

CHAPTER-III: STATE EXCISE

3.1 Results of audit

Test check of records of the State Excise Department conducted in audit during the year 2004-05 disclosed non recovery or short recovery of duty, licence fee, etc, amounting to Rs.32.37 crore in 129 cases, under the following broad categories:

(Rupees in crore)

Sl. No.	Category	Number of cases	Amount
1	Error in computation	46	1.43
2	Non/short recovery of licence fee	03	0.02
3	Granting of excessive production loss/wastage	06	3.90
4	Review on working of distilleries	01	20.77
5	Other irregularities	73	6.25
	Total	129	32.37

During the year 2004-05, the Department accepted underassessments of Rs.0.63 crore in 57 cases which had been pointed out in audit in earlier years and recovered the entire amount.

A few illustrative cases having monetary effect of Rs.24.24 crore including the results of a Review on **Working of distilleries** (Rs.20.77 crore) are given in the following paragraphs. After issue of draft paragraphs, Rs.0.61 lakh was recovered.

3.2 Review on Working of Distilleries

Highlights

There was considerable low yield of rectified spirit in private units as compared to co-operative/Government units with revenue implication of Rs. 102.37 crore.

(Paragraph 3.2.7)

Irregular drawal of medium grade alcohol during secondary distillation caused loss of revenue of Rs.20.48 crore.

(Paragraph 3.2.8)

Shifting of levy of fee from the stage of rectified spirit to neutral spirit resulted in forgoing of fee of Rs.57.21 lakh.

(Paragraph 3.2.10)

3.2.1. Introduction

A distillery is a licensed unit where spirits are obtained by distillation of molasses and other materials like malt, grapes (primary distilleries). It also includes units where such spirits are compounded, blended, processed and diluted to produce different kinds of Indian liquor which are then bottled for sale.

The Karnataka Excise Act, 1965 (KE Act) is the basic law governing excise matters. Licensing of distilleries and their actual working is governed by the provisions of the Karnataka Excise (Distillery and Warehouse Rules), 1967 (KE (DW) Rules). While the norms for yield, production and wastage are regulated by the Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer, Wine or Liquors) Rules 1998 (KE (Regulation of Yield, etc.) Rules), excise duties and fees are levied as per the provisions of the Karnataka Excise (Duties and Fees) Rules, 1968 (KE (DF) Rules).

3.2.2 Organisational set up

At the Government level, the general superintendence of the State Excise Department (including distilleries) is vested with the Principal Secretary to Government in the Finance Department. The Excise Commissioner (EC) is

the head of the department and is responsible for administration of excise matters in the State. Joint Commissioner of Excise (JCE) (Distilleries and Breweries) at the State level, 32 Deputy Commissioners of Excise at district level, 71 Superintendents of Excise (SOE), 406 Inspectors of Excise (IOE) and other staff at the distillery level assist the EC. As of 31 March 2004, there were 60 distilleries in the State supervised by 14 SOEs, 56 IOEs.

3.2.3 Audit objectives

The review seeks to ascertain whether:

- the yield of spirit from molasses and other materials conform to the prescribed standards;
- losses/wastages claimed during manufacture, transit, storage, transport of spirit and liquor are in accordance with the rules; and
- there was proper levy of duties, fees etc.

3.2.4 Scope of audit

There are 60 distilleries in 17 of the 27 districts in the State. Out of these, 22 distilleries located in 12 districts were test checked for the period from 1999-2000 to 2003-04 between December 2004 and April 2005. Besides, the records of EC's Office were scrutinised.

3.2.5 Trend of revenue

The revenue from distilleries mainly consists of licence fee and duty on liquor. Revenue realisable as per the budget estimates and that realised during the period from 1999-2000 to 2003-04 were as follows:

(Rupees in crore)

Year	Budget Estimates (BE)	Actual	Variation of actual over BE excess (+)/shortfall (-)	Percentage of variation
1999-2000	160.00	139.19	(-) 20.81	(-) 13.00
2000-2001	184.00	167.64	(-) 16.36	(-) 8.89

(Rupees in crore)

Year	Budget Estimates (BE)	Actual	Variation of actual over BE excess (+)/shortfall (-)	Percentage of variation
2001-2002	227.77	413.84	(+)186.07	(+)44.96
2002-2003	248.48	411.34	(+)162.86	(+)39.59
2003-2004	654.09	847.93	(+)193.84	(+)22.86

The basis for the preparation of the budget estimates was not made available. The Department attributed decrease in actual realisation during the years 1999-2000 and 2000-01 to drought conditions. Increase in actual realisation during the year 2001-02 was stated to be due to merger of sales tax component with excise duty. Increase in revenue for the year 2003-04 was stated to be due to greater compliance on account of reduction in rates of excise duty, additional excise duty and abolition of litre fee* from 1st July 2003.

