

No. K1.4000/05/CT

Office of the Commissioner
Commercial Taxes
Thiruvananthapuram
Dated. 17..08..05

[CIRCULAR No. 18/05](#)

Sub: - KVAT Act, 2003 – scrutiny of returns, assessments, audit visits and audit assessments- functioning of the VAT circles and the Audit Assessment wing- instructions- Issued.

Ref: _ 1. Circular No. 15/05 Dt. 04.04.05
2. Circular No.11/05 Dt. 17.06.05

In the circular first cited the salient features of the Kerala Value Added Tax Act, 2003 were communicated to all officers. In the circular 2nd cited detailed instructions were issued regarding the procedures to be adopted for the scrutiny of the statements furnished in Form 25A prescribed under the KVAT Rules, 2005 with regard to the claim of input tax credit in respect of goods held as opening stock on 01.04.05 and purchased during the period 01.04.04 to 31.03.05 which had suffered tax under the Kerala General Sales Tax Act, 1963.

2. The success of VAT mainly depends on the effectiveness of the audit mechanism. Sections 23 and 24 of the Act deal with audit visits and Audit Assessments. Section 23 provides for audit visits. The power for conducting audit visits is vested in officers not below the rank of a Dy. Commissioner designated for the purpose. Accordingly Dy. Commissioners (Audit Assessment) have been notified as the officer designated under section 23. Audit visits under section 23 have to be done by audit officers authorised by the designated officer in writing. Asst. Commissioners (Audit Assessment) as well as Commercial Tax Officers (Audit Assessment) can be nominated by the designated officer as audit officers. Rule 37 of the KVAT Rules, 2005 lays down the procedures for audit visits. Rule 37 (4) stipulates that audit visits during a period of one year from the date of commencement of the Act have to be done only under the directions of the Commissioner.

3. Audit visits have to be preceded by a sound selection of cases for audit. This has to be done impartially and on a scientific basis. Once the computerization of the department is completed, the VAT

software itself will take care of the selection process. But, till such time this will have to be done manually. It is imperative that proper discretion is exercised in selecting cases for audit. The cases selected should be representative in character. The following factors need to be taken into consideration in selecting cases:

A) Primary Factors:

- i. Type of business- whether manufacturer, whole saler, retailer etc.
- ii. Volume of taxable turnover.
- iii. History of the dealers- Previous offences and under declaration and the degree of compliance indicated by the number of assessments and reports of previous visits.
- iv. Evasion prone commodities
- v. Cases not previously selected for audit
- vi. Refund claims and excessive claims of input tax credit
- vii. Specific information regarding proven or attempted evasion of tax Information gathered through vehicle checking, other agencies like Central Excise, Customs, Income Tax etc, Information from other dealers and informants.
- viii. Failure to register.

B) . Secondary factors.

- i) Number of visits already made
- ii) Availability of trained and effective staff to form inspection teams.
- iii) Extent of available information.

4. Keeping the above factors in view, the following instructions are issued for the conduct of audit visits and consequential assessments:

(1). In the circular 2nd cited, the Commercial Tax Officers (VAT Circle) were directed to conduct preliminary scrutiny of Form No. 25 A submitted by dealers and forward cases, which in their opinion required further scrutiny, to the Audit Assessment wing. Input tax credit under section 11(13) was provided in order to prevent cascading on account of goods already subject to tax under the KGST Act again being subject to tax under the KVAT Act. But reports show that many dealers levied tax under the Act on such tax suffered goods

on the price of the goods inclusive of the KGST suffered. This is against the principles of VAT. Granting of input tax credit under section 11(13) in such cases would result in unjust enrichment of traders which is unconstitutional. In the Kerala Value Added Tax (Amendment) Act, 2005, a further proviso has been inserted under sub-section (13) of section 11 which provides for disallowing input tax credit under that sub-section where it is found out on audit that the dealer has charged tax under the Act on the goods held as opening stock, on the turnover of such goods which is inclusive of the tax paid on such goods under the KGST Act. The Commercial Investigation Wing will collect as much information as possible regarding collection of tax by dealers as above. The invoice issued by the dealers during March 2005 and April 2005 evidencing this would also be collected from various sources (including consumers) and cases which require audit shall be forwarded to the Dy. Commissioners (Audit Assessment). The Intelligence wing and the Commercial Tax Officers (VAT Circles) will also collect as much information as possible and forward cases requiring detailed verification to the Dy. Commissioner (AA) concerned. Such cases shall be selected for audit, preference being given to dealers who deal with goods which were subject to higher tax rates under the KGST Act (12 % and above)

