



**CHAPTER**

**2**

**PRODUCTION OF  
INDIAN MADE FOREIGN LIQUOR**





## 2.1 Introduction

### 2.1.1 The Sugar Industry

Manufactory is a unit where spirits are compounded, blended, processed, fortified and/or diluted to produce IMFL. The Government notifies for establishment of new manufactory or expansion of existing manufactories. On issue of such notification prospective distillers apply for grant of Letter of Intent (LOI) on payment of requisite refundable and non-refundable fee. Distillers shall obtain license within six months from the grant of LOI. They shall commence the production within two years from the grant of LOI. The license shall be renewed before the commencement of the license year<sup>8</sup>.

Molasses is used in manufacture of alcohol. Molasses is uncrystallised syrup obtained as an important by-product in the process of manufacture of sugar. The fermentable sugar content present in the molasses produced by sugar factories is ascertained by chemical analysis and generally ranges between 40 and 50 per cent of molasses. The regulation of molasses is governed by the Andhra Pradesh Excise (Possession, Import, Export, Transport of Molasses – Conditions of License and Permits) Rules, 2008.

There were 35 sugar factories in AP as at the end of 31 March 2010, of which eight were in the co-operative sector, three in the public sector and 24 in private sector. The Commissioner of Sugar & Cane Commissioner regulates the sugar factories in the State. The total quantity of sugarcane crushed and obtainable molasses yield from the cane crushed during the period of audit is given below:

Year	Number of sugar factories	Sugar cane crushed (in lakh MT)	Obtainable molasses yield @ 4.5 per cent (in lakh MT)
2005-06	38	123.07	5.56
2006-07	38	173.20	7.79
2007-08	38	131.93	5.93
2008-09	35	59.92	2.69
2009-10	35	55.49	2.49

Source: Figures obtained from Commissioner of Sugar & Cane Commissioner.

The effective functioning of a sugar factory depends on assured availability of sugarcane of good quality, optimum utilisation of machinery, capacity utilisation of mills, besides prudent marketing and financial arrangements. It may be seen from the above table that the quantum of sugarcane crushed in the State had declined sharply since 2006-07. While attributing the decline to shifting by the farmers to short duration remunerative crops, extreme scarcity of labour and non-remunerative cane price, the Commissioner, Sugar opined that a bumper sugarcane and sugar production is likely in 2010-11 as farmers planted sugarcane in more area due to better cane price paid during 2009-10.

Decline in sugarcane production in the State had a direct bearing on production of molasses which in turn adversely affects the domestic production of Rectified Spirit (RS). This, however, did not affect the total production of IMFL as the IMFL distilleries import RS from outside the State besides, using the locally available RS. Issues concerning this area are discussed in detail at para 2.2.1.