Though overall revenue from distilleries increased, the licence fee realised from distilleries showed downward trend due to decrease in number of licences of distilleries renewed, as per the details furnished hereunder:

(Rupees in crore)

Year	Budget Estimates	Actual revenue realised	Number of distilleries
1999-2000	9.14	17.22	100
2000-2001	10.51	20.40	82
2001-2002	13.02	25.13	81
2002-2003	14.01	22.83	68
2003-2004	14.01	17.45	66

3.2.6 Internal audit

Internal audit wing has been functioning in the Department since April 1990. It is headed by the Deputy Commissioner of Excise (Audit and Inspection) who is assisted by an internal audit officer, two assistant audit officers and two senior auditors. The details of coverage of audit are as under:

Year	Total number of distilleries	Number of distilleries audited	Number of distilleries not audited	Number of reports pending as on 31 March 2005	Number of paragraphs pending as on 31 March 2005
1999-2000	82	13	69	24	66
2000-2001	74	58	16	4	6
2001-2002	73	28	45	-	-

* litre fee: Fee per bulk litre of liquor manufactured

Year	Total number of distilleries	Number of distilleries audited	Number of distilleries not audited	Number of reports pending as on 31 March 2005	Number of paragraphs pending as on 31 March 2005
2002-2003	65	14	51	11	15
2003-2004	60	34	26	21	33

Regarding deficiency in coverage, it was stated by the Department that subject to availability of manpower, the major distilleries are audited annually and smaller distilleries are audited once in two/three years.

3.2.7 Need for revision of norms

The KE (Regulation of Yield, etc.) Rules lay down norms for minimum quantity of yield of spirits/liquor from the raw materials used. According to these norms, one tonne of grade I molasses should yield 220 bulk litres (BL) of rectified spirit (RS) of strength 166 degree proof.

The average yield of RS obtained per tonne of grade I molasses during the period 1999-2000 to 2003-04 by 15 primary distilleries was as under:

Sl. No.	Sector/ Name of the distillery	Molasses used (Tonnes)	RS produced (BL)	Average production of RS (BL)
Government/Co-operative				
1	HSSKN, Sankeswar*	1,64,762.120	4,34,31,372.400	263.60
2	MSSK, Hubli ^Y	65,647.800	1,62,82,873.400	248.03
3	Mysugar Co. Ltd., Mandya	1,74,857.400	4,32,54,603.000	247.37
Private				
4	IBDL, Bidar	34,350.000	81,22,133.000	236.45
5	Wilson Distillery, Mandya	15,200.000	36,81,300.000	242.19
6	Gouri Industries, Gauribidnur	1,33,340.000	3,15,11,768.000	236.33
7	J.J. Enterprises, Mysore	15,726.000	35,94,384.300	228.56
8	Revindra Distilleries, Bidar	32,543.000	75,20,610.000	231.10
9	Khoday India Ltd., Bangalore	33,819.000	75,88,828.000	224.40
10	SLN Garag, Dharwad	78,705.000	1,79,28,117.400	227.79
11	Samson Distilleries, Duggavati	1,54,120.000	3,52,55,866.000	228.75
12	Shri Venkateswara Distillery, Bidar	49,149.000	1,11,25,843.000	226.37

* Sri Hiryanakeshi Sahakari Sakkare Karkhane Niyamitha

^Y Sri Malaprabha Sahakari Sakkare Karkhane Niyamitha

Sl. No.	Sector/ Name of the distillery	Molasses used (Tonnes)	RS produced (BL)	Average production of RS (BL)
13	Gemini Distillery, Nanjangud	29,214.780	67,52,779.000	231.14
14	Chamundi Distillery, T Narasipur	19,254.280	44,17,621.000	229.44
15	J.P. Distillery, Kunigal	45,498.010	1,02,26,362.000	224.76

It would be seen from the above that though the yield in respect of all the units was more than minimum quantity of RS prescribed under the rules, higher yield was recorded by units in the Government/co-operative sector as compared to those in the private sector.

Based on the lowest average yield of 247.37 BL per tonne of molasses during the period 1999-2000 to 2003-04 achieved by a Government company (M/s. Mysugar Company Limited), the short yield of spirit recorded by the 12 private units worked out to 239.46 lakh BL with consequent revenue implication of Rs.102.37 crore in the form of excise duty. This also indicates that norms fixed were not in consonance with actual yield and need revision.

