Report of the Comptroller and Auditor General of India

on

Effectiveness of Kerala Value Added Tax Information System (KVATIS) in the Tax Administration of Commercial Taxes Department

The Report has been laid on the table of the State Legislature Assembly on 17-07-2014

Government of Kerala
Report No. 7 of the year 2014

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Preface

This Report of the Comptroller and Auditor General of India for the year ended March 2013 has been prepared for submission to the Governor of Kerala under Article 151 of the Constitution of India.

The Report contains the significant results of audit of the 'Effectiveness of the Kerala Value Added Tax Information System in the tax administration of Commercial Taxes Department' from April 2008 to May 2013.

The instances mentioned in this Report are those which came to notice in the course of audit during February to December 2013.

The audit has been conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.

Executive Summary

Executive summary

Content

Commercial Taxes Department contributes about 75 *per cent* of the revenue of the State which includes General Sales Tax, Value Added Tax and Central Sales Tax. Kerala Value Added Tax was introduced with effect from 01 April 2005. As part of e-governance initiative, the Kerala Value Added Tax Information System (KVATIS), application software was deployed during 2007 and became operational from 2007-08 onwards in a phased manner. This was developed by CMC Ltd., a TATA enterprise, as a web based application with 12 modules. Up to March 2010 total expenditure incurred on the project was ₹ 29.75 crore and three modules were fully operational. In this context, an audit of effectiveness of KVATIS on the tax administration was taken up.

In this Report

The audit was conducted from February to December 2013 and data was collected from the Information Technology Management Cell (ITMC) in the Commissionerate of Commercial Taxes. The entire data in the system for the period upto May 2013 was extracted and analysed using the Interactive Data Extraction and Analysis (IDEA) software. The audit observations were cross verified on a sample basis with the assessment details in the Assessment Circle Offices. The results of audit of information in the modules like Dealer information system, Checkpost management system and Return Processing System are narrated in Chapters II to IV and other deficiencies noticed in Chapter V of this Report.

Material value of Audit Findings

Audit observed several deficiencies/defects in the application of the system for tax administration. Some key risks resulting from weak systemic controls are highlighted in this Report which involves a tax effect of ₹ 4,653.43 crore. A maximum penalty of ₹ 7,311.81 crore and security deposit of ₹ 317.15 crore were also leviable.

Dealer information system

Audit found that the system accepted multiple registrations ranging from two to 18 on a single Permanent Account Number (PAN). Either a single PAN was used by different individuals or the same individual used same PAN for getting more than one registration. The dealers either avoided tax liability by keeping their turnover under each registration below ₹ 10 lakh, the threshold minimum for tax liability or minimised their tax liability by bringing the turnover below ₹ 50 lakh/₹ 60 lakh per year which was fixed as the threshold limit for presumptive tax. The system failed to generate any alerts by aggregating these multiple registrations. Audit also found cases of non-renewal of registration,

non-existence of a system for monitoring the expiry of security instruments etc. Short levy of tax including interest in the above cases amounted to ₹ 2.46 crore. A maximum penalty of ₹ 2.65 crore was also leviable.

[Chapter II]

Check Post Management System

Audit found that in the absence of an inbuilt control mechanism in the system to check inter state transportation of goods by dealers who have not renewed or cancelled their registration, such dealers transported goods without payment of security deposit (SD) at Check Post. Further, Audit found that 1,450 dealers were effecting inter state sales to dealers either without TIN or with defective TIN but claiming concessional rate for their inter-state sales. There were cases in which dealers short reported/short accounted inter-state purchase/stock transfer in their returns filed, cases in which transit passes were not surrendered, release of consignments brought by dealers for own use without verifying the genuineness of the purpose/details entered etc. In all these instances the information available in the system could have been better utilised for efficient monitoring and tax administration. Short levy of tax including interest in the above cases amounted to ₹ 1,928.45 crore. A maximum penalty of ₹ 2,888.96 crore and a security deposit of ₹ 317.15 crore was also leviable.

[Chapter III]

Return Processing System

Audit found that the absence of a system to generate demand notice for penalty for non-filing of returns resulted in non-imposition of penalty. Further, audit pointed out cases of inappropriate mapping of business rules resulting in short fixation of compounded tax for gold dealers, defects/deficiencies in accounting of purchases/sales/opening and closing stock for the financial year, short payment of tax due, scrutiny of presumptive tax payments etc. Short levy of tax including interest in the above cases amounted to ₹ 2,722.52 crore. A maximum penalty of ₹ 4,420.20 crore was also leviable.

[Chapter IV]

Other Important Points

Audit found that there was significant dependence on inefficient manual procedures due to non-utilisation of some modules like Audit Assessment Module, Refund System Module, Arrear Recovery System Module etc which were not operational.

[Chapter V]

Conclusion and Recommendation

The application software was only partially effective with respect to the modules which were operational. The Department continues to rely on manual controls which underutilises the possibilities that the system offers. Moreover, there existed many deficiencies due to non-utilisation of remaining modules.

Audit recommends that Government/Department may take early action to update/upgrade the software in a time bound manner rectifying the defects pointed out. The updating will be cost effective since it would generate additional recurring revenue to the exchequer.

Further, the system of monitoring and scrutiny merits a revisit as the selection of cases need to be risk-based with appropriate use of data available in the system across modules.

Chapter - I
General

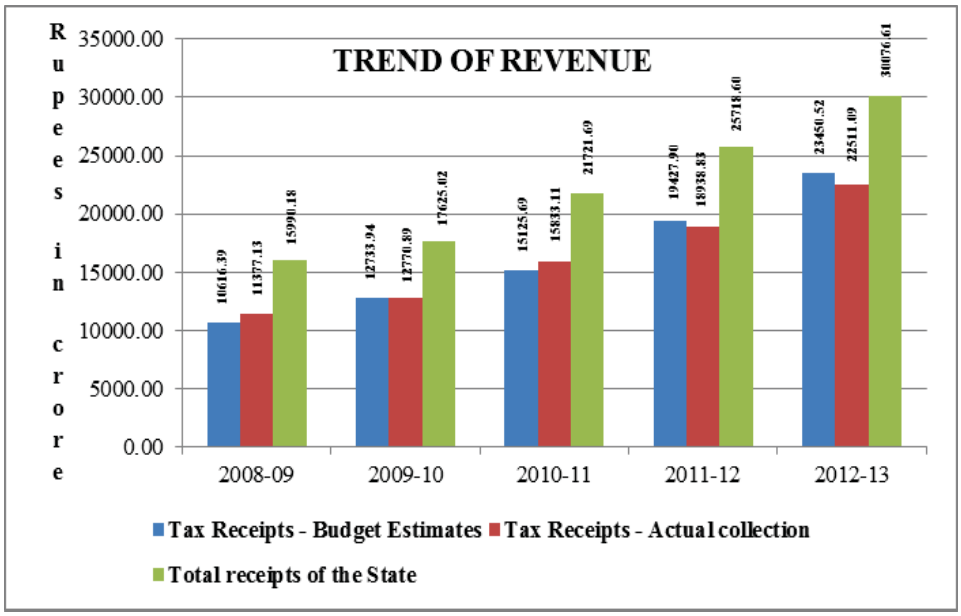
CHAPTER-I : GENERAL

1.1 Introduction

The Commercial Taxes Department contributes nearly 75 *per cent* of the tax revenue of the State through Kerala General Sales Tax (KGST), Kerala Value Added Tax (KVAT) and Central Sales Tax (CST) regulated by the Kerala General Sales Tax Act, 1963 (KGST Act), Kerala Value Added Tax Act, 2003 (KVAT Act), the Central Sales Tax Act, 1956 (CST Act) respectively and the notifications/circulars issued thereunder by the Government/Department from time to time.

1.2 Trend of receipts

The budgeted and actual receipts of tax on sales, trade etc., and the total revenue receipts of the State during the five years ended 31 March 2013 were as depicted below:



The revenue collected as KGST - levied on sale of ganja, opium, foreign liquor and certain petroleum products under the KGST Act, KVAT - levied on intrastate sale of commodities other than those mentioned above and CST - levied on interstate sales, during the last three years ended 31 March 2013 as recorded in Finance Accounts prepared by Principal Accountant General (A&E) Kerala were as detailed below:

Revenue head	(₹ in crore)			Increase in 2012-13 over 2011-12 (Percentage)
	2010-11	2011-12	2012-13	
Sales Tax	7,402.07	8,754.38	9,921.57	13.33
VAT	8,097.15	9,803.74	12,171.70	24.15
CST	310.42	292.66	320.88	9.64

During 2012-13 collection of VAT increased by ₹ 2,367.96 crore and that of sales tax increased by ₹ 1,167.19 crore.

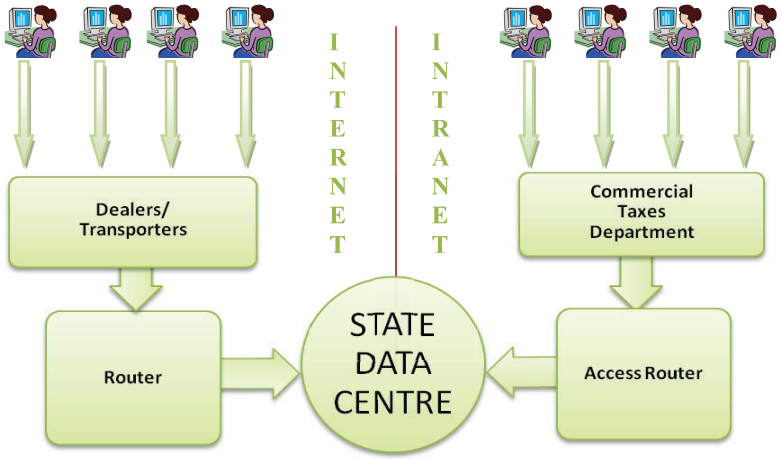
1.3 Kerala Value Added Tax Information System (KVATIS)

The Government of Kerala enacted the KVAT Act which came into effect from 1 April 2005. The work on project for the computerisation of commercial tax administration in Kerala (KVATIS) under the KVAT Act, was started during 2005-06 with the objectives to;

- develop a user-friendly IT solution for the effective and transparent tax administration with a view to maximise tax collection, reduce the tax evasion and corruption.
- simplify the procedures and deliver better services timely to the stakeholders.

The KVATIS software was developed, supplied and implemented by the Computer Maintenance Corporation (CMC) Limited. The scope of the project work entrusted to CMC included - design and development of the application to meet business requirements of the Department, provide appropriate hardware specifications and network design, testing, documentation and implementation. The system is based on industry standard three tier architecture (WEB) on J2EE Platform. The system is deployed on the Oracle 10g Application Server and Oracle 10g database engine as Relational Database Management System (RDBMS) with 12[1] Modules.

Diagram of architecture of the system



KVATIS is accessed through both Internet and Intranet. The Internet web based application for public interface is accessible to all registered dealers, transporters etc., through the website www.keralataxes.gov.in. The Intranet application is accessible only to the employees of the Department and is accessed through Wide Area Network (WAN). A unique role is assigned to each employee to access the KVATIS modules based on the nature of the work performed.

[1] Dealer Information System, Return Processing System, Checkpost Management System, Tax Accounting System, Enforcement and Raid System, Appeal and Revision System, Dealer Audit Assessment System, Penalty and Offences System, Arrear Recovery System, Refund System, Employees Information System, Kiosk and Web Enabled System

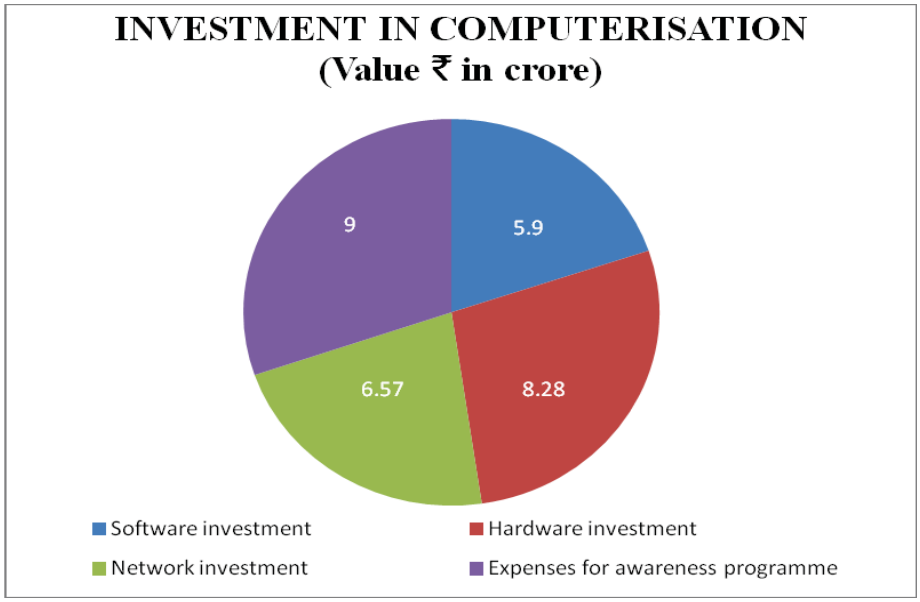
The application software became operational from 2007-08 in a phased manner. A chronology of important e-services introduced is given below:

Date of implementation	e-Services
January 2009	e-filing of Returns and uploading of lists of purchase/sales Invoices
September 2009	e-payment of Tax
January 2010	e-payment of Advance Tax
January 2010	e-consignment Declaration
April 2010	e-renewal of Registration, uploading of Closing Stock and Audited Statement
April 2011	Online registration

