

# **Executive Summary**



## EXECUTIVE SUMMARY

Excise Department is a major contributor (approx. 14 *per cent*) to GNCTD's Tax Revenue. Apart from fulfilling its primary responsibility of revenue collection, the Department controls and regulates the liquor and narcotics trade and discharges the responsibility of making available the same to the consumers, with requisite quality assurance. With effect from 1 July 2017, Excise Duty on various goods and services was subsumed under Goods and Services Tax (GST) except on "Liquor for Human Consumption", thus the revenue collection for Excise Department is mainly from liquor sale.

There are multiple stakeholders involved in the supply and distribution of liquor starting from the manufacturers/distilleries (located outside Delhi) to the respective Bonded Warehouses located in Delhi and then to the various corporation vends, private vends, Hotels, Clubs & Restaurants and finally the consumers. Apart from the multiplicity of stakeholders, there is a multiplicity of heads under which Excise Department collects revenue, i.e., Excise duty, License fees, Permit fees, Import/Export fees etc. on Liquor products. This entails a complex supply chain mechanism to monitor, control and regulate the supply of liquor. Further, the different types of liquor and intoxicants (Country Liquor, Indian Made Foreign Liquor, Foreign Liquor, Denatured spirits and narcotics) are subject to different taxes, pricing, and administrative mechanisms. The Performance Audit on "Regulation and Supply of Liquor in Delhi" has been taken up owing to the importance of Excise duty on liquor, and implications for the fiscal position of the state.

Audit has covered a period of four years from 2017-18 to 2020-21 to examine Regulation and Supply of IMFL and FL Liquor in Delhi, in detail. Supply chain of Country Liquor has been looked into with regard to confiscation activity in Chapter VI. Owing to the substantial changes in the Excise Policy regime from November 2021 onwards and its subsequent withdrawal w.e.f. 1 September 2022, the Excise Policy 2021-22 has been covered in Chapter VIII of this Report.

Audit observed several discrepancies in the way Excise Department monitored and regulated the supply of Liquor in NCT of Delhi. The working of Excise Department raises several questions about the way the Department is fulfilling its responsibility. Total financial implication of the audit findings is approximately ₹ 2,026.91 crore.

### **(A) Issues in Excise Policy for the period 2017-21**

- ***Violations in award of Licenses***

The Department issues several types of Licenses to Wholesalers, Retailers, Hotel, Clubs and Restaurants (HCR) etc., and annually reissues or renews the licenses subject to fulfilment of criteria laid down for the respective License category for the year. Audit observed that the Department could not ensure the implementation of Rule 35 of Delhi Excise Rules, 2010, which prohibits issue of multiple licenses of

different category (Wholesaler, Retailer, HCR etc.) to related parties, leading to the existence of common directorship among entities holding various License Types.

Further the Department was issuing licenses without checking various requirements relating to Excise Rules and Terms and Conditions for the issue of different type of licenses. It was observed that licenses were issued without ensuring solvency, submission of audited financial statements, submission of data regarding sales and wholesale price declared in other states and across the year, verification of criminal antecedents from the competent authority etc.

It is imperative that cases of cross ownership and proxy ownership among companies applying for licenses, based on criteria like common directorship, percentage share-holding, unsecured loan to companies, be dealt with strictly to avoid unfair practices like cartelization in liquor trade and brand promotion. Further, selective adherence of various Rules and Regulations while issuing Licenses is non-compliance of procedures and responsibility should be fixed for violations of the same.

- ***Lack of transparency in pricing of IMFL***

Pricing of liquor was important to ensure optimal excise revenue collection. Excise Department allowed discretion to L1 licensee (Manufacturer and Wholesaler) to declare its Ex-Distillery Price (EDP), for liquor priced above a certain level. All the price components after manufacture, including profit of manufacturer, were added thereafter. Audit observed varying EDP in various States for liquor supplied by same manufacturer unit. Further, this discretion allowed L1 licensee to manipulate prices of liquor to its own advantage, through increase in EDP. Analysis of pricing and sale of a few brands revealed that discretionary EDP led to decline in sales and consequent loss in excise revenue. As the costing details were not sought to ascertain the reasonability of EDP, there was a risk of L1 licensee getting compensated by the profits hidden in increased EDP.