After this was pointed out, Government stated in September 2005 that feasibility of revising the standards of minimum production would be considered.

3.2.8 Incorrect drawal of medium grade alcohol

The KE (Regulation of Yield, etc.) Rules provide for drawal of alcohol of strength lower than 166 degree proof [commonly known as medium grade alcohol (MGA) or impure spirit] to the extent of seven *per cent* during primary distillation (manufacture of RS from molasses) but do not permit such drawal during secondary distillation, that is, manufacture of neutral spirit (NS) from RS.

In six[∞] distilleries, during the years 1999-2000 to 2003-04, 22.32 lakh BL of MGA was allowed to be drawn during secondary distillation though no such drawal was permissible. This would have produced 45.52 lakh BL of IML earning a revenue of Rs.20.48 crore.

[∞] IBDL (Bidar), Ravindra & Company (Bidar), Samson Distillery (Duggavathi), SLN (Garag), Khoday Breweries Ltd. (Bangalore), Sri Venkateswara Distilleries (Bidar)

3.2.9 Incorrect allowance of transit wastage of malt/grape spirits

The KE (Regulation of Yield, etc.) Rules provide for wastage of upto one *per cent* during transport of RS. For wastage beyond this limit, penalty at the rate equivalent to rate of excise duty leviable on liquor could be imposed. As per the definition in the KE (RS) Rules and the KE (DF) Rules, RS means plain undenatured alcohol of strength not less than 52 degrees over proof (OP). Malt spirit and grape spirit (which are blended with RS to produce various kinds of liquors) have strengths of less than 52 degrees OP and hence do not qualify as RS. Therefore, wastage was not permissible during their transport. However, no penalty can be imposed on such wastage as it has not been specified.

In 10[♦] distilleries, 21,364 BL of malt and grape spirits were allowed as transit wastage. Non existence of the provision of levy of penalty equal to the duty payable resulted in loss of revenue of Rs.13.39 lakh.

Government stated in September 2005 that for the purpose of levy of fees, malt spirit and grape spirit are treated at par with RS. Therefore, transit wastage has been allowed at one *per cent* as applicable to RS. The reply is not tenable as the Rules provide for wastage of one *per cent* only for RS.

3.2.10 Levy of fee on RS/NS

The KE (DF) Rules provide for levy of excise duty/countervailing duty/additional excise duty on potable liquor and fees in respect of RS and denatured spirit.

- Under the Rules (as they existed prior to April 2001), no licensee who produced RS out of molasses was to issue such RS unless he had paid the fees specified. As per the amendment effective from 01 April 2001, no such fee is to be paid on the RS issued for the manufacture of NS in the same distillery.

In 10^{*} distilleries, a total quantity of 362.18 lakh BL of RS was redistilled during the years 2001-02 to 2003-04 to produce 318.28 lakh BL of NS. Considering that 35.10 lakh BL of MGA was also produced in the process,

[♦] Amrut Distilleries, Dasappa & Sons, IBDL Ltd., Anugraha Distilleries, Durga Distilleries, Shashi Distilleries, McDowell and Co, KBDL (Bidar), Sarvodaya Distillery, Venkateswara Distilleries

^{*} IBDL (Bidar), Samson Distilleries, Ravindra and Co, Gemini Distilleries, Wilson Distilleries, SLN Distilleries, Chamundi Distilleries, Sri Venkateswara Distilleries, Chamundeswari Sugars, Gowri Industries

there was wastage of 8.80 lakh BL of RS. Consequent to the amendment, fee of Rs.57.21 lakh leviable on this quantity was forgone.

The Department stated (May 2005) that fee was levied for the services rendered in taking appropriate action for controlling production, transportation, storage and utilization of spirit. No additional services were rendered in the process of further distillation of RS and hence, it was appropriate that levy was made on the final product, that is, NS. In addition, in practice, such charges relate to services rendered after the spirit leaves the place of production, that is, for monitoring and enforcement activities.

The reply is not tenable as the rules prescribe RS of not less than 166 degree proof as the basic material for manufacture of IML and hence it could not be considered as an intermediary product. As additional process of distillation is involved in the production of NS (168 degree proof), departmental supervision for NS was more than that for RS which needs to be reflected in fee leviable. Moreover, yield of NS is always less than that of RS on account of process wastage. Besides, since fee is also levied on captive consumption it can not be considered as leviable only after spirit leaves the place of production.