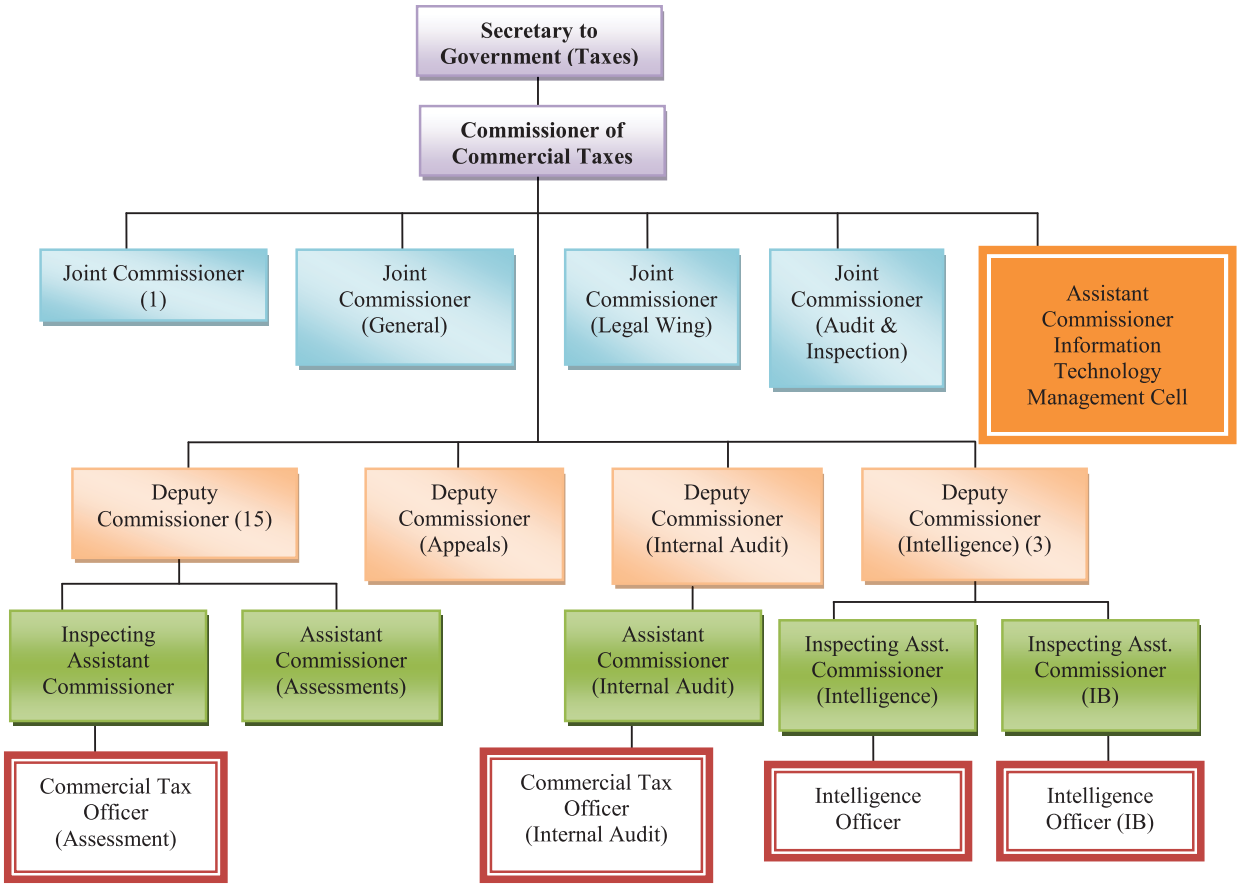
The Department has so far (March 2014) fully operationalised only three modules namely, Dealer Information System, Return Processing System and Checkpost Management System. The modules such as Enforcements and Raids system, Tax Accounting System, Employee Information System etc., were only partially used/made operational. The KVATIS also capture the data relating to e-filing of returns and e-payments under the KGST Act.

1.4 Expenditure incurred for computerisation

The details of expenditure incurred on the project as on March 2010 (Appendix) is shown in the chart below:



1.5 Organogram



The Department is under the administrative control of the Secretary to Government, Taxes Department. The Commissioner of Commercial Taxes administers the Acts and Rules. Department constituted the Information Technology Management Cell (ITMC) for the implementation of the KVATIS project, headed by an Assistant Commissioner, assisted by three Commercial Tax Officers and two Upper Division Clerks. One System Administrator each was also deployed in all districts to help district level implementation. The data required for audit were obtained from ITMC.

1.6 Audit Objectives

Audit was taken up to ascertain whether;

- the system has achieved the intended objectives like;
  - transparency in tax administration with maximisation of tax collection
  - reduction in tax evasion
  - support the business processes and ensure compliance with the applicable rules and regulations

- the input processing and output controls are adequate to ensure the integrity of data
- the database provides sufficient, complete, reliable and authorised information for management action.

1.7 Audit Criteria

Implementation of the KVATIS, data management and monitoring were examined with reference to;

- Guidelines on development of e-governance applications.
- Standard application development and implementation methodology.
- The Central Sales Tax Act, 1956 (CST Act, 1956)
- The Kerala Value Added Tax Act, 2003 (KVAT Act, 2003)
- The Kerala Value Added Tax Rules, 2005 (KVAT Rules, 2005)
- Notifications/Government Orders issued from time to time.

1.8 Scope and methodology of Audit

The audit was conducted from February to December 2013 by collecting the computerised data from the ITMC. The entire data in the system for the period April 2008 to May 2013 was extracted from the centralized data and analysed using the IDEA[2] software. The details of audit examination were made available to the Department for necessary action. Sample records were cross-verified to corroborate with the findings from data analysis.

1.9 Interaction with the Government/Department

A discussion was conducted with the Department and Oracle dump data of KVATIS as on date certified by the Department was collected on 22 May 2013. An exit meeting was conducted on 3 April 2014 with the Secretary to Government (Taxes) and the Commissioner of Commercial Taxes and the findings of the Audit were discussed in detail. The views of Government/ Department were considered while finalising the Report.

A Compact Disc containing assessing office wise findings were given to the Department/Government in March/April 2014. CD containing the results of field verification of individual cases has also been furnished to Department/ Government in July 2014. Hence separate detailed appendixes are not included in the Report.

1.10 Acknowledgement

Audit acknowledges the co-operation extended by the Commercial Taxes Department for providing necessary information and inputs required for preparation of the Report.

[2] Interactive Data Extraction and Analysis

Chapter - II
Dealer Information System

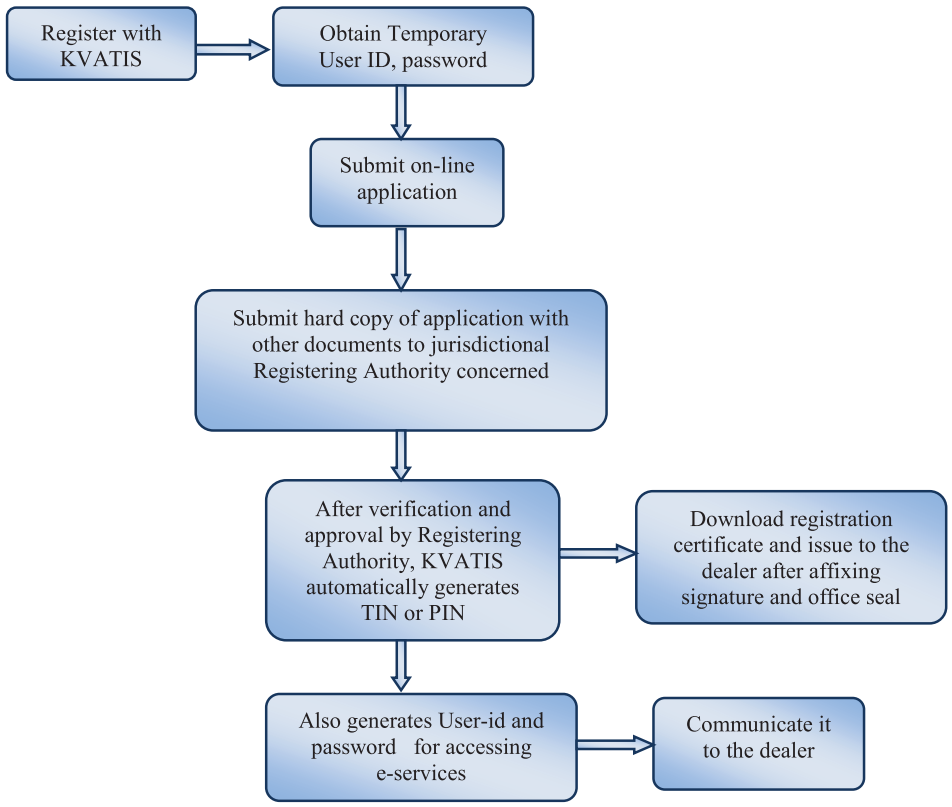
CHAPTER-II : DEALER INFORMATION SYSTEM

2.1 Introduction

A unique registration number to identify a dealer and to trace all his transactions is the foundation of the VAT system. The assessing officer (Commercial Tax Officer/Assistant Commissioner) in charge of the Circle Office is the authority to grant/renew/revoke the registration. Dealer Information System (DIS) Module in KVATIS helps the assessing officer to manage various aspects of the registration, viz., initial registration, yearly renewal, collection of fees and security, cancellation, suspension etc. As there are three types of dealers under KVAT Act, 2003 and CST Act, 1956 KVATIS allots three types[1] of registration numbers.

2.2 Process automation

The Department has provided the facility for e-renewal of registration from April 2010 and introduced online facility for submission of application for registration from 01 April 2011. The process of on-line registration is as depicted below:



[1] (i) Tax Payers Identification Number (TIN) – allotted to dealers paying tax under Section 6(1) and 8 of the KVAT Act, 2003. (ii) Presumptive Tax Payers Identification Number (PIN) – allotted to dealers who are not importers or first sellers and opt to pay tax at concessional rate where the annual turnover is below ₹ 50/₹ 60 lakh under Section 6(5) of the KVAT Act 2003. (iii) Central Sales Tax Number (CST) – allotted to TIN dealers registered under CST Act, 1956 who undertake interstate transactions.

2.3 Registration

2.3.1 Registration of new dealers

Fifth proviso to Section16 (1) of KVAT Act stipulates that a person shall not be entitled for more than one registration under the Act from 01 April 2007.

As per Section 2(xxxiii) of the Act, person includes, (a) an individual; (b) a joint family; (c) a company; (d) a firm;(e) an association of persons or a body of individuals, whether incorporated or not; (f) the Central Government or the Government of Kerala or the Government of any other State or any department thereof or a Union Territory in India; (g) a local authority; (h) every artificial juridical person not falling under any of the preceding sub clauses.

The system deficiencies noticed in the DIS module regarding the registration are discussed in the succeeding paragraphs.

2.3.2 Multiple Registrations

The statutory ID available to identify a person in the system is the Permanent Account Number (PAN) issued by the income tax authorities. Audit extracted PAN details, furnished by the applicants for the registration under KVAT Act and found that multiple registrations ranging from two to eighteen were permitted by the system against a PAN as detailed in Table 1 below. The system did not record whether multiple registrations were duly authorized as per relevant clauses of the KVAT Act. It was also noticed that in some cases single PAN was used by different individuals for registrations.

Table 1: Details of multiple registrations against single PAN

Nature of Registrations	No. of persons to whom multiple registrations granted	No. of registrations allowed
TIN	2,238	4,681
PIN	1,786	3,827
Total	**4,025**	**8,508**

On this being pointed out, Government replied (April 2014) that as per Section 20(3) of the KVAT Act, Commissioner may, on application by the dealer, treat each of such places of business as a separate unit for the purposes of levy, assessment and collection of tax, as if, such places of business were a separate unit, and hence same business entity is permitted to take multiple registrations; in such cases even though the TIN is different PAN is unique, and pointed out specific instances where multiple TINs were issued against single PAN.

However, there were no controls in the system to ensure that only genuine registrations are permitted and the Government had not specified whether all the multiple TIN registrations pointed out were granted under Section 20(3) of the KVAT Act. Further, the reply was silent on the usage of single PAN by different individuals for obtaining registration.

The Government also stated that the suggestion to include a rule into KVATIS to allow unique PAN for every registration shall be factored while systematically allowing on specific permission, multiple registration on single

PAN in genuine verified cases. It was also stated that PAN validation has now been done.

2.3.3 Risk of non-mapping of business rule on multiple registration

As per Section 20(4), dealers who were granted multiple registrations are liable to pay tax if their combined turnover crosses the threshold limit of ₹ 10 lakh for TIN dealers. Further, Section 20(3) restricts the Commissioner from granting multiple registrations to Presumptive Tax paying Dealers[2]. Audit analysed the multiple registrations and found that non-mapping of the above provisions properly into the system enabled the dealers to keep their turnover below the threshold limit and evade tax as discussed below:

2.3.3.1 TIN dealers evaded the tax liability by keeping the turnover against each registration below ₹10 lakh

Under the Act every dealer whose total turnover for a year exceeds ₹ 10 lakh shall pay tax at the rates prescribed in the schedules (Section 6(1)). Dealers are not entitled for more than one registration vide proviso 5 of the Section 16(1) of the Act**.** Based on application, Commissioner can treat each places of business as a separate unit for levy, assessment and collection of tax (Section 20(3)) and permit more than one registration. In such cases each place of business shall be liable to tax irrespective of the turnover provided the combined turnover exceeds ₹ 10 lakh. Audit observed that non mapping of business rules as stipulated in Section 20(4) of the Act into the application enabled the TIN dealers in evading tax by spreading over their turnover.

Audit extracted details of registrations and it was noticed that 270 TIN registrations were granted against 120 PAN enabling the dealers to keep their total turnover below ₹10 lakh, whereas the combined total turnover of a single dealer crossed the threshold limit of ₹ 10 lakh.

