Department in 119 cases out of the 157 cases where penalty was recovered, which defeats the very purpose of levy of penalty.

³⁶ Ballari, Belagavi, Bengaluru, Bidar, Chamarajanagara, Dharwad, Kalaburagi, Kodagu, Koppal, Mandya, Mysuru, Raichuru, Tumakuru and Udupi.

³⁷ Includes the cases audited during the year 2016-17 also.

2.14 Loss of revenue in the form of input tax credit

Under Section 10 (3) of the KVAT Act 2003, a dealer is liable to pay the net tax after adjustment of input tax. Re-assessment of returns filed is concluded under Section 39 of the KVAT Act after detailed scrutiny of the books of accounts of the dealer concerned.

Test-check of 360 re-assessments out of 6,541 (5.50 *per cent*) concluded in 18 Audit Offices in five Districts³⁸ (out of 69 Audit Offices in 13 Districts) between February 2016 and January 2018 revealed that 35 assessees (9.72 *per cent* of the audited sample) were allowed input tax credit aggregating ₹ 2.11 crore for the years 2009-10 to 2014-15.

On a verification of the purchase registers of such assessees, Audit noticed that there were 77 corresponding sellers for the input tax claimed. Cross-verification of the details of the sellers in eFS³⁹ revealed that 24 of them were de-registered at the time of purchase, three were from outside the State and the remaining 50 dealers were registered at the time of purchase. The de-registered dealers had not filed returns or paid the corresponding output tax while interstate purchases were not eligible for input tax credit. The remaining 50 dealers filed returns but had paid lesser output tax than the input tax claimed. Consequently, as against the input tax of ₹ 2.11 crore allowed by the Department, the corresponding output tax paid was only ₹ 0.16 crore. Thus, allowing input tax credit without realising the corresponding output tax resulted in loss of revenue of ₹ 1.95 crore. Penalty of ₹ 0.20 crore and interest of ₹ 1.08 crore was also applicable in this regard. Total dues worked out to ₹ 3.23 crore.

A Performance Audit⁴⁰ conducted on "Input Tax Credit under KVAT Act, 2003" for the period 2010-2012 had pointed out similar cases with money value of ₹ 97.53 crore. However, the Department appears to have failed to devise suitable checks to prevent recurrence of the same.

After these cases were brought to the notice of the Department and the Government between May 2018 and June 2018 an amount of ₹ 0.40 crore was recovered in 11 cases and orders were passed in three cases levying tax, penalty and interest. Reply was awaited in the remaining 21 cases (December 2018).

³⁸ Bagalkote, Bengaluru, Dharwad, Kalaburgi, and Shivamogga.

³⁹ Electronic Filing System - Used for filing of returns in Commercial Taxes Department of Karnataka.

⁴⁰ Paragraph No. 2.9 of the Audit Report for the year ending 31 March 2013 (Report No. 1 of the year 2014).