- As per the provisions of KE (Regulation of Yield, etc.) Rules, the basic material for manufacture of IML is RS of strength not less than 166 degree proof. The term “Neutral Spirit”, though not defined under the Act and Rules, connotes purified form of RS obtained by redistillation.

Since the conversion of RS into NS involves redistillation, additional supervision is required which is to be reckoned for the purpose of levy of fees. In view of this, fee on NS should be higher than that on RS. However, same amount of fees is levied during the course of issue of both RS and NS.

In 12[∧] distilleries, a total quantity of 817.68 lakh BL of NS was manufactured during the years 1999-2000 to 2003-04. Levy of higher fee, of 50 *per cent* more than that on RS, as in the State of Maharashtra, would fetch additional revenue of Rs.19.74 crore.

- The above amendment came into effect from 01 April 2001. As such fee at the prescribed rate was required to be levied on RS issued for the manufacture of NS prior to that date.

In eight[∧] distilleries, 109 lakh BL of RS was issued for the manufacture of NS in the same distillery during the years 1999-2000 and 2000-01. However,

[∧] Wilson Distilleries, Amrut Distilleries, Khoday's Distillery, Mc Dowell &Co, Sri Venkateswara Distilleries, Chamundi Distilleries, Gemini Distilleries, Gouri Industries, Ravindra and Co., SLN Distilleries, Samson Distilleries, IBDL (Bidar)

[∧]Chamundi Distilleries, Gemini Distilleries, JP Distilleries, Sri Venkateswara Distilleries, Wilson Distilleries, Samson Distilleries, Gouri Industries, IBDL (Bidar)

fee was levied at the point of issue of NS instead of that of RS resulting in non levy of Rs.3.51 lakh by way of fees on RS wasted in the process of manufacture of NS.

The Department stated in May 2005 that the proviso introduced with effect from 01.04.2001 is a clarification issued to the explanation below Rule 2(c) of Karnataka Excise (Duties and Fees) Rules, 1968. NS continues to be classified as RS only and it is not the intention of law to levy fee at any intermediary stage.

The reply is not tenable as rule was amended with effect from 01 April 2001. Earlier rule contemplated levy of fee on RS issued for any use or manufacture of potable or non potable product which included the manufacture of NS.

3.2.11 Check of samples in Government chemical laboratory

The KE (Regulation of Yield, etc.) Rules lay down that distillery officer shall draw three samples of molasses out of which one sample is sent to Government chemical laboratory for analysis for the purpose of determining minimum quantity of RS that could be produced by the distillery. The Rules further prescribe that the licensee shall pay such fees, as fixed by the EC, for such analysis. As per the circular instructions issued by the EC during June 1995, fee leviable shall be Rs.100 per sample.

In five* distilleries, as against 7,393 samples of molasses required to be tested during the years from 1999-2000 to 2003-04, only six were sent for chemical examination leaving grade of 7,387 samples of molasses undetermined for the purpose of producing RS. Besides, in three^ breweries, as against 5,248 batches manufactured during the years 1999-2000 and 2000-01 only 386 batches were sent for chemical examination leaving 4,862 batches untested. Consequently, there was non realisation of fee of Rs.12.25 lakh.

The Department stated in August 2005 that even though molasses were not sent for chemical examination, the yield obtained during the years was more than the minimum prescribed. It was further stated in respect of both the cases that as no testing was done, the fee was not collected. The reply is not tenable as the testing was to be done prior to molasses being put to use and the rules prescribe compulsory testing of samples by collecting required fee.

* Sri Venkateswara Distilleries, IBDL (Bidar), John Distillery, Mysugar Company Limited, Wilson Distillery

^ Mysore Breweries Limited, KBDL (Bangalore), Khoday's Breweries

3.2.12 Recommendations

In view of the above observations, Government may consider to

- revise the standards of yield of spirit from molasses and other ingredients with reference to technology adopted,
- provide for manner of dealing with all types of foreseeable process losses and their periodical revision and
- ensure sample analysis, as provided for.

3.2.13 Acknowledgment

The review was forwarded to Government and Department in June 2005 and was discussed in Audit Review Committee in September 2005. Secretary to Government, Finance Department (Budget and Resources) represented Government while the EC represented the Department. Views of Government/ Department have been incorporated in relevant paragraphs.