An illustrative example is given below:

PAN	TIN	Year	Turnover (₹)	Office
ABIPJ7008E	32150832175	2011	9,41,647	CTO, Angamaly
ABIPJ7008E	32150880472	2011	9,86,428	
			19,28,075	

To confirm the existence of multiple registrations under a single PAN, Audit subsequently verified (May 2014) the manual records with MIS report "Dealer complete details" in KVATIS and found that 74 TIN existed against 36 PAN. Non levy of tax in 110 assessment files in respect of the above 74 TIN worked out to ₹ 0.70 crore.

[2] Small and medium dealers who opt to pay tax at concessional rate of 0.5 *per cent* (sales turnover up to ₹ 60 lakh) under Section 6(5).

Further, as the dealers took multiple registrations and avoided payment of tax, penalty under Section 67[3] should have been imposed on them. The maximum penalty leviable worked out to ₹ 1.09 crore.

Government replied (April 2014) that if the combined turnover crosses the minimum turnover mentioned in Section 6, the assessing authority shall verify the books of accounts and complete the assessment manually. The Government also questioned the validity of the finding and integrity of analysed data. The matter was re-examined in audit and no data integrity issues were observed. The reply itself indicated that the KVATIS could not operate without combining with manual verification. Further, the system had no provision to capture the result of such manual verification.

Audit cross verified the details of assessments pointed out and found that the self assessment were not reopened in any of the 110 files of 74 dealers.

2.3.3.2 The Presumptive tax paying dealers continue to pay tax at presumptive rate by keeping the turnover below the limit of ₹ 50 lakh/₹ 60 lakh per year

As per Section 6(5), a registered dealer who is not an importer[4] or other dealers specified therein and whose turnover is below ₹ 50 lakh/₹ 60 lakh may pay at his option tax at the rate of half *per cent* of the turnover of sale of taxable goods as presumptive tax instead of paying tax under Section 6(1).

Audit observed that 31 PIN registrations were granted against 15 PAN and that the turnover of each such registration being below ₹ 50 lakh/₹ 60 lakh during the years, those dealers were treated as presumptive dealers, though their aggregate turnover on each PAN, exceeded the threshold limit of ₹ 50 lakh/₹ 60 lakh. Section 20(3) of the KVAT Act restricts the grant of multiple registrations to presumptive dealers. This provision was not mapped to the system and hence the system wrongly admits payment of presumptive tax, where the turnover of the dealers crossed the threshold limit.

Government replied (April 2014) that the point raised is not valid as the data mining team of the Department has already reported the cases of presumptive dealers whose turnover crossed the threshold limit to the assessing authority for taking necessary action.

However, the justification of the Department is not valid as the re-examination (May 2014) in audit revealed that the cases pointed out were not reported by the data mining team for rectification. Regarding grant of 31 registrations against 15 PAN, the findings were from the database as on 22 May 2013. Audit verified the live data of the KVATIS of May 2014 and found 8 TIN issued against 4 PAN.

It was also found that no assessments were completed in the 14 assessment files relating to the above 8 dealers with resultant short levy of tax including interest therein amounting to ₹ 1.02 crore.

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[3] Under Section 67 of the KVAT Act, a penalty not exceeding twice the amount of tax evaded or sought to be evaded is leviable for offences specified in the Act

[4] Person who obtains or brings goods from any place outside the State or country

Further, as the dealers minimised the payment of tax taking multiple registrations, penalty under Section 67 is also leviable; which worked out to ₹ 1.56 crore.

2.3.4 Renewal of registration

2.3.4.1 Non renewal of registration

As per Section 16(7), a certificate of registration issued shall be valid for a year and shall be renewed from year to year on payment of the fee of ₹ 500 in case of KVAT dealers and additional ₹ 1,000 for dealers having CST registration. The details regarding registration, cancellation and renewal during the period 2009-10 to 2012-13 are as described below:

Table 2: Yearly statistics of registration, cancellation and renewal/non-renewal of registration under KVAT Act

Year	Registered Dealers as on 1 April	No. of dealers registered during the year	No. of dealers cancelled their registration during the year	No. of live dealers as on 31 March (To be renewed next year)	No. of dealers renewed their registration next year	No. of dealers failed to renew their registration
1	2	3	4	5 (2+3-4)	6	7 (5-6)
Upto 2009-10	2,13,572 (upto 31 March 2010)		34,865	1,78,707	1,54,551	24,156
2010-11	1,78,707	20,207	9,106	1,89,808	1,64,592	25,216
2011-12	1,89,808	22,102	8,365	2,03,545	1,74,951	28,594
2012-13	2,03,545	23,565	8,242	2,18,868	1,69,992	48,876

Table 3: Yearly statistics of registration, cancellation and renewal/ non-renewal of registration under CST Act

Year	Registered Dealers as on 1 April	No. of dealers registered during the year	No. of dealers cancelled their registration during the year	No. of live dealers as on 31 March (To be renewed next year)	No. of dealers renewed their registration next year	No. of dealers failed to renew their registration
1	2	3	4	5 (2+3-4)	6	7 (5-6)
Upto 2009-10	64,346 (up to 31 March 2010)		3,190	61,156	60,620	536
2010-11	61,156	7,368	81	68,443	55,971	12,472
2011-12	68,443	8,424	113	76,754	64,493	12,261
2012-13	76,754	9,113	717	85,150	72,594	12,556

Audit found that the system permits transactions by the dealers who have not renewed their registration. It was noticed that 3,979 dealers who had not renewed their registration had effected interstate transactions. Further, 953 dealers filed return for their transactions during the non-renewed period and 1,946 dealers had effected sales to other registered dealers. Non-renewal of registration by such dealers in each year resulted in short collection of renewal fee of ₹ 0.74 crore[5].

[5] Calculated @ ₹ 1,500 per renewal per year in case of 3,979 dealers who had effected interstate transactions and @ ₹ 500 per renewal per year in case of 2,899 dealers

In cases where the dealers failed to renew their registration, notices should have been generated by the system. Absence of this process control in the system indicated that business rules in this regard have not been mapped in the system properly.

On this being pointed out, Government stated (April 2014) that the audit point is not valid as there are various alerts in the system to prevent transactions like filing of returns/interstate trade by a dealer who failed to renew his registration.

This statement is not correct as the cases mentioned above were from the database provided to audit. This issue is still persisting. Audit re-verified (May 2014) the live data in KVATIS in respect of 16 dealers and found that they had not renewed their registration though they effected interstate transactions and failed to file return/pay tax.

2.3.4.2 System allows cancelled dealers to renew their registration

As per Section 16(7), the registration is valid for a year and shall be renewed yearly on payment of fee of ₹ 500 in the case of KVAT dealers and ₹ 1500 is the case of CST dealers. There is no provision in the statute for renewal of registration of dealers who cancelled their registration. A dealer whose registration is cancelled should obtain a fresh registration.

Out of the 2,79,446 registered dealers under KVAT Act (as on 31 March 2013) 60,578 dealers cancelled their registration. Audit found that 768 dealers who cancelled their registration renewed it without fresh application for registration. Out of this, 420 dealers are still in the list of live dealers (for the year 2013-14). This shows that the system does not have an inbuilt process control to prevent the renewal of cancelled registration.

On this being pointed out Government stated (April 2014) that some dealers were permitted to keep their registration live in order to download statutory forms against previous purchases or to submit annual return, closing stock inventory etc. The reply is not acceptable since these cancelled dealers not only have access to the system to download statutory forms, but could also renew their registration and were permitted to continue their business.

2.4 Security deposit for registration

2.4.1 Non renewal/revalidation of security instruments

As per Section 17 of the KVAT Act, 2003, registration shall be granted only against furnishing adequate financial security to protect the interest of revenue considering the volume of the business of a dealer. Rule 19(2) of KVAT Rules provides that security may be furnished in any of the form such as deposit with treasury, Government securities, Post Office Saving Bank Deposit, Bank Guarantee, National Savings Certificate pledged and deposited with the authority. A Bank guarantee cannot be invoked if the same is not renewed on expiry of validity period. As such the system should alert the authorised officer and generate notices to the dealers whose Bank Guarantee had expired.

An extraction and analysis of data revealed that the validity of the Bank Guarantee furnished by 395 dealers aggregating to ₹ 3.49 crore had expired and the system permitted transactions by such dealers.

This indicates that necessary process controls were not built into the system to ensure the detection and timely renewal of expired Bank Guarantee.

On this being pointed out Government stated (April 2014) that receipts of bank guarantee are entered in the security register maintained in the assessing circle and renewal are done manually.

The reply is not acceptable as the data regarding validity of bank guarantee is available in KVATIS itself, the Department could have utilised this system controls instead of manual controls.

2.5 Conclusion

Audit found that the Dealer Information System Module lacks in certain aspects:

- The system does not indicate whether the multiple registrations were duly authorised by the competent authority as provided under the Act.
- The risk of tax evasion by dealers having multiple registrations by keeping turnover under each registration below the threshold levels was found to be significant.
- The KVATIS allows dealers to transact business without renewing the registration and after cancellation of registration.
- The validity of Bank guarantee furnished as security for registration by many dealers though expired were not revalidated. This is not identified by the system for taking corrective action.

2.6 Recommendations

- ❖ Business Rules regarding registration may be mapped properly to avoid acceptance of multiple registrations by the system unless specifically permitted by Commissioner of Commercial Taxes under Section 20(3).
- ❖ The system be updated to cover the risk of tax evasion by dealers having multiple registration, working out their aggregate turnover as specified in Section 20(4) of KVAT Act
- ❖ Department may conduct periodical analysis of dormant registration numbers, other than application for temporary stoppage of business (vide Section 16), and take timely action for issuing notices for renewal or otherwise cancel the registration of dealers who had no business transactions for more than two years, to avoid misuse of Registration Certificate.
- ❖ System should generate appropriate alerts for renewal of Bank guarantees before its date of expiry and while dealers are effecting transactions.
- ❖ Necessary modifications may be made to the system to adequately capture the results of manual verification done by Assessing Officers.

Chapter - III
Check Post Management System

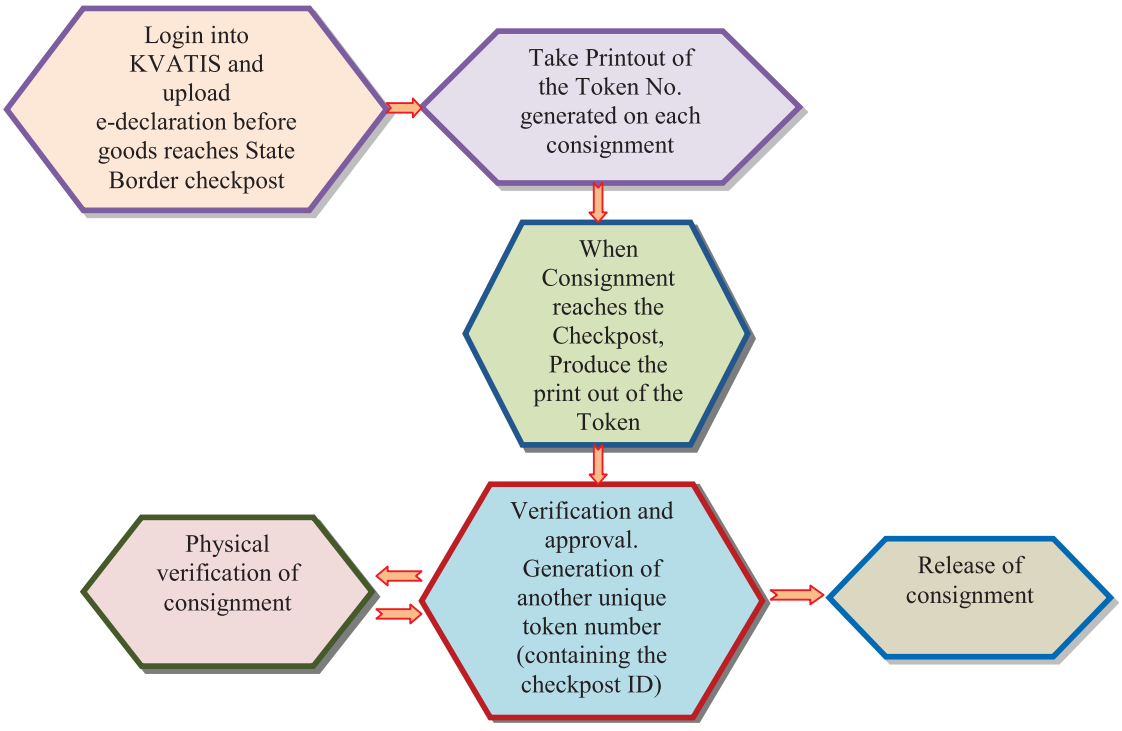
CHAPTER-III : CHECKPOST MANAGEMENT SYSTEM

3.1 Introduction

The Commercial Taxes Department has established checkposts along the borders of the State for monitoring the movement of goods into and outside the State. These are managed by Inspecting Assistant Commissioner/ Commercial Tax Officer/Commercial Tax Inspectors. The Checkpost Management System (CPMS) module in the KVATIS captures the details of goods purchased/sold and stock transferred into and outside the State by registered dealers, etc.