(2) In the cases of export and interstate sale, full refund of input tax paid is provided for . In the case of stock transfers refund of tax paid in excess of 4 % is provided for. Till further under, all refund cases should be fully subjected to audit. The dealers claiming refund have to file an application in Form No.21B or 21C, as the case may be, along with declaration in Form 21J obtained from the dealer who sold the goods to the dealer claiming refund. The declaration requires the selling dealer to certify the remittance of tax in respect of the goods sold, which has to be confirmed by the assessing authority with whom the seller is registered. But where the selling dealer claims input tax credit in respect of his purchases, the output tax remitted by him for a month will not be the total of the output tax collected by him. This aspect should be taken into account while conducting audit of such cases. The Dy. Commissioners (Audit Assessment) will first ascertain the total number of refund claims in each office and the amount involved in each case and then do an ABC analysis of such cases and then prepare the audit plan in such a way that thrust is given to cases where the refund claim is the highest, but not totally ignoring cases where the amount of refund claimed is less. In other words, the sample selected for each month should be a mix of all the categories, weightage being given to major claims.

(3). Section 21 of the Act provides that where the return submitted by a dealer under sub-section (1) of section 20 is in the prescribed manner and accompanied by the prescribed documents, the assessments relating to the return period shall be deemed to have been completed, subject, of course, to the provisions of section 22, 24 and 25. The returns filed and the statements furnished therewith provide us with sufficient data for selection of cases for audit. It is therefore imperative that the scrutiny of the returns is completed on a time bound basis and as much information as possible, which will help in the selection of cases for audit, is gathered. When computerization is completed the scrutiny of the return and selection of cases for audit will by and large be done through the computer. But till such time, the scrutiny will have to be done manually. The available manpower may not be sufficient to complete the scrutiny in some offices. The audit officers [including Asst. Commissioners (AA)] will have to associate with the Asst. Commissioners and Commercial Tax Officers in the VAT circle in conducting the scrutiny in offices where the scrutiny is in arrears. The following procedure shall be followed in the matter:

- (i) The Dy. Commissioners (Audit Assmt) shall allot the Audit officer [including Asst. Commissioners (AA)] to such offices where there is substantial pendency of scrutiny of returns, at the request of the Dy. Commissioner of the district concerned.
- (ii) The returns shall be distributed among the Commercial Tax Officers and the Audit officers deputed for the purpose as per the plan to be finalized jointly by the Dy. Commissioner and Dy. Commissioner (AA) in such a way that the Audit Officers get time for conducting Audit visits and other work.
- (iii) In cases where defects are noticed, the Audit officers deployed shall hand over the scrutinized return to the Asst. Commissioner (Assmt)/Commercial Tax officers of the VAT Circle with a note on the defects noticed. The Asst. Commissioners (Assmt)/Commercial Taxes Officers, VAT circle shall then, issue notice to the dealers concerned, pointing out the defects. It is not necessary in such cases to call for the books of accounts of the assessee or to propose a best judgment assessment since section 22 allows the dealers to file a correct return and pay the tax due thereon with interest and avail himself of the benefit of self assessment. A best judgment assessment will become necessary only where the dealer fails to file a return or to file a fresh return after the defects in the return being pointed out. The Asst. Commissioner

- (Asmt)/Commercial Tax Officer concerned will be held personally responsible for prompt issue of defect notices and delay/ ineffectiveness will be viewed seriously.
- (iv) Wherever a best judgment assessment is warranted whether under sub-section (3) of section 22 or under sub-section (1) of section 24, the Asst. Commissioner (Assmt)/Commercial Tax Officers concerned shall transfer the records to the Audit Assessment wing and assessment shall be done by the Audit Officers.
 - (v) The Dy. Commissioner (AA) and the Dy. Commissioner of the district concerned shall jointly review the progress of scrutiny once in a fortnight. Details of reviews will be included in the monthly diary.
 - (vi) The Asst. Commissioner (Audit Assmts)/Commercial Tax Officer (Audit Assmt.) shall keep a record of the number of returns scrutinized by him and the number of returns in which defects are noticed and furnish the details in the monthly diary submitted by him.
 - (vii) In districts where the Asst. Commissioners (Audit Assmt) or Commercial Tax officers (Audit Assmt) are not so deputed, the Asst. Commissioners (Audit Assmt)/Commercial Tax officers (Audit Assmt) shall conduct a random scrutiny of five percent each of the returns already scrutinized by the officers of the VAT Circles and found to be defective and also of those in which no such defects were detected, as per a programme to be fixed by the Dy. Commissioner (Audit Assessment), and select cases for audit.