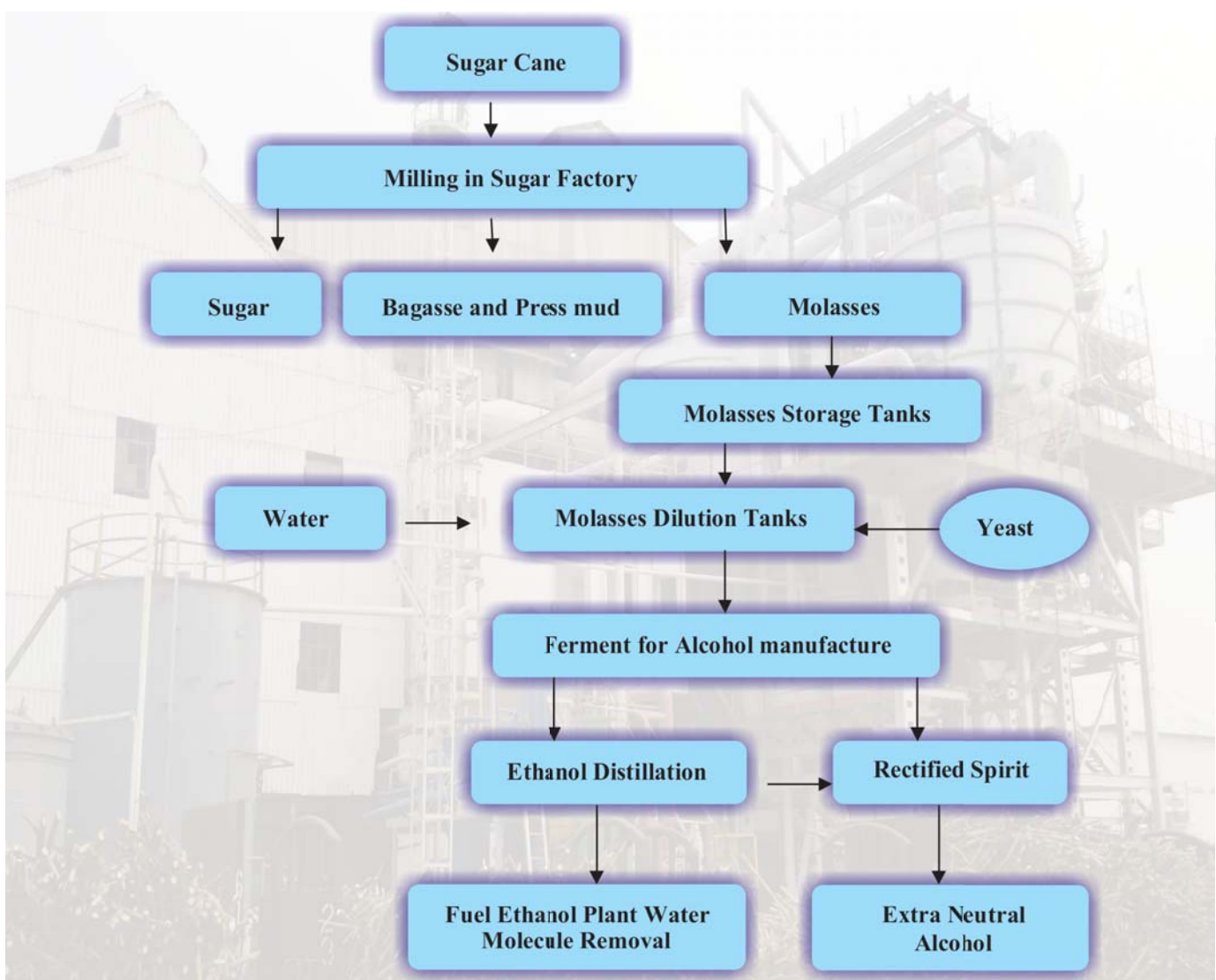
<sup>8</sup> License year starts from April to March of next year.



Rectified Spirit (RS) is used in producing IMFL. RS means liquor containing undenatured alcohol of strength not less than 50 per cent over proof and includes absolute alcohol in other forms and Extra Neutral Alcohol (ENA) but does not include arrack issued in varying degrees of concentration for potable purposes. Various stages involved in manufacture of IMFL using molasses as the raw material is depicted in the following charts.