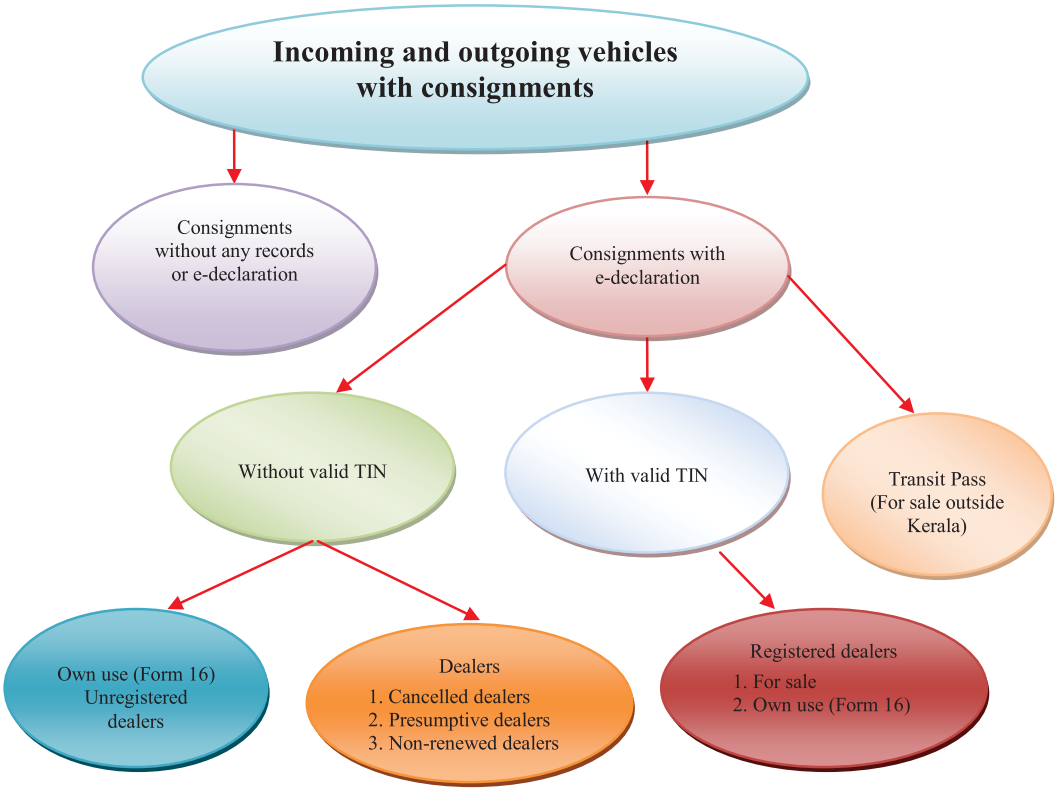
3.2 Process automation

There are 76 checkposts in the State, out of which only 36 are provided with online Wide Area Network (WAN) connectivity. The data regarding transactions through offline checkposts are uploaded to KVATIS from the nearest online office in the same week. Since 2010, the Department introduced a new system - 'e-declaration of consignments' (in Form No.8F), on interstate transfer of goods. This provides system information to the Department about the consignments arriving at the checkposts, enabling speedy clearance. The following diagram depicts the process of e-declaration.



The most important control in e-declaration is the 'second token system'; which identifies the person who transports the goods; the commodity transported in the vehicle and the checkpost. It helps the assessing officers spread all over the state to identify the dealer wise details of interstate transfers in VAT assessment.

The flow chart of the checkpost transactions are given below:



The year-wise details of token generated for inward and outward vehicles are as shown below:

Year	No. of tokens Generated (IN)	No. of tokens Generated (OUT)
2008-09	6, 07,979	1,85,862
2009-10	6,65,081	1,98,763
2010-11	7,07,916	4,49,401
2011-12	9,99,025	5,76,237
2012-13	18,33,802	7,56,351

3.3 Non-mapping of business rules for Token generation

As per Section 8 of CST Act, a registered dealer can purchase taxable goods from outside the State at concessional rate and transport it into the State for trading. If the dealer's principal place of business is outside the State or if he is acting as an agent of a principal dealer outside the State, then that dealer can also transfer the goods into the State for trading (Section 6A of CST Act).

Under Section 47(2) of the KVAT Act, if the goods under transport are not covered by proper and genuine documents or that any person transporting the goods is attempting to evade payment of tax, the same shall be allowed to be transported only on furnishing of security deposit at double the amount of tax likely to be evaded as estimated by the Officer.

As per Section 16(7), a certificate of TIN registration issued shall be valid for a year and shall be renewed from year to year on payment of the fee. If a

dealer fails to renew his registration in any year, he should be considered as an unregistered dealer and shall not be eligible for the concessional rate of tax for interstate transactions and transport of goods through checkpost without remitting security.

The KVATIS system is expected to map the above business rules. It should have an inbuilt control mechanism to give an alert to the authorities, on a non-renewed/cancelled dealer trying to generate a token for interstate transportation of goods. It should also generate a demand notice for collection of security deposit from the errant dealers.

The system deficiencies noticed in the CPMS module are discussed in the succeeding paragraphs.

3.3.1 Interstate transactions of dealers whose registrations were not renewed

Due to the absence of proper system for detection of transaction using non-renewed TIN; goods worth ₹ 2,029.57 crore were transported into the State by 3,979 dealers during 2010-11 to 2012-13, without collecting security deposit.

Audit analysed the risk in allowing non-renewed dealers effecting interstate transactions by cross verifying their transactions with the returns filed and cases of non-reporting of interstate purchases were noticed during analysis. Two illustrative cases are shown below:

TIN	Year to which the registration was not renewed	Token Number	Value of goods transported (₹)	Interstate purchase declared in returns
32070235994	2010-11	320310/2010-11/ 7629	12,12,695	Nil
32010805314	2012-13	320117/2012-13/ 4474	57,12,000	Nil

On this being pointed out, Government stated (April 2014) that assessing authorities are provided with Management Information System (MIS) reports to identify the defaulters in filing returns having checkpost transactions. Additional demands can be created by them using this data. Short-levy worked out by audit requires verification of individual cases and hence not sustainable.

The reply is not acceptable as audit found that self-assessments in respect of 59 assessment files[1] relating to 55 dealers who failed to renew their registration were not reopened though they failed to report their interstate transactions. Short levy of tax in this regard works out to ₹ 4.37 crore. Out of these, audit cross verified (May 2014) 16 cases with the live data available in KVATIS and found that in all the cases the dealers failed to file the return and pay tax on the sales turnover of goods purchased interstate. The resultant short-levy of tax in the 16 cases worked out to ₹ 1.67 crore. This shows that assessing authorities are not taking proper action based on MIS reports. Hence, the system should be modified to detect and generate notices on the

[1] Where tax effect is greater than rupees one lakh

interstate transactions effected by the dealers who have not renewed their registration.

Further, dealers who have not renewed their registration were effecting interstate transport of goods leading to evasion of tax. However, security deposit as stipulated in the Act had not been collected in the checkpost. Non-collection of security deposit from these 55 non-renewed dealers is worked out to ₹ 7.89 crore.

3.3.2 Interstate transactions of dealers whose registrations were cancelled

Absence of proper system for detection of transaction using cancelled TIN resulted in irregular release of 1,605 consignments of 184 dealers without collecting security deposit. Audit analysed the risk in allowing cancelled dealers effecting interstate transactions by cross verifying data on interstate transactions with information as per returns filed. Instances were noticed where dealers failed to report their interstate purchases. Two illustrative cases are shown below:

Sl. No	TIN	Name of the dealer	Date of cancellation	Reason for cancellation	Token Number	Date of transporta-tion of goods	Value of goods (₹)
1	32070292143	JT.INTERNATIONAL (WHOLESALE) INDIA PVT LTD.	28.03.2011	Business stopped	320921/ 2011-12/ 65718	05.09.2011	3,41,198
2	32071739062	BIOTECH SCIENTIFIC	25.03.2010	Business stopped	320921/ 2012-13/ 303007	29.08.2012	1,32,487

On the risk being pointed out, Government stated (April 2014) that in cases of *suo motu* cancellation of registration by assessing authorities, the cancellation could be revoked later by appellate/revisional authorities on application by the dealers concerned, the process of filing appeal/revision and disposal of which were purely manual. Further, it was stated that in cases of transaction by cancelled dealers, checkpost authorities and data mining wing were given facility to view the checkpost transactions of cancelled dealers so that the authorities can initiate statutory measures.

The controls pointed out in the reply is not adequate since audit found that in spite of these precautions, there were 153 dealers (178 assessment files) who effected interstate transactions, even after cancellation of registrations. Even if the registration was restored by appellate authorities, the dealers had the liability to report and pay tax on their interstate transactions. On analysis audit found that no returns were filed by these assessees. Short-levy of tax including interest would work out to ₹ 0.45 crore.

Since cancelled dealers were transporting goods interstate and evading payment of tax, in order to protect the revenue, the department should collect the security deposit at the checkpost for interstate transactions effected by dealers whose registrations were cancelled treating it as a transaction made by an unregistered dealer. Non-collection of security deposit from 153 cancelled

dealers, whose tax liability of goods transported into the state is above rupees one lakh, worked out to ₹ 0.69 crore.

Audit rechecked (May 2014) 22 cases (12.23 *per cent*) with reference to the live data in KVATIS at the assessing offices and found that dealers did not file any return and thus sales turnover of goods purchased interstate was not assessed to tax. Thus, the controls stated by the Department were not effective.

3.4 Lack of processing/validation control against master files

3.4.1 System allows transport of consignments into the state by dealers without a valid TIN

TIN is used to track all the transactions of a registered dealer. TIN, the identification number allotted to a registered dealer is an eleven digit number, which is unique all over India. The first two digits identify the State. Thus, '32' is allotted to Kerala dealers.

The system should have the input controls to ensure that the data entered are valid, complete, accurate and properly authorised. Lack of input control by the system results in goods being transported, purchased/ stock transferred, into the State without declaring their TIN or declaring a defective TIN[2] at the Checkpost as detailed below:

Year	No. of entries made into the State without declaring a valid TIN	Value of goods transported (₹ in crore)
2010-11	14,328	496.70
2011-12	3,15,236	2,577.04
2012-13	5,17,118	3,332.59

Inability of the system to process/validate the data without a valid TIN resulted in non-payment of tax and interest of ₹ 171.51 crore[3] on 2095 assessment files.

To curtail the evasion of tax, the system should alert and generate a demand for security deposit to be collected at the checkpost from the dealers who fail to declare their valid TIN. Non collection of security deposit on the above files worked out to ₹ 308.57 crore.

Government stated (April 2014) that in case the documents are defective, the checkpost officials detain the vehicle and demand security deposit. Since this is a manual process the short collection of revenue can be ascertained only after verifying the Offence Register (OR) maintained at checkpost. During the Exit Conference (April 2014) the Secretary, Taxes Department assured that necessary business rules will be built into the system to block the consignments brought into the state not for own use by unregistered dealers.

The effectiveness of manual controls pointed out in the reply is not adequate since audit analysed the details of consignments on which release order was

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2 TIN without mandatory eleven digits.

3 Dealers excluding Government departments and PSUs and those dealers having tax liability of more than rupees one lakh for the interstate transaction effected without a valid TIN.

issued without compounding[4] any offence. Audit visited two major checkposts, CTCP Walayar and CTCP Amaravila that covered 69.70 *per cent* of the cases. It was found that the security deposit were collected for other offences like overload, difference in commodity transported etc and Token number which is the unique recognition number for transport of goods were not mentioned in the OR maintained. Moreover, the department admitted that the total security deposit collected for all the offences in the State for the above three years were ₹ 109.52 crore only whereas the security deposit to be collected for above said cases alone comes to ₹ 308.57 crore. Lack of proper controls in the system enabled transport of goods into the state without furnishing valid TIN.

3.4.2 System allows irregular claim of concession for Inter State sales effected to unregistered dealers

Section 3 of CST Act provides that a sale or purchase of goods shall be deemed to take place in the course of interstate trade if the sale or purchase occasions the movement of goods from one state to other or is effected by a transfer of documents of title to the goods during their movement from one state to another. Section 8(1) of the Act provides that, if the sale is to a registered dealer outside the state, a dealer can claim concessional rate of tax for that sale provided the dealer should produce valid C Form issued by that registered dealer. If movement of goods from one State to another occasioned as a result of an anterior contract of sale, then it is an interstate sale. There must be an inextricable link between movement of goods and prior order. As such, a dealer effecting interstate sale to a registered dealer outside the State would be aware of the details of the dealer.

Audit found that 977 dealers effected interstate sale to dealers having invalid TIN. This means that the dealers were not aware of the registration details of the purchasing dealers even at the time of transport of goods outside the State. As there was no inextricable link between movement of goods and prior order by a registered dealer outside the State in the aforesaid case, tax shall be levied at full rate for such interstate sale. Audit noted that self-assessments were not reopened in respect of 1,276 assessment files of the above 977 dealers, that tax to the tune of ₹ 192.57 crore was paid short by availing inadmissible concession. Penalty under Section 67 also should be imposed. Maximum penalty to be imposed would come to ₹ 316.52 crore. Two illustrative cases are shown below:

Token Number	Year	Consignor TIN	Consignee TIN	Value of goods transported Out of State (₹)
320921/2011-12/ 516576	2011-12	32071694602	Nil	2,05,221
320921/2011-12/ 161434	2011-12	32150304235	Nil	1,30,949

[4] 'Compounding of offence': Section 74 of KVAT Act allows registered dealers to legalise their irregular transactions, paying an additional amount equal to the tax evaded as penalty. This process is termed as 'compounding of offence'.

Lack of necessary input controls in the system, for detecting interstate sale to a consignee without TIN or to an unregistered dealer, enabled dealers to claim concessional rate for their interstate sale which was not due to them.

On this being pointed out, Government stated (April 2014) that at the time of assessment the assessing officer will allow the concessional rate only on production of statutory forms. Hence without verifying the details of assessment records the actual short levy could not be ascertained.

Audit verified (May 2014) 35 cases with the returns filed along with the checkpost transactions and found that in all the cases dealers effected interstate sale to unregistered dealers and availed concession for that sale resulting in short-levy of tax of ₹ 5.10 crore. Thus, the justification of the Department about manual controls is not acceptable.

3.5 Inadequate process control - Lack of integration between modules

3.5.1 Interstate purchase/stock transfer of goods short/non-reported

If a dealer purchases or stock transfers goods from outside the State and transports it into the State by declaring it at any of the checkposts, he should disclose that transaction through his periodical return and tax shall be paid on the sale of such goods within the State. He should also account it in his P&L Account and submit the copy of the certified Annual Accounts to the assessing authority.