(4) Under section 11 of the Act input tax credit is allowed against output tax payable for the return period and if input tax is not fully set off against output tax, the amount of input tax remaining unadjusted against output tax is carried over to the subsequent return period. If the returns filed show excess input tax over output tax, it can be indicative of sales suppression. So cases in which the returns filed show excess of input tax over output tax continuously for three return periods should be selected for audit.

(5) Parcel Agencies, (including Railways) clearing and forwarding agents, banks, warehouses etc have to file periodical returns. The details available in such returns will form a database, for the

Department. But until computerization is completed, the details gathered through these returns will be transferred to the dealers' folder for being considered for selection for audit.

(6) The other cases which can be selected for audit are: -

(i) Cases where the returns filed show fall in taxable turnover inspite of increase in purchase continuously for two return periods.

(ii) Cases where attempts of evasion of tax have been detected through vehicle checking or inspection of business places or through verification of extracts taken. Dealers will be ranked on the basis of the number of offences/gravity of offence detected.

(iii) Evasion prone commodities: The Commercial Investigation wing should collect information regarding commodities in which tax evasion is rampant and pass on the same to the Dy. Commissioners (Audit Assessment). A certain percentage of the dealers dealing in such commodities will be selected.

(iv) Dealers against whom departments like Central Excise, Income Tax etc have booked cases should be fully selected. In the case of offences booked by Customs, the Commercial Investigation Wing will identify cases, which have a bearing on VAT and communicate to the Dy. Commissioner (Audit Assmt) and cases will be selected out of such cases.

(v) Commercial Tax Officers (VAT Circle), Commercial Investigation wing and the Investigation Branch should do random verification of the declarations/invoice filed at the check posts or those collected during checking of goods vehicles at places other than check posts and identify cases where the sales declared are not commensurate with the import of goods into the state, and dealers selected out of such cases can also be included in the field of choice.

(vi) Commercial Investigation wing should gather information regarding unregistered dealers having volume of business sufficient for attracting liability for registration. Such cases will be selected for audit.

(vii) Consumers get first hand information regarding the evasive tactics of dealers and can be of help to the department in arresting evasion of tax. They should be encouraged to inform the department about dealers who follow evasive tactics (failure to issue bills for sales, under value the sales, show the sale bills as estimates, maintain undeclared godowns, smuggling goods into or out of the state etc.)

(viii) Cases involving substantial quantities of closing stock as compared to purchase and sales.

(ix) Cases involving substantive changes in trade practices- E.g. excessive stock transfers, material decline in inter-state purchases, material increase in exports/sales to exporters.

(x) Dealers having substantial transit sales

(xi) Sales to Mahe dealers.

(7). Preparation for Audit:-

Once cases are selected by the Dy. Commissioner (Audit Assmt) and Audit officers have been nominated, the Audit officers will have to prepare for Audit. The officers should -

(a) Study the contents of the dealer's folder to see whether there are any special features of the activities of the dealer to be looked into during audit visits.

(b) Gather additional information from the actual returns if the information already passed on to the Audit officers is found to be inadequate for audit purposes. Care should be taken to ensure that the information gathered do not fall into the wrong hands.

(c) Acquire basic knowledge about the nature of the trade or industry. In the case of a manufacturing concern, the officers should study the manufacturing activities involved, the raw materials used, the input out put ratio etc. Necessary data for this may be gathered from the Department of Industries and Commerce, Rubber Board, Publications etc. The Dy. Commissioners (Audit Assmt.) shall, in their periodical meeting, discuss these topics and try to enlarge the areas of knowledge of the officers.