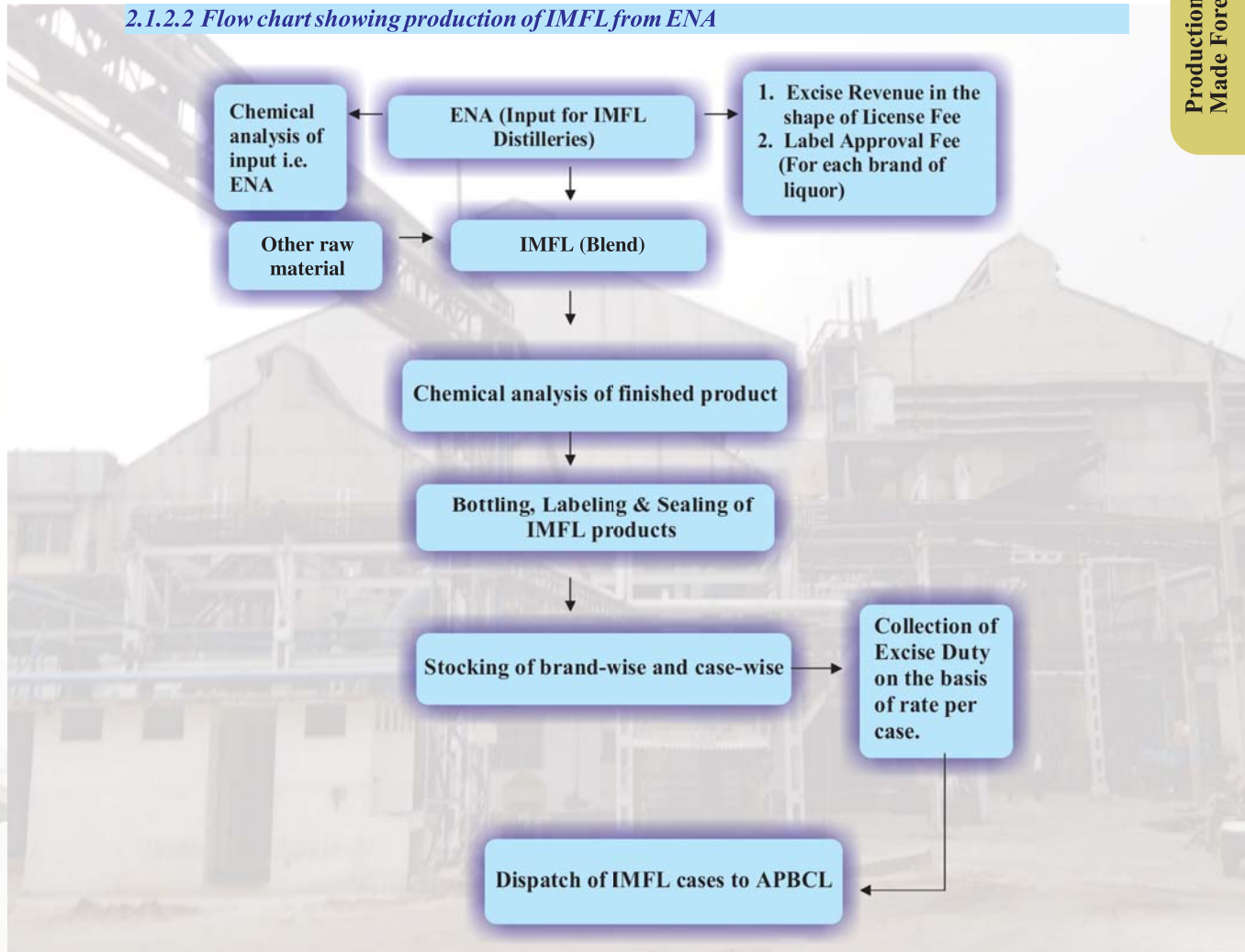
## 2.1.2 The Process

### 2.1.2.1 Flow Chart showing production of Rectified Spirit from Molasses





**2.1.2.2 Flow chart showing production of IMFL from ENA**



We noted the following shortcomings during the verification of the records of the selected RS/IMFL distilleries with regard to capacity utilisation, issue of new licenses/expansion of the existing units as detailed below:

**2.2 Under/non-utilisation of licensed capacity**

**2.2.1 RS/ENA distilleries**

There are 26 distilleries in the State that manufacture RS/ENA. License fee has to be paid annually by all the license holders for manufacturing RS/ENA. In the event of a need, distilleries send a request for molasses allotment to the Distillery Officer (DO) posted in the distillery with information regarding molasses allotments and lifting during that year and an assurance of supply from the sugar factory. Based on the recommendation of the DO, the Commissioner issues an allotment order based on which the transport permit is issued by the DO. When the molasses are to be imported from another State, the



transport permit is issued by the concerned DC. The AC (Distilleries) is responsible for monitoring the functioning of the Distilleries under his jurisdiction. For this purpose, Distilleries are required to furnish various returns to the AC (Distilleries). The AC (Distilleries) also is required to conduct periodical inspections to ascertain the proper functioning of the Distilleries.