The concept of EDP needs to be transparently defined and cost sheets should be obtained in support of the declared EDP. Department should regulate pricing so as to optimize excise revenue by analysing the impact of pricing on sales.

- ***Inadequate Quality Control***

Ensuring that the liquor supplied in Delhi conforms to prescribed quality standards is the responsibility of the Excise Department. The extant regulatory framework contained relevant provisions which makes it mandatory for the wholesale licensees (L1) to submit various test reports, at the time of issue of licenses, in accordance with the Bureau of Indian Standard (BIS) provisions, as Excise Commissioner had not prescribed separate quality specifications. Audit observed a number of instances where test reports were not compliant with BIS Specifications and the Excise Department issued licenses despite major shortcomings. Important test reports of water quality, harmful ingredients, heavy metals, methyl alcohol, microbiological tests reports etc., were not submitted for various brands. Moreover, the test reports

submitted by some of the licensees were not from National Accreditation Board for Testing and Calibration Laboratories (NABL) Accredited Lab as per the requirement of Food Safety and Standards Authority of India (FSSAI) Act. Deficient test certificates was also noticed during scrutiny of test checked reports. In respect of 51 *per cent* of the test checked reports, relating to Foreign Liquor, it was found that test reports furnished were older than one year/or no test report was provided/date not mentioned.

There is an urgent need that the Excise Department should proactively monitor the quality of alcohol and frame stringent quality standards and ensure compliance of the same.

- ***Weak Regulatory Functioning***

Effective and efficient exercise of the regulatory and administrative function by the Department is paramount for timely identification and plugging of revenue leakages and acting as a deterrent against smuggling of liquor. The role of the Excise Department was largely limited to making record of seizures and disposal of case property and data suggested that the Excise Intelligence Bureau (EIB) failed to act as an effective deterrent. The data maintained by the Department was fragmented and rudimentary with little to no analytical value, which further hindered any attempt at gaining data driven actionable insights.

Country liquor was the most seized liquor type forming 65 *per cent* of the total liquor seized by EIB. The reasons for smuggling of country liquor was largely structural, with a supply side constraint on quota of supplied liquor, and availability of bottle sizes and presence of limited number of brands. Analysis of registered FIRs revealed a pattern with some areas being the hotspots for smuggling, and a few regional brands having overwhelmingly large share in the smuggled liquor.

Detailed analysis of the case-wise aggregated data of confiscation and EIB cases should be made, to identify liquor smuggling hotspots, brands involved, possible reasons for smuggling, estimated revenue leakage etc. A coordinated action with other State Excise enforcement machinery might help in curbing the smuggling of liquor.

- ***Poor execution of Enforcement function***

Apart from its role as a deterrent, Enforcement is supposed to penalise existing licensees for violations of Delhi Excise Act/ Rules etc. Various critical weaknesses were noticed which hampered the ability of the Department to either penalise violation appropriately or act as sufficient deterrent against further violations. The actual raids were discretionary and fragmented in the absence of any Standard Operating Procedure. Further, lack of rigour in evidence collection and substantiation including utilization of ESCIMS data did put the cases on weak footing to begin with. Lapses were observed at each stage of the enforcement process, ranging from incorrect Inspection Reports to deficient Show Cause Notices.

Enforcement function needs to be strengthened starting from formulation of Standard Operating Procedure, meticulous evidence collection and investigation and expeditious disposal of cases. Computerization of Inspection Reports and the process followed thereafter needs to be done to ensure transparency and accountability in the enforcement function.

- ***Lacunae in End to End Tracking of Inventory***

An IT enabled system was operationalized in December 2013, for barcode based tracking of inventory and payment solution for all stakeholders. The primary objective of ESCIMS was to ensure end-to-end tracking of liquor, via barcode capture, at every stage and authentication of sale at Point of Sale (POS). However, the Department's inability to ensure sale of all the liquor through scanning led to the adoption of stock reconciliation post-sale (Monthly Stock Reconciliation- MSR Gap) which was outside the scope of contract agreement. This reconciliation procedure introduced various anomalies in the sales data and undermined inventory tracking, data accuracy, regulatory effectiveness and also increased the risk of Non-Duty Paid Liquor being circulated through use of duplicate barcodes.