Lack of application controls enabling cross-linkage of the checkpost transactions with information submitted in the returns allowed dealers to short report/short account interstate purchase/stock transfer in their returns filed.

Two illustrative cases noticed are shown below:

(₹ in lakh)

TIN	Year	Total value of goods transported (IN) to the State	Total Interstate transaction (IN) returned/ accounted	Short reporting of Interstate transaction (IN)
32070381682	2012	53,013.59	6,089.36	46,924.22
32151597344	2011	2,519.17	2,426.47	92.70

On analysis of electronic data audit could identify 1,581 cases involving a tax effect of ₹ 1,559.55 crore due to short reporting of interstate transactions.

Penalty under Section 67 should also have been imposed. Maximum penalty to be imposed works out to ₹ 2,572.44 crore.

On this being pointed out, Government stated (April 2014) that estimation of short levy based on assumption is not fair and reasonable. There is already a manual control in which short reporting of transactions can be detected during the process of scrutiny. At the time of return scrutiny the Assessing authority is provided with a number of options in the KVATIS to verify the veracity of the returns filed by the dealer. If any unaccounted transactions are detected by assessing authorities, assessment will be completed based on best judgement creating additional demand and it is a manual process.

The reply is not acceptable as the coverage of this manual control (scrutiny) in terms of percentage of assessments scrutinised may be low and a significant proportion of cases would remain undetected.

Further, Audit re-verified (May 2014) 46 cases with reference to returns and checkpost transactions available in KVATIS and found that in 11 cases invalid data was recorded in column concerned and in 35 cases dealers failed to report the entire interstate purchases effected by them resulting in short-levy of tax of ₹ 288.41 crore. Department/Government may take effective action to verify the remaining cases.

This indicates that the inherent risk of relying on manual scrutiny of returns instead of relying on the strength of an automated system where the information available across different modules of KVATIS will help prioritize files for scrutiny. Hence necessary controls needs to be built-in the system and to integrate the checkpost module with the return processing module.

3.5.2 Non-surrender of Transit Passes

Under Section 48 of the KVAT Act and Rules thereunder, transport of goods through the border checkposts that are not to be unloaded in Kerala should be accompanied by a transit pass in Form 7B. This pass should be issued by the entry checkpost and has to be surrendered at the exit checkpost. In case of failure to surrender the transit pass at the exit checkpost, the goods which are transported into the State through the entry checkpost should be treated as the goods delivered within the State for sale and are liable to tax under this Act.

The system should provide information about the non-surrendered transit pass to authorities including the intelligence wing of the department and alert them to track the vehicle.

An extraction and analysis of data for the period from 1 April 2012 to 22 May 2013 revealed that out of the 13,146 transit passes issued surrender details of 3,534 (27 *per cent*) cases were not available in KVATIS, which had a tax implication.

On this being pointed out, Government stated (April 2014) that out of 83 checkposts, only 29 have online access to KVATIS. Hence, if the vehicles entered into State through online checkposts and exit through offline checkposts, the details would be entered in the manual register maintained at the exit checkpost. Therefore, the short levy alleged is not correct. Government also stated that the system now generates alert messages to the checkposts, to detain vehicles which have not surrendered online transit pass on previous occasion.

The Department's reply on existing manual controls exercised at checkposts was cross verified at four major checkposts[5] where goods in respect of 2046 cases out of the 13146 transit passes referred to in the observation above should have exited. Verification of the manual registers showed that only 674 transit passes were recorded as surrendered. The reply of the department is therefore not acceptable and tax implication on non surrender of transit passes could not be ruled out.

3.6 Use of risk management system

3.6.1 Release of consignments brought by registered/unregistered dealers for own use without verification of genuineness

As per Section 46(3) of the KVAT Act, goods for own use can be transported through checkposts on the strength of certificate of ownership and Rule 58(18) of the KVAT Rules, 2005, stipulates that every person other than a registered dealer who brought in goods not in pursuance of a sale shall furnish a certificate of ownership in Form-16. The facility of transporting goods for own use except capital goods were extended to registered dealers also, vide Circular No.14/2007. The statute (Section 70B) provides for penalty (not exceeding three times of tax due on such goods) for commercial use of goods brought from outside the State declaring it as for own use.

The extraction of data relating to release of consignments for own use revealed that both registered and unregistered dealers brought substantial volume of taxable goods into the State by furnishing Form 16 at checkposts. An illustration of aggregating similar consignments each time as for own use is given below:

Consignee TIN	Name of the consignee	Frequency	Nature of goods	Value of Commodity (₹)
32130275782	New Western Saw Mill	114 times	Timber	4,99,70,720
Unregistered	Southern Batteries Private Limited	4 times	Bars - Lead	59,178,739

Audit extracted the details of transport of bulk quantities of taxable goods such as paint, toothpaste, medicines, medical and surgical equipments, cosmetics, computer peripherals, batteries, plastic granules etc. by registered dealers and found that 399[6] registered dealers transported bulk quantity or transported same goods repeatedly (six times or more in a year) into the state, stating as for own use. The total value of such goods comes to ₹ 117.02 crore.

[5] Walayar, Wellingdon Island, Aryankavu and Amaravila
[6] Commodity value above ₹ Five lakh

Similarly, 178[7] unregistered dealers transported goods of value above ₹ 10 lakh into the state for own use. The total value of these comes to ₹ 81.02 crore.

The system should be geared up to gather the details of bulk quantity or repeated transactions into the state and generate over a period, a report on the type of commodity and type of persons transporting such goods to alert the authorities against the misuse of this facility. The system should also have been designed to use a risk management system to block/scrutinise such consignments before release.

Based on the scrutiny, the system should generate a demand notice for security deposit from the dealers/persons misusing this facility.

On this being pointed out, Government stated (April 2014) that the physical verification of the consignment with the transporting document is the routine function of the checkpost. After verification only genuine consignments brought for own use will be permitted to proceed. Government also stated that the system data contains token details of both approved and unapproved transactions. The data set given to audit would also contain information related to unapproved, test tokens. The reply is not acceptable. The Audit observation is based on analysis of data relating to approved transactions. The reply itself validates the observation as it has been pointed out that the physical verification is a routine manual control, with minimal data driven intelligence built into the procedure. Each consignment is treated independently. The benefit of having computerised information on similar and related transactions is not taken care of by the Department.

The system should be redesigned to use such information for preventing misuse of the facility.

3.7 Input data quality issues

3.7.1 Release of consignments brought by registered dealers without verification of the genuineness of the details entered by them

Checkpost Module System (CPMS) Module is an important unit of KVATIS in assisting the administration of tax. As the assessing officers had to rely heavily on the details of this module for assessment purpose, it is important that the data fed into this module is accurate. Audit observed that the system accepts any numerical in the value field due to weak validation controls. As a result, certain registered dealers had entered irrelevant figures like their TIN etc as the value of commodity transported into the state for trading. Illustrations of abnormal value entered into the CPMS module are as shown below:

[7] Commodity value above ₹ 10 lakh

Sl. No.	Token no	Tin	Consignee name	Commodity value	Commodity name
1	321409/2012-13/88008	32101075708	Energy Papers	59929710019	Paper, Rolls - Uncoated (Other)
2	321310/2011-12/75759	32080750492	Gemco Rubber Pvt. Ltd	32080750492	Carbon Black
3	320921/2010-11/193513	32070482684	Geeyem Motors (P) Ltd	355700911062371	Motor Cars
4	320924/2010-11/10954	32090900174	J.M.P Traders	32090900174	Day Old Chicks
5	321310/2010-11/87485	32100252794	KVR Automobiles	1675261675261	Motor Cars

On this being pointed out, Government stated (April 2014) that errors crept into the database mainly due to data entry mistakes made by daily wage employees who entered the data into the system prior to the introduction of the system of e-consignment declaration in January 2010.

The reply is not acceptable as the data entry errors persisted during 2011-12 and 2012-13, after the introduction of e-declaration indicating absence of appropriate input controls. Integrating the data in CPMS module with that of the Return Processing Module for validation of data would enhance data integrity.

3.8 Data on physical verification of consignments

The main duty of the checkpost authorities is physical verification of consignment of goods in a vehicle and ensuring the correctness of the details entered in the e-declaration or invoices. They issue notices to the transporters in case of variation in quantity or commodity. An extraction and analysis of the data revealed that out of 1,91,43,413 vehicles with consignments released during the period from 1 April 2010 to 31 March 2013 details of physical verification were not seen entered in the field records for such verification in 99 *per cen*t cases. Hence audit could not ensure/ascertain whether the consignments were physically verified or not.

The department may equip the system to capture data of physical verification using techniques such as hand held devices, x-ray scanners, uploading photographs etc. based on process and feasibility study.

On this being pointed out, Government stated (April 2014) that KVATIS is facilitated to capture the relevant details. However, due to slow performance of the application, at present, it is not practical to operate these modules as it would affect the vehicle movement. The recommendation can be incorporated once the system is upgraded by replacing the existing servers.

3.9 Conclusion

The checkposts were established to prevent the evasion of tax on interstate transport of goods. We found that the CPMS Module fell short of being an effective instrument in preventing or detecting tax evasion for the reasons stated below:

- Entering of registration numbers in the e-declaration was not made mandatory for generation of token in the case of registered dealers. Many consignments with e-declaration were released without insisting on Registration number.
- KVATIS has no provision to identify and raise alert on transport of consignments using cancelled registration numbers and transport of consignments by dealers who had not renewed their registration.
- System is not alerting the authorities concerned, though significant proportion of transit passes issued were not surrendered at the exit checkposts.
- Large quantity of goods are being transported into and outside the State 'for own use'. These include bulk quantities of medicines, surgical equipments etc. The system generates no alert to Checkpost authorities on the basis of information in KVATIS relating to the frequency and nature of these items brought in by certain dealers.

3.10 Recommendations

- ❖ The department may provide adequate controls in the software to detect and alert the interstate transactions by cancelled dealers and the dealers who have not renewed their registration.
- ❖ Entering of valid registration numbers in the field for Consignee TIN/Consignor TIN in the e-declaration format for generating e-token may be made mandatory.
- ❖ System generated alerts needs to be devised for tracking consignment of goods in bulk quantity to prevent misuse of the facility for transporting consignments 'for own use' without payment of tax
- ❖ The system should be enabled to provide information about the non-surrendered transit passes to authorities including the intelligence wing of the department so as to track such vehicle.

Chapter - IV
Return Processing System

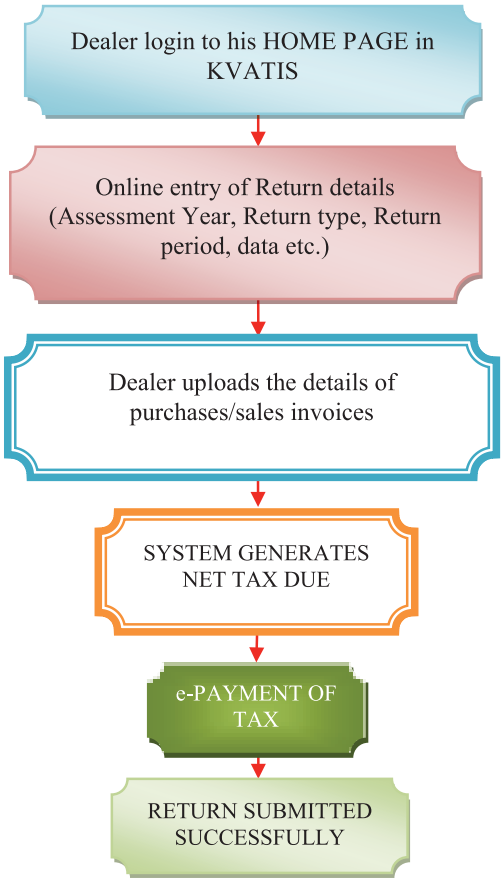
CHAPTER-IV : RETURN PROCESSING SYSTEM

4.1 Introduction

VAT is a self-assessment system, which contemplates that the tax liability is calculated and paid by the dealers through periodical returns. Hence, Return Processing System should ensure that, all the dealers carrying out business have filed periodical returns regularly; the returns filed are in complete shape and with all enclosures required; and dealers have shown their tax liability correctly and paid them to Government.

4.2 Process Automation

Government incorporated a new provision (2A) to Section 20 of KVAT Act to facilitate electronic filing of returns, mandatory for all dealers from 1 April 2009. In order to facilitate better and simplified services to dealers, the various returns to be filed under KVAT Act, CST Act, and KGST Act were integrated into a single return and 8,230 commodities were grouped into 361 commodity groups. Rule 22(1) and (2) of KVAT Rule, 2005 (Rule) stipulates that every dealer should file periodical[1] and annual return showing the details of transactions effected during the return period. A flow chart of the e-filing process of periodical return is shown below:



[1] Returns filed monthly and quarterly

Periodical Return is the return uploaded by the dealer in each month (in some cases quarterly) reporting all the transactions effected by him during the previous month along with the details of his purchases and sales invoices and the e-payment of tax. Annual Return is the consolidated figure of all periodical returns generated by the system on the command of the dealer.

In the e-filing system, the dealer can file returns electronically from any place at any time through the Internet. Once the returns are submitted by the dealers, the assessing authority has to accept the return. The dealer can revise the return within two months. The KVATIS provides the platform for the detailed effective scrutiny of returns through verification of invoices, checkpost declarations, crime files etc.

The Department introduced e-payment of net tax payable in September 2009. The system generates an e-challan for the payment of net tax payable, which is automatically calculated. The payment is effected through the bank account of the dealer, connected with the KVATIS.

KVATIS also provides the facility for downloading the statutory forms (prescribed under CST Act, for the claim of concessional rate or exemption) needed for the interstate transactions and upload the details of closing stock and audited statements in Form 13/13A.