The licensed capacity and actual production of RS/ENA<sup>9</sup> by the State distilleries is furnished below.

Sl. No.	Year	No. of RS/ENA Distilleries	Total licensed capacity* (in lakh BLs)	Actual production (in lakh BLs)		Capacity utilisation %
				RS	ENA	
1.	2006-07	24	1,858.05	609.86	672.64	69.02
2.	2007-08	26	2,732.64	769.01	1,017.06	65.36
3.	2008-09	26	2,732.64	547.23	1,061.71	58.87
4.	2009-10	26	2,732.64	349.79	1,450.50	65.88

*Note:* \*Includes licensed capacity of M/s. Tern Distilleries, Kasimkota whose RS plant was not functioning for want of pollution clearance and Sagar Sugars, Chittoor whose production during the period 2006-07 to 2009-10 was almost nil.

**Source: Figures obtained from Commissioner of Distilleries and Breweries.**

It can be seen from the above data that the capacity utilisation was hovering between 59 per cent and 69 per cent.

We further noted in the test checked distilleries, that the licensed capacity was never utilised fully during 2005-06 to 2009-10. The actual utilisation was as low as zero per cent in case of M/s Sagar Sugars, Chittoor. M/s KCP Sugar, Vuyyuru had recorded the maximum utilisation i.e. 77.78 per cent.

RS is the key input for manufacture of IMFL and we are aware that the entire quantum of RS produced is not put into use for IMFL production as some RS is used in pharmaceutical, industrial and toilet preparations. But the fact remains that majority of RS produced in the State is used for production of IMFL and there was a ban on export of RS. In this backdrop, production of lesser quantity of RS than the sanctioned capacity for whatever the reasons be, had an impact on the revenue that would have accrued in the form of excise duty on IMFL that would have been produced using locally produced RS. While any attempt to calculate the revenue forgone could only be an approximation, we are of the view that the State had certainly forgone some revenue which could be calculated vis-à-vis the capacity under utilised by the distilleries as detailed below:

Year	Percentage of under utilisation		
	KCP, Vuyyuru	SPY Agro, Nandyal	Sagar Sugars, Chittoor
2005-06	19.66	0.00	0.00
2006-07	0.00	0.00	99.64
2007-08	20.11	96.51	99.64
2008-09	32.54	9.18	100.00
2009-10	60.93	0.00	99.64

**Source: Figures obtained during test check of above units.**

<sup>9</sup> Licensed capacity and actual production were taken from 2006-07 i.e. after introduction of AP Distilleries (Manufacture of Spirits) Rules, 2006.



Based on the discussion with the Department and analysis of records, we are of the opinion that the decline in capacity utilisation of the above distilleries is possibly due to lack of modern machinery and poor quality of RS produced. **Though the data on actual production of the above mentioned distilleries was available to the Department, they had not analysed the decline in actual production and capacity utilisation for possible remedial action. There is a case for examining this matter specifically for those distilleries who had initially a good track record of production but had subsequently declined.**

The Government replied (July 2011) that the Government can not compel the distilleries to produce more RS and added that the revenue was linked to IMFL produced and not RS since the distilleries import RS depending on quality and lower rates. While conceding the fact that there is no control on the import of RS by distilleries from outside the State, it is equally true that domestically produced RS contributes a significant portion (72 per cent) of the total RS production in the State. Since there was a ban on the export of RS from the State, the Government/Department could monitor the RS production of distilleries to ensure maximum production commensurate with their licensed capacity which would enable more production of IMFL from domestically produced RS and resultant accrual of enhanced excise revenue to the State. Based on the above deliberations, the Government, however, assured to analyse and examine the matter for suitable action.