(d) Refer to reports of previous audit visits to see whether any aspects identified on previous visits need to be pursued.

(e) Ascertain if the dealer is maintaining computerized accounts, the systems of accounting and the software, which has been declared by the dealers, and ascertain whether there is any change in the system subsequent to such declaration.

(8). Audit Visit.

As per rule 37(2) a notice has to be issued to the dealer before Audit visit, giving a minimum of fifteen days' notice.

The actual procedure to be followed during audit visit may vary from trade to trade and from industry to industry depending

on the purpose of the visit, size of the business, manufacturing process involved, complexity of the accounts kept, reputation of the dealer etc, which the officers may finalise, in consultation with the Dy. Commissioner (Audit Assmt.) or Asst. Commissioner (Audit Assmt.), as the case may be, on the basis on the guidelines given above. But there are certain general points to be borne in mind while conducting audit visits.

- (a) The visiting officers shall first contact the person in authority (director, manager, partner, proprietor etc.)
- (b) The person contacted should be asked to confirm whether the dealers information available with the officer, is correct.
- (c) The officer should ascertain, the problems, if any, faced by the dealer in complying with the provisions of law and should attempt to help the dealer with genuine problems. Care should be taken not to answer hypothetical questions or to enter into arguments. The officer should not also give answers on issues, if he is not sure about the correct answer. In such cases the officer should arrange to give answers in due course.
- (d) The person in authority should be asked to nominate a person responsible for the maintenance of accounts and filing of returns to furnish the audit officers with the required information
- (e) The officer should ascertain the activities involved.
- (f) Details available with the officer should be cross verified with reference to the records maintained by the dealer to see whether the statements already furnished tally with the accounts kept.
- (g) The officers should ensure that the returns and other statements submitted before the VAT circles have been signed by a person duly authorised in this behalf, in writing as intimated to the assessing authority.
- (h) The officer should examine whether goods have been utilised for non-business purpose and if so whether liability to reverse tax has been conceded.
- (i) The officers should also examine whether the deduction claimed as discounts is actually permissible.
- (j) The audit team should verify the invoice to see whether the rates applied are correct.
- (k) The team may take extracts from the accounts or other records which, in the opinion of the officer, are to be included in the dealers folder.

- (l) The officer should verify whether the dealer is adopting any dubious methods for evading tax which, in the opinion of the officer, would necessitate a further detailed investigation or inspection. In such cases the officer should not seek any clarification from the dealer (as evidences may be lost) nor should he mention anything in the reports. This should be kept confidential for further confidential investigation or for making any surprise inspection. However, such matters should be reported in writing to the immediate superior and the Dy. Commissioner (Audit Asst)
- (m) The Audit officer should also inspect the stock of goods, verify the receipt, and consumption of raw materials, records relating to placing and receipt of orders for goods etc.
- (n) Any other useful information concerning the dealer should be noted.
- (o) On conclusion of audit the Audit officer should again meet the person in authority and thank him for the cooperation. He should also be informed of the defects noted during audit and the steps to be taken for rectification. Indications about malpractices, forgery etc noticed should not, however, be given, since further verification or investigation may be adversely affected.

The officer should give a report on audit to the Dy. Commissioner (Audit Assmt) concerned.

(9) Audit Assessment

(i) All cases audited may not lead to assessment. Section 24 of the Act provides for audit assessments only when any discrepancy is noticed in audit. The second proviso to sub-section (1) of section 24, newly inserted by the Kerala Value Added Tax (Amendment) Act, 2005, gives an option to a dealer to avoid audit assessment by filing revised returns and paying the balance tax, interest and thrice the interest as settlement fee in cases where the defect noticed in audit is only application of wrong rate of tax, wrong claim of input tax credit, special rebate or refund. When no irregularity is noticed in audit, the officer will give a certificate of audit in Form No.18B to the dealer concerned on the report of audit being accepted by the Dy. Commissioner (Audit Assmt).

(ii) Audit assessment under section 24 will be justified in the following situations:

- Where the details furnished in the return are found to be incorrect, either because output tax reported is too low or because input tax claimed is too high.
- Where the dealer cannot produce records to substantiate the sales or purchases or claims of input tax, special, rebate, exemption or refund.
- Deduction is claimed in respect of discount where discount had not actually been given or where the discount is not allowable.
- Exemption has been wrongly claimed or where taxable sales are misclassified as non-taxable sales.
- Goods are appropriated for non-business purposes; but no reverse tax is admitted.