Further, the project of Excise Adhesive Labels, aimed at enhancing security of labels, could not be implemented as a result of which the objective of authenticity, traceability and security aspects of the supply side could not be achieved.

There was a need to replace the outdated MSR-gap method with real time end to end barcode tracking. Secure barcode labels should be implemented swiftly to prevent barcode duplication and misuse. Data Analytic tools and Artificial Intelligence algorithms should be deployed to help in analysis and automatic generation of red flags for anomalous data and easy identification.

**(B) Issues in the New Excise Policy (2021-22)**

Excise Policy for the year 2021-22 was framed ostensibly to achieve the objectives including to not allow formation of any monopoly or cartel in liquor trade, to ensure equitable access of liquor supply to all the wards/area of Delhi, to allow the responsible players in the industry to carry out the trade transparently without resorting to any proxy model and to eradicate sale of spurious liquor and check bootlegging.

- ***Infirmities in formation of Excise Policy***

Recommendations of the Expert Committee, formed for suggesting changes for formation of new Excise Policy, were ignored while formation of the same, justification of which was not available in records provided. These changes included grant of wholesale license to private entities instead of State owned wholesale entity, upfront charging of excise duty in the license fees in place of excise duty to be charged per bottle, applicant being allowed to get a maximum of 54 retail vends in place of an individual being allotted a maximum of two vends.

Further, in violation of Cabinet decision, necessary permissions from the Cabinet/opinion of the Lieutenant Governor were not obtained before giving important exemptions/relaxations having revenue implications.

- ***Issue in Design and Award of Licenses***

One of the objectives of the policy was prevention of the formation of monopoly or cartel. However, the new policy had inherent design issues including the imposed exclusivity arrangement between manufacturers and wholesalers and formation of retail zone with a minimum of 27 wards in each zone. These issues resulted in limiting the number of total licensees and increasing the risk of monopolisation and cartel formation. It was noticed that wholesale licenses for supply of IMFL and FL were granted to 14 business entities, whereas the same were granted to 77 manufacturers of IMFL and 24 suppliers of FL in the old policy (2020-21). Similarly, for the purpose of Retail Vends, Delhi was divided into 32 Zones (containing 849 vends) whose licenses were granted to 22 entities through tendering, whereas, 377 retail vends were run by four Government Corporations and 262 retail vends were allotted to private individuals previously. Moreover, cases of related business entities holding licenses across the supply chain and skewed distribution pattern highlighted the risk of exclusivity arrangements and Brand Pushing.

- ***Issues in implementation of Excise Policy***

While some retailers retained licenses till the expiry of the policy period, some surrendered the same before the policy period was over. As retail licensees were limited in numbers, it caused disruption in supply because the Policy did not contain any provision requiring the licensees to give advance notice before surrendering the license. Further, there was revenue loss of approximately ₹ 890 crore to the Government as it did not retender the surrendered retail licenses.

In spite of being aware that vends were required to be opened in non-conforming wards in order to achieve the objective of equitable distribution, the Department did not take timely action to work out modalities leading to non-achievement of the objective. It also resulted in loss of revenue of approximately ₹ 941 crore due to exemptions which had to be given to the zonal licensees.

Despite being mentioned in the conditions of the Tender Document that any commercial risk shall lie with the licensee, clarification provided during the pre-bid meeting that there is no provision for *force majeure* and against the opinion of the Excise Department to relax the license fees, a waiver of license fees of ₹ 144 crore was granted to the zonal licensees on the basis of COVID restrictions (28 December 2021 to 27 January, 2022), resulting in loss of revenue to the Government.

Apart from the above three, incorrect collection of Security Deposit from zonal Licensees, led to loss of revenue of around ₹ 27 Crore. Therefore, these implementation issues of the new policy led to a loss of revenue of approximately ₹ 2,002 crore.

Excise Policy aimed to eradicate sale of spurious liquor and check bootlegging. However, important measures which were planned in the policy like setting up of liquor testing laboratories, batch testing for rigorous quality assurance, and monitoring and regulation through creation of a dedicated post were not ensured.