### 2.2.2 IMFL distilleries

As mentioned above RS is used for production of IMFL by the license holders. The number of IMFL distilleries, their production capacities and actual production of IMFL during the period of audit is as follows:

Sl. No.	Year	No. of IMFL distilleries	Total licensed capacity (in lakh PLs)	Actual production (in lakh PLs)	Capacity utilisation %
1.	2005-06	27	2,083.96	2,996.15	143.77
2.	2006-07	25	2,083.96	2,164.03	103.84
3.	2007-08	28	2,579.91	2,159.58	83.70
4.	2008-09	28	2,579.91	2,432.84	94.29
5.	2009-10	29	2,580.18	2,607.21	101.04

Source: Figures obtained from Commissioner of Distilleries and Breweries.

It can be seen that in most of the years, the distillers had exceeded their licensed capacities. When a distillery exceeds the permitted licensed capacity, additional license fee is payable by the licensee. Issues concerning this aspect are discussed later in this chapter. The top five producers of IMFL in the State for the year 2009-10 are as follows. They contribute nearly 41 per cent of the total IMFL produced in the State during this period and they continue to maintain this position for the last five years.



IMFL Distillery at Hyderabad



Sl. No.	Name of the distillery	Production (In Lakh PLs)
1.	Shaw Wallace & Co. Ltd.	330.00
2.	Pearl Distillery	241.06
3.	McDowell & Co. Ltd.	209.95
4.	Srikrishna Enterprises	149.69
5.	Bagga Distilleries Pvt. Ltd.	132.19
<b>Total</b>		<b>1,062.89</b>

**Source: Figures obtained from Commissioner of Distilleries and Breweries.**

Performance trends of IMFL manufactories indicate that they can perform beyond their licensed capacity. Obviously, this presupposes abundant supply of RS. As already stated above, domestic supply is the major contributor up to 72 per cent. This underscores the point that enhancing domestic supply of RS will contribute for higher production of IMFL and higher excise duty.

Therefore, we believe that there is a need for reviewing the under performing RS distilleries in the State for their revival and ensuring seamless supply of RS to the IMFL manufactories in the State.

### 2.3 Manufacturing by Distilleries

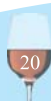
Government issues notification from time to time for grant of Letter of Intent (LOI) for establishment of a new manufactory or expansion of existing RS/IMFL manufactories. The prospective distillers apply to the Government for obtaining LOI along with the requisite documents and special fee of ₹ 20 lakh. The validity period of LOI for new manufactory and expansion of existing distilleries of IMFL is three and two years respectively. In case of RS distilleries, the validity period of LOI is two years for new as well as expansion of existing distilleries. No compensation for damage or loss shall be payable when a LOI is rejected or revoked or withdrawn. In case the holder of LOI fails to commence production within the validity period, he forfeits his right over LOI and on the license. The holder of LOI shall apply and obtain license within six months duly fulfilling all the requirements of obtaining No Objection Certificates (NOC) from the competent authorities of AP Pollution Control Board and Local Authorities etc.

#### 2.3.1 New licenses

According to the provisions, a prospective distiller should go through the following steps for obtaining a license or its renewal.

- ◆ Application for LOI (Rule 8 (1) of AP Distilleries (Manufacture of Spirits) Rules, 2006)
- ◆ Notification and sanction by the Government (Rule 4 (1), (2) and 5 (1), of AP Distilleries (Manufacture of Spirits) Rules, 2006)
- ◆ Acceptance or rejection of application by the Government (Rule 5(2)(d) of AP Distilleries (Manufacture of Spirits) Rules, 2006)
- ◆ Applicant to obtain a license from the Commissioner (Rule 5(2)(e) of AP Distilleries (Manufacture of Spirits) Rules, 2006)

The Department sanctioned two new distilleries during the period 2005-06 to 2009-10.





### 2.3.1.1 Non-commencement of production by Distillery

As per sub rule (6) of Rule 8 of AP Distillery (Manufacture of Spirits) Rules 2006, in case the licensee fails to commence manufacture before expiry of two years from the date of issue of LOI, the licensee forfeits his right over LOI and on the license. In such cases the Government shall initiate action to forfeit the right over LOI and Special Fee. Further, according to sub rule (2) of Rule 8 ibid, no application for grant of LOI by the Government is entertained unless a non-refundable and non-adjustable special fee of ₹ 20 lakh is paid to government and the challan in original in support of such payment is produced along with the application. AC (Distilleries) who processes the application is responsible for watching the commencement of the production within the stipulated period.