3.3 Loss due to permitting sale of bottled beer without valid licence

According to the definition in the Karnataka Excise Act 1965, Indian liquor does not include beer. Under the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules 1968, licences were being issued for running a refreshment room (bar) for sale of both Indian and foreign liquors in Form CL-9. By an amendment effective from February 1990, foreign liquors were excluded from the purview of this licence. Thereafter, for selling beer in such places, a licence in Form-II issued under the Karnataka Excise (Lease of the Right of Retail Vend of Beer) Rules, 1976 is required. Licences under both these Rules are to be obtained each year by payment of the amount prescribed.

It was noticed in November 2004 that 3,381 CL-9 licence holders were incorrectly permitted to sell bottled beer though they had not obtained the licence in Form-II as required. This deprived Government of revenue of Rs.1.75 crore during 2003-04 calculated at Rs.5,175 prescribed for issue of licence in Form-II for sale of bottled beer.

After this was pointed out in November 2004/ May 2005, Government contended in July 2005 that the licence issued in Form CL-9 privileges the

licensee to vend beer also. The reply was not tenable as the amendment dated February 1990 excludes beer from the purview of CL -9.

3.4 Loss of revenue in retail vending of arrack

The Karnataka Excise (Lease of the Right of Retail Vend of Liquors) Rules, 1969 provide for disposal of the right of retail vend of liquors, *inter alia*, by tender cum auction. The Rules empower the Deputy Commissioner to reject any tender, offer or bid submitted on grounds of being too low or for any other reason to be recorded in writing.

In Raichur district, tenders were called in May 2003 for the disposal of the right of retail vend of liquors in Sindhanur taluk for the year 2003-04 by auction. The highest offer of monthly rent of Rs.50 lakh received was rejected as being lower than Rs.68.80 lakh accepted for the previous year. In the reauction held in June 2003, the highest offer received was for Rs.71 lakh. This was also rejected on the ground that it was higher only by 3.19 *per cent* than the previous year's offer. A further auction was held in July 2003 and the offer received for Rs.58.48 lakh was accepted.

While evaluating the offers in the second auction in June 2003, no grounds for anticipating higher offers than the 42 *per cent* increase over the previous highest offer of Rs.50 lakh were made out. However, the Deputy Commissioner of Excise (DCOE) stated in June 2005 that the highest offer received in the second auction was rejected in anticipation of securing higher bids in reauction. It was noticed from the records of the Excise Commissioner that the DCOE while recommending confirmation of acceptance of the bid for Rs.58.48 lakh stated in July 2003 that since there had been not much rain in the taluk, there was no cultivation of crops and due to the fear of drought, nobody had come forward with higher bid than that of the previous year. He had further stated that if reauction was held in future there was no probability of obtaining higher bid than the present offer and hence in the interest of Government revenue, he had provisionally accepted the offer. This was accepted by the Excise Commissioner and confirmed by Government in July 2003.

The grounds stated for rejection of the offer of Rs.71 lakh are not tenable, as the insufficient rains, non cultivation of crops and fear of drought and its consequences which were taken into account in July 2003, were not considered in June 2003. The rejection was not in the interest of Government revenue as projected. Non acceptance of the bid of Rs.71 lakh led Government to forgo additional revenue of Rs.1.50 crore for the year at Rs.12.52 lakh per month.

After this was reported to the Excise Commissioner in April 2005 and referred to Government in May 2005; Excise Commissioner in October 2005 and

Government in December 2005 have stated that the decision for reauction was taken with the bonafide intention of securing higher rentals. The reply is not tenable in view of the facts mentioned above.

3.5 Non/short levy of interest

The Karnataka Excise Licences (General Conditions) Rules, 1967 provide that a person to whom licence to sell liquor is granted shall credit the rent in respect of the shop for the month to the treasury by the last working day of that month (by the 10th day of that month till June 2003). On default, interest at 15 *per cent* per annum shall be charged from the day following the due date on the outstanding amount of rentals as long as it remains undischarged.

In Chickmagalur and Shimoga districts, it was noticed during March/ September 2004 that in respect of five contractors for six^r taluks, rentals for the months of February to June 2003 were paid after delay ranging from 14 to 178 days. The belated payments attracted interest of Rs.32.40 lakh. However, interest of only Rs.10.33 lakh was levied and collected. Thus, there was short levy of Rs.22.07 lakh.

After these cases were pointed out in March and September 2004, Government stated in July 2005 that in respect of two cases relating to Chickmagalur district Rs.0.61 lakh has been recovered and in respect of other cases action would be taken to recover the dues. Report of recovery has not been received (January 2006).

^r Chickmagalur District: Chickmagalur, Kadur
Shimoga District: Bhadravathi, Hosanagara, Sagar, Shimoga