4.3 Filing of Returns

4.3.1 Default in filing of periodical and annual returns

As per Section 20 of the Act every registered dealer shall submit to the assessing authority such return or returns on or before the date prescribed. Further, under Section 22(3) of the Act, if a dealer failed to submit any return as provided, the assessing authority shall estimate the turnover of the return period and complete the assessment to the best of judgment and a penalty under Section 67(1)(c) not exceeding Rupees ten thousand may be imposed on him.

The system should have an inbuilt input control mechanism to give alert to the assessing authority on the non-filing of returns, so that the assessing officer could complete the best judgment assessment effectively.

Audit extracted the number of dealers who have not submitted the periodical returns and annual return during the period 2009-10 to 2011-12 and found that 75,758 dealers failed to submit returns. Non-mapping of the business rule and absence of a system to generate a demand notice for penalty for non-filing of returns restricted the system in imposing penalty.

On this being pointed out, Government stated (April 2014) that in the e-filing scenario, no separate annual return is to be filed by the dealers. Moreover, it was stated that, they had verified the cases and the number of defaulters comes to 13,677 only as against 75,758 pointed out by audit as there were many dealers who may have commenced business in the middle of the year. The Department stated that remedial action will be taken by the assessing authorities.

The reply of the Department that no separate annual return need to be filed by the dealer is incorrect as the same is mandatory under Rule 22(2) of KVAT

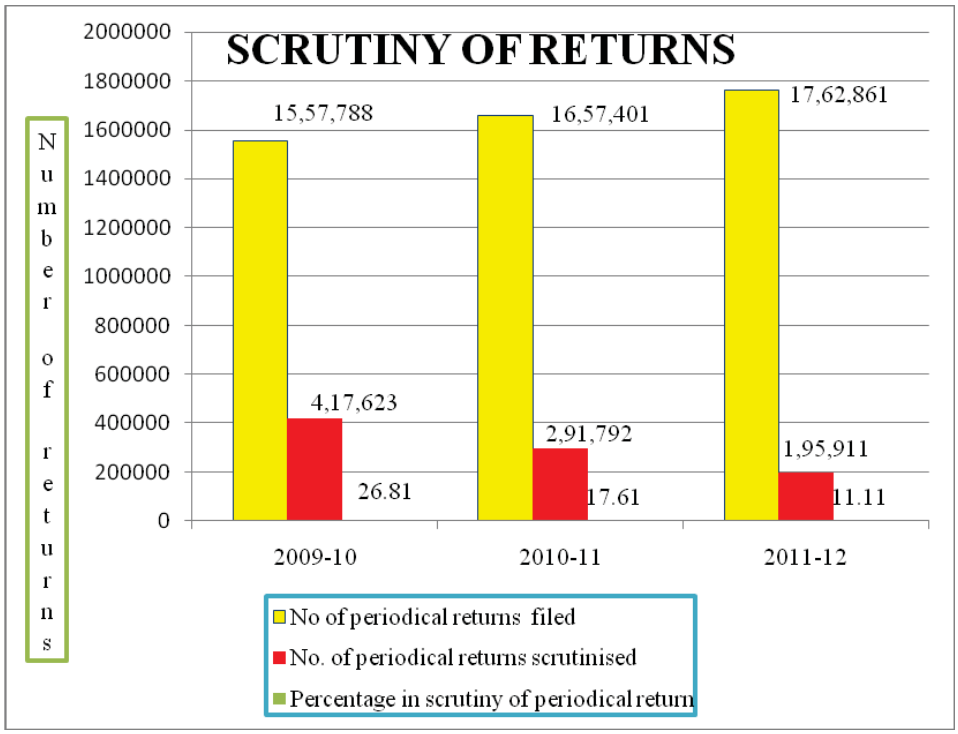
Rules. Further, non-levy of penalty on return defaulters as verified by the Government, works out to ₹ 13.68 crore[2].

During the Exit conference (April 2014), the Secretary, Taxes Department assured that, necessary steps would be taken to ensure that the business rules are properly mapped in the system to prevent such deficiencies.

4.4 Scrutiny of Returns

It is the primary duty of the assessing officers to scrutinise the returns filed by the dealers and to ensure that the receipt due to Government are correctly and properly assessed, realised and credited to government account. Under Section 22 of the KVAT Act, assessing authority has to issue notices in cases of non-filing/defective filing of self assessment returns and complete the assessments in deserving cases.

Return scrutiny is an important function in the administration of VAT and a provision was incorporated in the KVATIS for the detailed scrutiny of returns filed. Audit extracted and analysed the details of online scrutiny of periodical/ annual returns by assessing officers and the percentage of scrutiny done are shown in the chart given below:



On this being pointed out, Government stated (April 2014) that, even though the scrutiny status is provisioned in KVATIS, the officers were not mandated to record the scrutiny status due to slow performance of the system. Further, it was stated that, the actual *per cent* of scrutiny can be known from monthly diary of Assessing Officers and that steps are being undertaken to upload the diaries of assessing authorities so that the Department can review the assessments made by them through KVATIS.

[2] 13,677 cases @ ₹ 10,000

The reply depicts constraints in incorporating controls due to insufficient server capacity. Further, there exist no inbuilt controls in the system to assist the assessing officers to identify high risk transactions for assessment.

4.5 Short fixation of compounded tax for Gold dealers

Section 8(f)(v) of the Act provides that where a dealer in Gold had paid compounded tax[3] for the previous year, the compounded tax payable for the year 2011-12 shall be at the rate mentioned in item (i) below[4] the said clause or at the rate of 1.25 *per cent* of the turnover of the sales of the goods covered under the said clause for the previous year, whichever is higher.

Non-mapping of business rules and lack of process control in the system to automatically calculate the compounded tax of a dealer based on his previous years return had resulted in remittance of compounded tax less than due.

Analysis of the electronic data revealed that due to the above, compounded tax amounting to ₹ 5.08 crore was short collected in 10 assessment files and that self assessments were not reopened in any of the cases. Illustrative cases noticed are given below:

TIN	Year	1.25 *per cent* of previous year's turnover (₹)	Compounded tax fixed (₹)	Compounded tax short fixed (₹)
32010177712	2011-12	1,93,74,053	1,52,10,336	41,63,717
32150890664	2011-12	23,38,725	10,45,125	12,93,600

Penalty under Section 67 should also have been imposed. Maximum penalty leviable would work out to ₹ 8.61 crore.

On this being pointed out, Government stated (April 2014) that the dealers can file compounding option online and the assessing authority can upload the orders issued in KVATIS. The dealer can file 10D return entering the tax due and at the end of the financial year if more tax is to be paid on the turnover, he can make manual payment on the order of the assessing authority. The short levy arrived at by audit without physical verification of assessment records is not correct and sustainable.

The reply is not correct. As per Departmental instruction physical payment is not allowed from 2011-12. Payment could be made only electronically. Further, on verification (May 2014) of the returns filed, Audit found that no additional payment of tax have been made in any of the above cases.

Government assured that, necessary steps would be taken to ensure that the business rules are properly mapped into the system to prevent such deficiencies.

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[3] To attract more dealers dealing with Gold, Works Contractor etc into the tax net, they are permitted to pay tax at a specified rate instead of paying tax under Schedule rate.

[4] Turnover for the previous year (a) below ₹10 lakh – same as tax paid in previous year,
(b) ₹ 10 lakh to ₹ 40 lakh – 105 *per cent* of tax paid in the previous year,
(c) above ₹ 40 lakh to ₹ one crore – 115 *per cent*,
(d) above ₹ one crore – 125 *per cent*

4.6 Accounting of Purchases

VAT is charged on the value addition on the purchase of a dealer. Accounting of purchases, so as to avail Input Tax Credit (ITC), is one of the important information to be included in the returns filed.

As per Section 24(1)(a) of the Act, if it is found during the scrutiny of books of accounts that the dealer had submitted incorrect return, his return shall be rejected and the assessment to be completed on "best of judgment". Audit observed that while reporting the local purchases, certain dealers claimed ineligible ITC and thereby reduced their tax liability. Instances noticed are discussed below:

4.6.1 Discrepancies in reporting of purchases

Audit observed that out of the 40,981, 40,006 and 39,573 dealers who filed audit certificate along with their annual return, in 7,293, 7,425 and 7,271 cases, purchase disclosed in the Statement of Particulars (Form 13 A) was less than that declared in the annual return during the year 2009-10, 2010-11 and 2011-12 respectively. The system had no input validation to match the purchase data declared through return and through Form 13A. This had the risk of dealers boosting their purchase in the return to avail excess ITC on local purchase or to issue C/F Form on non-existent interstate purchase/ stock transfer or for reporting a lower purchase in the accounts to suppress sales. Lack of control in the system to integrate the data in the return filed with that of the figures uploaded in Form 13A could result in short payment of tax.

Audit compared the details of assessments completed and found that the self assessments were not reopened in 1,902 assessments in respect of 1,283 dealers whose purchase figures did not match. Short-remittance of tax on this account could not be ascertained in audit as the details of opening stock, closing stock, purchases and sales available in the system were not integrated.

On this being pointed out, Government stated (April 2014) that cross verification of the value by the system is very difficult in the present situation due to slow performance of the system and that the tax impact can be arrived at only after verifying the opening stock, purchases and closing stock manually by the assessing officers while completing assessments.

The reply is not acceptable as the details of opening stock, closing stock, purchases, sales etc are available in the system. The requirement is only to integrate the data. This reiterates the need for the automated validation checks.

Government in the exit conference assured that, steps would be taken to incorporate necessary controls into the system to prevent such deficiencies.

4.6.2 Excess Input Tax Credit (ITC) availed

4.6.2.1 Availing of ITC by dealers for purchases from dealers who are not liable to pay tax under Section 6 of KVAT Act

As per Section 11(5) of KVAT Act, no ITC shall be allowed for the purchases effected from a registered dealer who is not liable to pay tax under Section 6 of KVAT Act.

Necessary validation and process control checks needs to be provided in the system to identify the status of the selling dealers from whom the taxable purchases were effected and reject the claim of ITC paid on purchases from dealers who are not liable to pay tax under the Act. Audit observed that due to lack of adequate controls, in 21 assessment files of 18 assessment circles, 19 dealers claimed ITC for the purchases effected from registered dealers who are not liable to pay tax under Section 6 of KVAT Act, and that their self assessments were not reopened. The short-levy of tax including interest worked out to ₹ 0.98 crore in the mentioned cases. The maximum penalty under Section 67 leviable on those cases would work out to ₹ 1.46 crore.

On this being pointed out, Government stated (April 2014) that during return scrutiny such irregularities would be verified by the assessing authorities and assessments completed by creating additional demand. It was also stated that it is impossible to cross check the TIN furnished using existing server capacity. Once the system is upgraded by replacing the server, linkage could be provided to cross check the TIN.

4.6.2.2 Availing of ITC by dealers for the purchases of goods not coming under the purview of Capital goods

As per Section 11(2) of the KVAT Act, ITC on capital goods shall be allowed to a registered dealer from the date from which the capital goods are put to use. Section 2(x) defines Capital Goods and SRO No.324/2005 excludes certain capital goods[5], from the purview of the definition.

Non mapping of the above business rules into the system resulted in dealers availing ITC for the purchases of goods not coming under the purview of capital goods such as, air conditioners, building materials etc.

Excess ITC claimed including interest by 31 dealers in 43 assessment files worked out to ₹ 1.64 crore. The maximum penalty under Section 67 leviable on them worked out to ₹ 2.45 crore. Two illustrative cases are given below:

(₹ in crore)

TIN	Goods description	Year	Purchase value	VAT paid
32151208509	Air Conditioners And Coolers	2010	0.27	0.03
32151044158	Cement / White Cement	2009	0.12	0.02

On this being pointed out, Government stated (April 2014) that while disposing the application in Form 25B the assessing authority would verify the eligibility of the claim and such verification is a manual process. Further, it was stated that as per notification, all kinds of Cranes, Earthmovers and similar machines used in connection with the supply of labour and services alone were coming under negative list.

The reply is not correct since the notification *inter alia* includes Air Conditioners, Building materials and Fixtures used in construction activities and the system allows to avail ITC on the purchases made for goods coming under the negative list.

[5] Air conditioners, civil structure, vehicles other than delivery vehicles, office furniture elevators, all kinds of cranes, earth movers, excavators, building materials etc.

Audit cross verified (May 2014) 10 cases out of the above 43 cases with respect to the details available in KVATIS and found that in all the cases the dealers effected purchases of capital goods falling under the negative list.

Government assured in the exit conference that the business rules would properly be mapped in the system enabling it to reject the claim of ITC on capital goods coming under the negative list.

4.6.2.3 Availing of more ITC by dealers than the tax actually paid/due on the purchases

ITC is available for any registered dealer for the tax paid on the purchases made by him and no ITC shall be available for any amount illegally collected by way of tax as specified in Section 30(3)(a) of the Act.

Lack of necessary validation and process control in the system, to calculate the actual ITC eligible on the purchase as per the invoices uploaded and to detect and block any excess claim of ITC had resulted in dealers availing excess ITC than eligible.

Audit observed that in respect of 485 assessments files of 404 dealers , tax and interest to the tune of ₹ 43.37 crore was short paid by availing ITC in excess than the tax actually due or paid by them. The maximum penalty under Section 67 to be imposed on these cases would work out to ₹ 66.03 crore.

Two illustrative cases noticed are shown below:

(₹ in crore)

TIN	Year	Value of goods	Tax paid [6] on purchases	Tax due on purchase	ITC eligible	ITC claimed	Excess ITC claimed
32030583164	2010-11	14.40	1.79	1.67	1.67	1.79	0.12
32050817032	2011-12	51.27	2.06	2.05	2.05	2.06	0.02

On this being pointed out, Government stated (April 2014) that the automated control will adversely affect the system performance and hence the scrutiny is being done manually which is effective also. During scrutiny of returns the assessing authorities would find out such irregularities manually and complete the assessments. There is no loss of revenue as alleged by Audit.