We noted during the audit of office of the Assistant Commissioner of Distilleries, Vijayawada that M/s Vasista Fermentations Pvt. Ltd had not commenced production of RS/ENA/Ethanol even after more than two years from the date of issue of LOI. It was further observed that even the building construction had not commenced (July 2011). However, the Department did not initiate action to forfeit LOI along with Special Fee as required under provisions.

Due to delay in commencement of production, the Government had lost ₹ 8.66 lakh towards proportionate license fee and the opportunity of earning ₹ 62.83 crore on account of excise duty for probable production of IMFL from RS/ENA/Ethanol that would have produced by the unit.

The Government replied (July 2011) that the extension was given to obtain various clearances which was aimed at promoting better industrial relations. The reply is not acceptable as M/s Vasista Fermentations Private Limited had not even commenced the civil construction till July 2011 and therefore extension of time limit was not warranted and the Department should have prevailed upon the unit to commence production as per LOI conditions.

### 2.3.1.2 Undue favour to assessee

According to Sub Rule (i) of Rule 4 of A.P. Distilleries (Manufacture of IMFL) Rules, 2006, no LOI for establishment of any new manufactory or expansion of the production capacity of an existing manufactory shall be issued unless non-refundable and non-adjustable fee of ₹ 12 crore and non-refundable and adjustable special fee of ₹ 6 crore is paid by the IMFL Distillery.

We noted during the audit of M/s SPY Agro Industries Limited, Nandyal that the distillery obtained LOI for production of IMFL from the Government in October, 2008, without payment of non-refundable and non-adjustable fee of ₹ 12 crore and short payment of the non-refundable and adjustable special fee by ₹ 3 crore.

The Government replied (July 2011) that an amount of ₹ 18 crore had been collected (December 2010 and March 2011) along with penal interest. However, the Government failed to explain the reasons for granting the LOI to licensee, without deposit of the prescribed fees which was a precondition for grant of license. We also noted that the distillery had not commenced production (August 2011).





### 2.3.2 Renewal of license without pollution clearance certificate

As per Rule 6(f) of AP Distilleries (Manufacture of Spirits) Rules, 2006, the holder of a D2 (RMGO) license should produce clearance certificate from the Andhra Pradesh Pollution Control Board (APPCB). As per Rule 14(6) *ibid* renewal of license is subject to the fulfillment of one of the eligibility conditions i.e. obtaining clearance from APPCB. As per Rule 18(13), if Commissioner is not satisfied with the maintenance of the buildings, plant and machinery including the measures and other appliances, he may require the licensee to stop working of the distillery and direct to rectify the defects within a period as may be specified.

We noted during the audit of M/s Tern Distilleries, Kasimkota that though ‘stop production’ order was issued by the APPCB in April 2007 for not maintaining the appropriate pollution control measures, license in Form-D2-(RMGO) had been renewed regularly by the Commissioner despite non-clearance from APPCB.

The Government replied (July 2011) that though the action taken was technically not correct, to protect the Government revenue, license was renewed but the unit was not allowed to function. The reply confirms that the license was renewed without the pollution

clearance certificate which is a pre-requisite for renewal. Though, the ‘stop order’ was issued, we believe that revenue consideration can not bypass the environmental considerations.

### 2.4 Manufacture of Liquor

The Department endeavours to ensure better yield of spirit from molasses during the distillation process and it is monitored through a series of checks prescribed under the provisions for this purpose. One of the key parameters monitored during the distillation is the percentage of non-fermentable sugars in the molasses. According to Rule 27 of AP Distillery (manufacture of spirit) Rules, 2006 the molasses shall not contain more than 5 *per cent* of non-fermentable sugars i.e. fermentable sugar produced should not be less than 95 *per cent*. If on chemical analysis, non-fermentable sugars are found to be more than 5 *per cent*, the Commissioner, who is responsible to look into this aspect, shall be informed immediately. Further, according to Indian Standard Specifications (ISS), 95 *per cent* of total invert sugar<sup>10</sup> is fermentable. Every quintal of fermentable sugar present in the molasses should yield 91.8 proof liters of alcohol.