(iii) The procedure prescribed under section 24 read with Rule 39 shall be strictly followed in completing the assessments.

(iv) Assessment of escaped turnover under section 25, protective assessment under section 26, and the assessments under sub-sections (3) and (4) of section 48 shall also be done by the Audit Officers.

(v) The Intelligence /Investigation wing shall inform the Asst. Commissioner (Audit Assmt) about materials gathered by them through shop inspection, vehicle checking, extract verification and other investigation on detection of such cases and also forward the records of the cases on completion of the proceedings, under intimation to the Dy. Commissioner (Audit Assmt.). The Dy. Commissioner (Int.) concerned will ensure that the processing of such cases is not delayed beyond three months except with the approval of the Dy. Commissioner (Int) concerned for justifiable reasons.

(vi) The Dy. Commissioner (AA) shall exercise his jurisdiction U/s 24(2) of the Act. Accordingly, he may, on his own motion or on a reference being made by the assessing authority or on an application of an assessee, call for and examine the record of any proceedings in which an assessment is pending and if he considers that, having regard to the nature of the case or the amount involved or for any reason, he may issue such direction as he thinks fit for guidance of the assessing authority to enable him to complete the assessment. Such direction shall be binding on the Assessing authority both in the VAT Circles and Audit Assessment Wing. While exercising this jurisdiction, if any question of law arises, he may, if necessary, refer the matter to the Commissioner for directions.

(vii) The Audit Officers shall forward all proceedings pertaining to assessment and penalty together with the connected records to the concerned VAT Circle for recovery of tax, penalty and other amount due under the Act within 7 days of the date of acknowledgement of the order and demand notice by the dealer concerned..

(viii) The officers of VAT Circles shall enter the demand created, both under VAT Circles and Audit Assessment Wing, in the register of Demand, Collection & Balance and initiate action to collect the arrears. The details of assessment and penalty proceeding completed by the VAT Circles as well as the Audit Officers shall be reported to the undersigned through the DC/DC (AA) as the case may be.

(10) The Dy. Commissioners (Audit Assmt) shall prepare their audit plan for three months commencing from September 2005 onwards immediately and personally discuss with the undersigned before finalising the same.

5. The capacity building of the audit wing can be achieved only through continuous evaluation of the results achieved and exchange of information amongst the officers of the Audit Wing. Each Dy. Commissioner (Audit Assmt) shall arrange a group discussion by audit officers working under his jurisdiction every month. Various methods of evasions detected and the kinds of defects noticed shall be discussed. The discussion shall be held on the 15th working day of every month. The Dy. Commissioner (Audit Assmt) shall include a brief note on the discussion in his monthly D.O.letter to the Commissioner.

6. The functioning of each wing of the department is complementary to each other. Increase in the overall efficiency of the department can therefore be achieved only through regular interaction among officers of the different wings of the department. The officers of the VAT Circles, audit and intelligence wings in each district will meet once in a month and discuss issues which affect the effective functioning of the respective wing. This meeting will be held on the same day on which the Dy. Commissioner holds his monthly conference which shall be on the tenth working day of every month. Officers of the cadre of Asst. Commissioners and Commercial Tax Officers of the VAT Circles, Audit Assessment Wing and Intelligence and Investigation Wings will invariably

attend the meetings held at the place where they are stationed. The Dy. Commissioners (Audit Assmt) and Dy. Commissioners (Int) shall attend such meetings in each district coming under their jurisdiction, once in three months. The Asst. Commissioner (Audit Assmt) and the Inspecting Asst. Commissioners (Int) and the Inspecting Asst. Commissioners (IB) shall report the result of such meetings to the Dy. Commissioners concerned. The Dy. Commissioners of the districts shall include a note on such interactions in their monthly D.O. letter to the Commissioner.

7. This circular is meant for circulation among the departmental officers only and not to others.

8. The District Dy. Commissioners, Dy. Commissioner (Audit Assmt) and Dy. Commissioners (Int) shall acknowledge the receipt of this circular and circulate this among the officers of the respective wings.

Sd/-
Commissioner