The reply is not correct since the short levy pointed out in Audit resulted due to lack of process control in the system to calculate the actual ITC due. Audit verified (May 2014) 31 cases with respect to the details available in KVATIS and found that in all the cases the dealers availed ITC more than what was actually due to them. Short-remittance of tax on these cases comes to ₹ 3.36 crore**.** These cases do not figure in the list of cases for which additional demand is created. It is recommended that the system be upgraded to achieve effective automated control. Moreover, Government had assured in the exit conference that necessary changes would be incorporated once the system is upgraded, replacing the existing servers.

[6] Excess tax paid is the tax illegally collected by his seller than the actual tax due on that commodity.

4.6.2.4 Non reversal of ITC when the goods purchased are sent outside the State otherwise than by way of sale

Proviso third below Section 11(3) of the Act provides that where any goods purchased in the State are subsequently sent outside the State or used in the manufacture of goods and the same are sent outside the State otherwise than by way of sale in the course of interstate trade or export or where the sale in the course of interstate trade is exempted from tax, ITC under this Section shall be limited to the amount of input tax paid in excess of four *per cent* on the purchase turnover of such goods sent outside the State.

Non mapping of such business rules coupled with lack of necessary controls in the system to trace the interstate stock transfer of goods to which ITC was claimed and to reverse the ITC in the next return automatically resulted in non-reversal of ITC by dealers who sent goods to outside the state otherwise than by way of sale.

Audit noted that self assessments were not reopened in respect of 278 assessments files on which tax including interest of ₹ 30.21 crore was short paid due to non reversing of ITC claimed on goods sent outside the state other than by way of sale.

The maximum penalty under Section 67 to be imposed on 174 dealers in 278 files worked out to ₹ 46.83 crore. Two illustrative cases are shown below:

TIN	Year	Tax paid up to four *per cent*	*Percentage* of interstate stock transfer to total sale	ITC to be reversed	ITC reversed
				(₹ in crore)	
32080204326	2009-10	0.96	97	0.93	0
32070336232	2011-12	14.96	2	0.29	0.01

On this being pointed out, Government stated (April 2014) that the verification for disallowance of ITC on goods purchased locally and sent outside the state as stock transfer or used in the manufacture of goods coming under first schedule required application of human intelligence and verification of physical records.

The reply of the Government is not acceptable. Since all the data is available in the system, the system can do all the verification and calculations if proper control were built in it. Moreover, audit verified (May 2014) the 20 cases thrown up by the system for verification with physical records and found that short-reversal of ITC of ₹ 12.79 crore exist in all these cases.

Government assured that the observation would be taken care of once the system is upgraded, replacing the existing servers. Further report has not been received.

4.7 Accounting of Sales

4.7.1 Accounted sales escaped self assessment

Section 42 of the Act stipulates that every dealer whose total turnover in a year exceeds ₹ 40 lakh/₹ 60 lakh[7] shall get his accounts audited annually by a Chartered Accountant and shall submit copy of it in the manner prescribed. Further, Rule 22(1) and (2) stipulates that every dealer shall file periodical and annual return showing the details of transactions during the return period.

Section 24(1)(a) of the Act, stipulates rejection of the return, if there is discrepancy between the return filed and audited accounts and to complete the assessment to the "best of judgement". As per Section 42(2), the dealer is liable to pay any additional tax with reference to the audited figures.

Since audited statement is a key control instituted by the statute to ensure correctness of sales/purchase turnover declared by the dealers, the system should have necessary in-built controls to cross verify the annual return filed with the audited statement of accounts uploaded. Necessary controls also need to be built into the system to accept only Form 13A duly authorised by the Chartered Accountant. The system should also generate a demand if there is any increase in the tax liability of a dealer.

Audit extracted data and analysed the details of 40,981, 40,006 and 39,573 dealers who filed Form 13A along with their annual return during the years 2009-10, 2010-11 and 2011-12 respectively and found short reporting of accounted sales in 2,303 assessment files due to lack of inbuilt control in the system to match the figures in the return with that in Form No.13A. The resultant short levy worked out to ₹ 783.78 crore. The maximum penalty under Section 67 to be imposed on 2,303 cases would work out to ₹ 1,113 crore. Two illustrative cases noticed are as shown below:

(₹ in crore)

TIN	Assessment year	Sales turnover accounted	Sales turnover returned	Turnover escaped assessment	Short levy of tax
32010667312	2011-12	390.14	195.31	194.83	7.90
32070329842	2010-11	355.36	344.89	10.47	0.47

The Government stated (April 2014) in reply that though the suggestion of embedding this control in the system is welcomed, there would be practical difficulty to implement the recommendation due to the slow performance of the existing servers. Both annual returns and audit statements are filed online and is made available to the assessing officers while conducting scrutiny. The assessing officers will cross check the values furnished as per returns and as per audit statements and send defect notices to the concerned dealers and take remedial action. Government assured that the recommendation for inbuilt controls would be incorporated once the system is upgraded, replacing the existing servers.

Audit verified (May 2014) 52 cases out of the 2,303 cases with respect to the details available in KVATIS and found that in all the cases the dealers failed

[7] The turnover limit for filing Audit Report has been increased from ₹ 40 lakh to ₹ 60 lakh from 2010-11 vide Finance Act 2010.

to report the actual sale accounted in their certified annual accounts. This was not detected by the assessing officers. Thus the claim of the department is not correct. The short-remittance of tax in these 52 cases comes to ₹ 41.84 crore**.** Department/Government may take effective action to ascertain the cases of short-remittance in the remaining cases.

The adequacy of the manual control as stated in the reply is evidently ineffective, given the coverage of the control and the possibility of human errors.

4.7.2 Short reporting of interstate sale than that reported at check posts

Registered dealers upload the details of their interstate sales and stock transfer (out) of goods before the consignment reaches the checkposts. When the consignments are released from checkpost, the details of consignments transported as approved by the checkpost authorities are linked to the Return Processing Module through KVATIS. Audit found that 1,165[8] dealers had transported out goods worth ₹ 5,516.32 crore as interstate sale, interstate stock transfer (out) and consignment stock transfer (out) through various checkposts. However, the total value of interstate transaction (out) reported was only ₹ 2,737.12 crore (49.62 *per cent*).

Lack of process control in the system to integrate the interstate sales captured in the checkpost module with the interstate sales of the dealer in the Return Processing Module resulted in short reporting/non-reporting of interstate sales. Analysis of electronic data revealed that in 1,345 assessment files, interstate transaction (out) amounting to ₹ 2,779.20 crore escaped from assessment resulting in short levy of tax and interest of ₹ 189.88 crore. The maximum penalty under Section 67 to be imposed would work out to ₹ 310.77 crore. Two illustrative cases are given below:

TIN	Year	Value of goods reported at checkposts (₹)	Interstate sale returned (₹)	Interstate sale short reported (₹)	Tax due (₹)
32021102542	2011-12	3,20,66,845	2,95,13,300	25,53,545	1,03,163
32080829332	2011-12	4,64,47,810	99,97,785	3,64,50,025	16,26,540

On this being pointed, Government (April 2014) stated that the cross validations for the value of goods reported at the checkposts to the interstate sales turnover declared in the return filed is practically difficult since the volume of transactional invoices through checkposts to be consolidated are very high to arrive at the interstate sales turnover. This is impossible using the existing server capacity. Further, it was assured that once the system is upgraded by replacing the existing servers the audit recommendations can be incorporated.

4.7.3 Excess deduction of tax in respect of sales return

As per Section 41(1) read with Rule 9 and 59, if any taxable goods sold have been returned by the purchaser, the dealer effecting the sale shall issue to such

[8] Tax liability of goods transported (out) above Rupees one lakh only is taken.

purchaser a credit note in Form No.9[9]. Further Rule 59 provides that credit note claim shall be supported by debit notes issued by the purchaser in Form No.9.

Audit compared the output tax deducted by the sellers through credit notes issued by them and ITC reversed by purchaser through their debit notes for the years 2010-11, 2011-12 and 2012-13 and found a significant mismatch with a probable revenue impact.

Year	OPT deducted by sellers through credit notes (₹)	ITC reversed by purchaser through debit notes (₹)
2010-11	42,09,30,775	15,81,29,502
2011-12	50,13,91,709	20,56,45,832
2012-13	15,59,43,284	6,16,20,273

It was observed that there are no fields in the system to capture the essential details such as, Seller/ Purchaser TIN, the invoice number and date, the date of return of the goods, tax amount, etc., in Form No.9. In the absence of such fields, it is not possible to detect from whom the goods are received back, whether the goods received back are within the time limit fixed, whether corresponding debit notes are issued for all credit notes, etc. These details are all mandatory requirements for allowing deduction of output tax (OPT) for sales return. Non mapping of the requisite business rules into the system leave a significant risk of revenue loss.

Similar case was pointed out in Paragraph 2.16.1 (Item 5 of Table) in Audit Report 2013.

Government stated (April 2014) that the system of verification of above aspects are done manually by the assessing officers while scrutiny of returns. The officers had already taken remedial measures in the cases where irregularities were noticed. It was further stated that specific cases had not been pointed out in the observation. The statistics of scrutiny of returns and additional demands raised by the Department was shared to show that remedial measures had already been taken and there may not be any revenue loss as alleged by audit.

The reply is not acceptable since the statistical data furnished by the Department was not relevant to the points raised by Audit. Better data capture will only obviate the need for manual control, and improve effectiveness of tax administration. In absence of the details as pointed out in the observation, it was not possible to draw conclusions on individual cases. Moreover, during exit conference, the Department assured that filing of credit note and debit note would be made online and necessary controls would be put into the system to check the tax credit taken for sales return by integrating the details of credit and debit notes. Further report has not been received.

[9] Form No.9- The form stipulated for filing both credit note by seller and debit note by purchaser.

4.7.4 Failure to remit the collected tax

4.7.4.1 Failure to pay the collected tax as reported by the dealer through the details of his sales invoices

As per Rule 41(1) of KVAT Rules 2005, where a registered dealer collects tax under Section 30, he shall pay it over to Government and as per sub Rule 2 to Rule 41(1), if the assessing officer is satisfied that any amount collected by way of tax have not been paid by the dealer to the Government, he shall issue notice to the dealer specifying the amount withheld by him and the dealer shall pay such sum within the time prescribed along with interest.

The system should be designed in such a way that it had necessary controls to cross verify the periodic returns of the dealers with the details of sales invoices uploaded by dealer to ensure that the entire amount collected by way of tax, after adjusting the eligible ITC, was paid to the Government. Audit cross checked the details of sales invoices uploaded by the dealers with their returns filed and cases were noticed that dealers withheld a portion of the amount collected by them, by way of tax without remitting it to the Government. Illustrative examples are given below:

TIN	Collected tax as per invoices (₹)	Output tax as per return (₹)	Collected tax withheld by the dealer (₹)
32010125354	5,27,19,481	5,23,95,981	3,23,500
32081490808	32,94,031	29,04,125	3,89,906

Audit noted that the self assessments were not reopened in respect of 2,480 assessments files on which tax to the tune of ₹ 632.59 crore was short remitted by dealers withholding the tax collected through their invoices. The maximum penalty under Section 67 leviable in these cases would work out to ₹ 1,082.55 crore. On this being pointed out, Government stated (April 2014) that the incorporation of necessary controls to check the returns of the dealers with the details of the sales invoices uploaded by dealer to ensure that the entire amount collected by way of tax after adjusting the eligible ITC was paid to the Government involves high volume of data. It is impossible to incorporate the suggestion in real time using the existing server capacity as the system would get choked and would become inaccessible for availing e-services. Government assured that the observation would be taken care of once the system is upgraded, replacing the existing servers.

Audit test checked (April 2014) 31 cases and found that in 17 cases invalid data was recorded in the column concerned. In the remaining 14 cases there was actual short remittance of tax collected which amounted to ₹ 39.23 crore. Department/Government may take effective action to ascertain the cases of short remittance in the remaining cases and collect the balance tax due in all cases.

4.7.4.2 Failure to pay the collected tax by the dealers as reported in the details of the purchase invoices by their purchasing dealers

Audit compared the details of purchase invoices uploaded by the purchasing dealers with the returns filed by the selling dealers and found that 8,746[10] selling dealers in 12,574 assessment files withheld a portion of the amount collected by them by way of tax from the persons who purchased goods without paying it to the Government. Lack of process controls in the system to detect collected tax details uploaded by the purchasing dealers and it's cross check with the return filed by the selling dealer enabled the selling dealer to withhold a portion of the collected tax without remittance to Government. In such cases the system should generate a demand notice for any shortfall in the payment of collected tax

Audit noted that self assessments were not reopened in respect of 12,102 assessments files on which tax to the tune of ₹ 959.45 crore was short remitted by dealers withholding the tax collected as per their purchaser's invoices. The maximum penalty under Section 67 to be imposed on 12,102 files would work out to ₹ 1,650.31 crore**.** Two illustrative cases are given below:

TIN of the seller	No of purchasing dealers from whom collected tax withheld	Tax collected by seller as per the invoices of purchasers (₹)	Corresponding VAT collected as per seller invoices (₹)	Collected tax short reported by seller (₹)	Tax paid without uploading invoices by seller (₹)	Collected tax withheld by the dealer (₹)
32070314384	31	11,32,981	7,72,556	3,60,425	35,172	3,25,252
32070455144	12	47,73,946	35,37,162	12,36,784	9,80,389	2,56,395

On this being pointed out, the Government stated (April 2014) that the volume of invoices to be uploaded being very high it is impossible to incorporate it using the existing server capacity. The cross verification of purchase and sale invoices could be done by the assessing officers manually. Once the system is upgraded the above details could be incorporated.