<sup>10</sup> Invert sugar means the quantity of total reducing sugar present in the molasses.





We noted in six<sup>11</sup> test checked RS units attached to sugar factories that the fermentable sugar produced was below 95 per cent as detailed below.

Sl. No.	Name of the Distillery	Quantity of Molasses used (in MT)	Fermentable sugar produced (%)	Non-fermentable sugar (%)	Excise duty equivalent of short yield @ ₹ 15.40 per PL (details in Annexure I) (₹ crore)
1.	KCP Sugars & Industries Corporation Ltd., Vuyyur	1,52,776.16	40.04	59.96	53.12
2.	Andhra Sugars Pvt. Ltd., Tanuku	1,39,368.49	90.34	9.66	4.23
3.	Empee Sugar Pvt. Ltd., Naidupet	94,906.70	90.47	9.53	2.79
4.	Sagar Sugars Pvt.Ltd., Chittoor	4,345.00	93.58	6.42	0.04
5.	Jeypore Sugars Co. Ltd., Chagallu	13,606.00	89.59	10.41	0.49
6.	Jeypore Sugars Co. Ltd., J.R.Gudem	6,010.06	89.40	10.60	0.22

Source: Figures obtained during test check of above units.

We noted that the distilleries send monthly returns on various results that include the levels of non-fermentable sugars in the molasses. However, we observed that the Commissioner's office had not taken any steps to investigate the reasons for shortfall in production of fermentable sugars as per the standards.

The Government assured (July 2011) to put in place a system to monitor the same by revising the provisions of the Excise Act.

## 2.5 Additional license fee

The Department enforces capacity control for distilleries, breweries and blending units by monitoring molasses' availability and licensing the creation of additional capacity. Unlike some other States like Uttar Pradesh where penalties are levied for excess production than permitted, the State permits capacity expansions by collecting additional license fee. Additional fee is also payable in case of production of liquor in excess of sanctioned capacity.

We noted shortcomings on this account as detailed below.

<sup>11</sup> Andhra Sugars Private Ltd., Tanuku, West Godavari District; Empee Sugars Pvt. Ltd., Naidupet, Nellore District; Jeypore Sugar Company Ltd., Chagallu, West Godavari District; Jeypore Sugar Company Ltd., Jangareddigudem, West Godavari District; KCP Sugars and Industrial Corporation Ltd, Vuyyuru, Krishna District and Sagar Sugars, Chittoor District.



### 2.5.1 Additional License fee not paid for sanctioned capacity

According to Rule 8(4) (e) of AP Distillery (Manufacture of IMFL other than Beer and Wine) Rules, 2006, whenever the licensed production capacity is fully utilised by the licensee and if he desires to produce additional production he shall take special permission from the Government for causing additional production on payment of additional license fee as prescribed by the Government from time to time.

We noted in three<sup>12</sup> test checked offices, that the distilleries had produced IMFL over and above the annual production capacity and additional quota sanctioned for the year 2009-10. Based on the production figures of IMFL furnished by the distilleries, the Government was required to collect the additional license fee. Omission to do so resulted in short collection of additional license fee of ₹ 1.06 crore.

The Government replied (July 2011) that the matter would be examined and reply furnished in due course.

### 2.6 Identification of bottles-use of Excise Adhesive Labels (EALs)

As per Rule 17(1) of the AP Distillery (Manufacture of IMFL other than Beer and Wine) Rules, 2006, the Licensee shall affix each sealed bottle of liquor with the Excise Adhesive Label (EAL) supplied by the Excise Officer and no bottle containing liquor without EAL shall be issued from the manufactory. Each EAL costs ₹ 0.10 payable by the distillery as user charges to the Commissioner. DO is responsible for implementation of this Rule.

We noted various shortcomings in this regard as under:

#### 2.6.1 Variation in the number of EALs

We noted during the audit of Rhizome Distillery that there was a variation between actual number of EALs shown as utilised and the actual number of liquor bottles manufactured for the years 2009-10. The details are as follows:

Sl. No.	Name of the Distillery	Year	Total No. of liquor bottles manufactured (in lakh)	Total No. of EALs shown as utilised (in lakh)	Variation (in lakh)
1.	Rhizome Distilleries, Medchal, R.R. district	2009-10	407.06	412.56	5.49

The above situation is fraught with a risk of sending out liquor bottles from the distilleries without payment of excise duty.

<sup>12</sup> G.S.B & Co., Prag Distilleries and Radico Khaitan Ltd.



On this being pointed out, the Government replied (July 2011) that the matter would be examined and intimated to audit.

### 2.6.2 Holograms not prescribed

Hologram is a photographic image designed, approved, printed and supplied under the supervision and control of the Commissioner from time to time in different forms for the purpose of its affixture to sealed bottles of different varieties and sizes containing IMFL other than Beer and Wine.

We noted that in nine<sup>13</sup> test checked units, bottles were sent out of the distilleries without holograms being affixed on them. Commissioner of Distilleries and Breweries replied that issue of introducing hologram labels in place of paper based EALs was under examination by an Expert Committee constituted by the Government vide G.O.Ms.No. 749 Rev (Ex.II) dept. dated 23.09.2004.

Due to non-affixing of Holograms, circulation of unscrupulous liquor bottles cannot be ruled out. The Department is already dealing with several cases of unauthorised sale and illicit liquor distillation. Lack of appropriate identification mark may stifle the Department's efforts to curb the crime.

The Government replied (July 2011) that a system of bar coding the bottles was under active consideration for proper identification. In August 2010, though Government decided to call for fresh tenders for supply of complete Holographic EAL in place of paper based labels, we feel that this important internal control measure has not been addressed effectively, since no decision has been taken for its implementation (August 2011).

## 2.7 Other points of interest

### 2.7.1 Non-forfeiture of LOI

As per Rule 4 (2)(f) of AP Winery Rules, 2006 if the holder of letter of intent fails to commence production within two years of date of issue of LOI, he forfeits his right over LOI and on the license.

We noted during the audit of M/s Durga Distilleries India Private Limited, Vijayawada, a Wine manufacturer licensee that they failed to commence production within the stipulated period of two years.

On this being pointed out the Department replied that due to delay in getting alcohol quota and No Objection Certificate (NOC) production could not be commenced.

The fact remains that due to these delays the LOI was not forfeited, since allotment of alcohol quota is done at the level of Commissioner and there was nothing on record to justify this delay.

<sup>13</sup> M/s Bagga Distilleries, Shamshabad; M/s Shaw Wallace, Malkajgiri; M/s Aroma Wines, Sanathnagar; M/s Sri Durga Distilleries, Kankipadu, Vijayawada; M/s Liquor India Limited, Nacharam; M/s United Spirits Nacharam; M/s Rhizome Distilleries, Medchal; M/s R.K. Distilleries, Medchal and The Commissioner of Distilleries and Breweries, Hyderabad.



### 2.7.2 Loss of stamp duty

As per Sl.No. 31(a) (ii) of schedule-IA to Indian Stamp Act, 1899, a lease including sub lease where the period of sub lease is not less than one year shall attract stamp duty @ 2 per cent on the total rent reserved besides registration fee @ 0.5 per cent. Further, as per AP Amendment Act 4 of 1999, all leases including sub lease agreements are compulsorily registerable documents. DO shall watch all the payments due to the Department.

We noted that in three<sup>14</sup> test checked offices, the sub lease deeds were not registered by the distilleries, which resulted in loss of revenue to the Government by way of non-collection of stamp duty and Registration fee amounting to ₹ 19.60 lakh.

The Government collected the amount after we pointed out (July 2011).

<sup>14</sup> M/s Pearl distilleries, Singarayakonda, Prakasam District; M/s Durga liquor India Ltd., Kankipadu, Vijayawada and M/s Liquor India Ltd. Nacharam.