4.8 Short accounting of opening stock of a year as compared to the closing stock of the previous year

Accounting of stock and its corresponding sales has a direct bearing on the payment of tax, the system should be designed in such a way that the opening stock of a year should be automatically generated from the closing stock of the previous year rather than giving an option to input the values of opening stock by the dealer.

Audit extracted data of the 'accounted stock' from the statement of particulars filed in Form 13A for the years 2009-10, 2010-11 and 2011-12 and found that 517 dealers in 2010-11 and 465 dealers in 2011-12 accounted lesser opening stock than their accounted closing stock of the previous year. Out of these cases the short accounting of stock by 223 dealers, who had tax liability of over ₹ one lakh was to the tune of ₹ 654.37 crore.

Tax evaded by these 223 dealers in 225 assessment files including interest worked out to ₹ 47.53 crore. The maximum penalty under Section 67 leviable

[10] Amount withheld more than Rupees one lakh is taken.

on them would work out to ₹ 76.56 crore. Two illustrative cases are given below:

TIN	Opening stock current year (₹)	Closing stock previous year (₹)	Stock difference (₹)
32030463407	7,368,398	73,368,398	66,000,000
32071308535	97,251,571	54,823,755	42,427,816

On this being pointed out, Government stated (April 2014) that the cross verification of opening stock with the closing stock of the preceding year has been facilitated to the assessing officer during scrutiny of return manually. During this verification if any irregularities are reported they proceed to "best judgment assessment"[11]. All the assessment files where audit reports have been filed may have been physically subjected to audit by the assessing officers. Hence, the loss of revenue arrived at by the Audit without verification of physical records is not sustainable. The reply is not acceptable. We collected the details of all assessments completed during the audit period and found that best judgment assessments were done only in less than five percentage of files to which we found discrepancies. Hence the claim of 100 *per cent* scrutiny is not acceptable

Audit verified (April 2014) 14 cases out of the 225 cases where dealer had filed audit report. There was mismatch found between opening stock and closing stock values. Audit found that in seven cases the value recorded in the column concerned was invalid. In the remaining seven cases actual short levy including interest amounted to ₹ 12.13 crore. Department may take necessary action to verify remaining 213 cases pointed out and take effective action to make good the short levy.

4.9 Scrutiny of Returns of Presumptive tax dealers

4.9.1 Non-demand of schedule rate of tax from Presumptive tax dealers who imported goods into the State

As per Section 6(5), a registered dealer who is not an importer[12] or other dealers specified therein and whose turnover is below ₹ 50 lakh/₹ 60 lakh may pay at his option tax at the rate of half *per cent* of the turnover of sale of taxable goods as presumptive tax instead of paying tax under Section 6(1)[13].

Necessary input control should have been made in the system where a presumptive dealer effects any interstate transaction, the system should recalculate the tax due on the turnover of sale as if the sale was effected by a regular tax payer. Audit found that 369 presumptive dealers had transported goods from outside the State through various checkposts. Lack of proper validation controls and checks in the system resulted in 369 dealers in 430 assessment files paying presumptive tax instead of at the schedule rate. Short levy of tax including interest in this regard works out to ₹ 24.81 crore[14].

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[11] Assessment completed under Section 22 (3) of the Act by reopening of self assessments in case of defective filing of return

[12] Person who obtains or brings goods from any place outside the State or country

[13] The liability to pay tax and the rate of tax are derived from Section 6(1) of Act

[14] Tax liability of more than Rupees one lakh

The maximum penalty under Section 67 leviable on them would work out to ₹ 42.52 crore.

On this being pointed out, Government stated (April 2014) that the status of the dealer can be verified at the checkpost through KVATIS and if it is found that the consignment into the state by PIN dealers checkpost officials may collect security deposit for the release of vehicle, the details of which can be ascertained from the manual registers maintained at the checkposts. Further, it was stated that the value of goods transported from outside the state by the presumptive dealers was meagre and there is no restriction in the statute for a presumptive dealer to transport goods for own use by paying CST.

The reply is not acceptable since it is not relevant to the points raised by Audit. Audit extracted data from interstate transaction of trading goods and not from goods meant for own use and the statute clearly mentions that an importer, irrespective of the value of goods imported, is not permitted to pay tax at presumptive rate.

Audit verified (May 2014) 22 assessment files with respect to the returns and checkpost transactions and found that all these presumptive dealers effected interstate purchase. Short remittance of tax by these dealers worked out to ₹ 6.03 crore. Hence, necessary validation should be made into the system to change automatically the presumptive status of the dealer and demand tax at schedule rate.

4.9.2 Non-demand of schedule rate of tax from Presumptive tax dealers whose turnover crossed the threshold limit in the previous year

As per the third proviso below Section 6(5) of KVAT Act, a dealer shall not be eligible to opt for payment of presumptive tax if his total turnover had exceeded the threshold limit during the year preceding the year to which such option relates. Further, Rule 18 (31) stipulates that a presumptive dealer who is likely to become ineligible for the payment of tax under that Section shall intimate the fact to the registering/assessing authority at least thirty days prior to the date from which he expects to so become ineligible and he shall be liable for payment of tax under Section 6(1) or (2) from the date on which he has become ineligible. Audit found that 48 dealers in 37 assessment circles continued to pay presumptive tax though their total turnover crossed the limit specified in the Act.

Non-mapping of business Rules into the system to change automatically the status when the turnover of the dealer for the previous year crossed the threshold limit[15] had resulted in 48 dealers in 56 assessment files short paid tax including interest of ₹ 3.20 crore. Since the dealers, who are liable to switch over to regular tax payer status as and when their turnover crossed the threshold limit, paid tax at presumptive rate even after their turnover crossed the limit, penalty of ₹ 5.43 crore was leviable under Section 67.

On this being pointed out, Government stated (April 2014) that the data mining team of the department had already listed out the cases of presumptive

[15] Threshold limit- ₹ 50 lakh total turnover up to 2010-11 and thereafter ₹ 60 lakh

dealers crossing the threshold limit and forwarded to the respective assessing officers for remedial action. Based on the report the assessing authorities had already taken necessary steps to convert the PIN to TIN. Verification result of one of the cases pointed out indicated that the levy and conversion of status was applied correctly. It further stated that the short levy worked out had no basis and the audit is not sustainable.

The reply is not acceptable. The departmental reply relates to crossing of threshold limit in the current assessment year whereas Audit objection relates to turnover crossing threshold limit in the previous year. Audit verified (April 2014) 12 cases and found that in the above cases though turnover of the previous year crossed the threshold limit PIN was not converted to TIN. The tax effect involved in these cases amounted to ₹ 1.23 crore and maximum penalty leviable amounted to ₹ 2.08 crore**.** Department may verify the physical records in respect of the remaining cases.

4.10 Conclusion

- Audit observed that the Return Processing System Module developed for automation of the manual procedures in filing of returns and scrutiny of returns is not fully effective due to the following:
  - The business Rules regarding the filing and scrutiny of returns were not properly mapped into the system.
  - Lack of proper input and process controls in the system to detect and rectify all possible tax evasion.
  - The validation checks and cross linking of each modules inbuilt in the system is not adequate for the effective administration of tax.
  - The data available in various modules were not utilised by the Assessing Officers for effective tax administration.
- Though the system provides a platform for detailed scrutiny of returns, the low percentage of scrutiny of returns filed by the dealers through KVATIS shows that the departmental officers are not giving adequate attention/priority to scrutinize the returns filed.

Thus, due to the above shortcomings, the benefit of Return processing system module, such as, online processing of data available, scrutiny of returns through cross verification of invoices, generation of various demand notices, generation of return defaulters etc rendered unutilised.

4.11 Recommendations

- Department may ensure that all business Rules are mapped to the system properly, that the system provide all necessary input and that there exists adequate process controls and validation checks to detect shortfalls in payment of tax.
- Government may consider strengthening KVATIS for monitoring the scrutiny of returns through it.

- The Department may incorporate a provision in the KVATIS to ensure that the closing stock shown in the certified accounts in Form 13-A of a year is correctly taken as the opening stock of the succeeding year.
- Proper controls be built into the system so that the system can scrutinise returns collecting details from different databases.
- Department/Government may initiate early action for the upgradation of the present server which would be cost effective in terms of improvement of revenue realisation it would fetch.

Chapter - V
Other Important Points

CHAPTER-V : OTHER IMPORTANT POINTS

5.1 Non-utilisation of modules

Audit observed that some modules viz. Dealer audit assessment system, Refund system, Arrear recovery system, Penalty and offence system, Appeal and Revision system which are important for effective tax administration are not made functional. The deficiencies due to non utilisation of the said modules are discussed below.

5.1.1 Audit Assessment Module

In the VAT scenario the conventional system of assessments has been replaced by self assessment, which is a voluntary compliance system. Thus the correctness of the self assessment depends up on the integrity of the dealers. In the white paper prepared for formulating State level VAT, the Empowered Committee[1] has stressed the necessity of an independent assessment wing other than the tax collection wing for the detailed audit on the basis of risk analysis. Sections 23 and 24 of the KVAT Act, empowered the department for such detailed audit assessment.

An audit assessment wing which functioned for such assessment was abolished in 2009 and the detailed assessments were entrusted with the officers conducting regular scrutiny and best judgment assessments. KVATIS had an audit assessment module with various parameters to identify the high risk dealers. But the Department had not utilised this Module due to abolition of the audit assessment wing.

The audit recommends that the audit assessment Module be made operational with suitable modifications in such a way that high risk dealers are selected on the basis of specific parameters through KVATIS that can be monitored by Inspecting Assistant Commissioners/Deputy Commissioners/ higher authorities.

5.1.2 Refund System Module

As per proviso below Section 11(6), the dealer is eligible to get refund of the excess input tax remained unadjusted at the end of the year. Since refund is the pay back of the excess tax paid to the government, the refund under VAT is a potential risk area. The Refund Module developed for the automation of procedures involved in the refund process especially for cross verification of transactions could not be put to use so far.

5.1.3 Arrear Recovery System Module

The Arrear Recovery System Module was developed for helping the officers in watching the various process involved in realisation of huge amount of arrears such as revenue recovery, vacation of stay, preparation of second appeals etc,. Non utilisation of the Module resulted in accumulation of arrears without proper follow up action. With the operationalisation of the module the

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[1] A Committee formed (17 July 2000) by the Government of India consisting of Finance Ministers from all States for implementation of VAT

assessing/higher authorities can monitor the arrear recovery mechanism effectively.

5.1.4 Other Modules

Other modules like Appeal and Revision System for the use of appellate wing, Penalty and Offences System to capture the details of nature of the penalty levied and Employee performance system Module were also not operational and the continuation of manual procedures in those area resulted in non monitoring of disposal of appeals/performance by higher authorities through KVATIS.

5.2 Inadequate Management Information System (MIS) Reports

KVATIS provides for various MIS reports. Audit found that MIS Reports available in the KVATIS were not adequate to analyse the various risk parameters and to solve the deficiencies pointed out in earlier chapters. More over certain reports like sales turnover details, employee performances etc are not being generated even though there is provision for such reports in the system.

Audit recommends that well defined MIS Reports be developed which would enable better tax administration through KVATIS.

5.3 Insufficient training

In order to ensure the effectiveness of KVATIS in tax administration, continuous and timely training in various aspects of KVATIS to officers and staff are required for the smooth operation of the relevant Module. Audit conducted a study among the assessing officers by issuing questionnaires and from their replies Audit found that insufficient training especially for the officers and staff working in the assessment wing and checkposts affected the effective utilisation of system and thereby tax administration.

5.4 Conclusion

- The KVATIS was planned and designed to capture the complete workflow of all main functions in the Department. Due to lack of proper inbuilt control, the system is not equipped to analyse, evaluate and report all the transactions. The Government replied that the existing server capacity is not adequate to cater to the additional requirements.
- Carrying on partial manual and partial automated procedures with inadequate data capture relating to manual procedures limits the adequacy of information available in the system.
- The automatic workflow as envisaged through the KVATIS system was not attained and the continuation of manual intervention in important functions may lead to deviation from the main objectives of computerisation.
- Due to non integration of modules, the system could not utilise the data available to evaluate the risk areas of tax evasion and achieve the objectives of computerisation viz, maximisation of tax collection, reduction of tax evasion and corruption.

5.5 Recommendations

Audit recommends that -

- ❖ the Department may operationalise the Audit Assessment Module with suitable modifications for the selection of high risk dealers through KVATIS for detailed audit. Thus the progress can be monitored by higher authorities and failure penalised.
- ❖ the Department may initiate action to make use of other Modules so that the disposal of appeals, the nature of penalty levied, progress of collecting arrears etc can easily be monitored.
- ❖ important/required MIS reports may be made available in the software.
- ❖ the Department may impart sufficient training to all officers and staff periodically.
- ❖ the upgradation of the present system/server which is slow, would be cost effective in terms of improvement of revenue realisation, which was one of the primary goals of implementation of KVATIS.
- ❖ the Department may lay down norms for check of physical records on the basis of reports generated through KVATIS indicating risk areas.

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Appendix

APPENDIX

Reference: Paragraph 1.4

Table showing details of investment in computerisation

Sl. No.	Item wise	₹ (in crore)
1	Software investments. Software development- ₹ 160,80,000 Oracle Licences and ATS- ₹ 419,10,175 Antivirus Licences - ₹ 995,820	5.90
2	Hardware investments Hardware for Data Centre- ₹ 385,82,101 -do- for Hqrs and other offices- ₹ 442,18111	8.28
3	Network investments Lease line rent-BSNL- ₹ 433,52,651 WAN network expenses- ₹ 223,80152	6.57
4	Expenses for awareness programme Advt. through electronic media- ₹ 834,64,889 Advt. Through print media ₹ 65,76,468	9.00
	Total	**29.75**