

Chapter III State Excise

3.1 Tax Administration

The State Excise duty is levied on any liquor, intoxicating drug, opium or other narcotics and non-narcotic drugs which the State Government may, by notification, declare to be an excisable article. The Karnataka Excise (KE) Act, 1965 and Rules made thereunder govern the law relating to the production, manufacture, possession, import, export, transport, purchase and sale of liquor and intoxicating drugs and levy of duties of excise thereon. The State Excise Department is working under the administrative control of the Finance Department and is headed by the Excise Commissioner, who is assisted by Joint Commissioners of Excise. The excise duty is administered by the Deputy Commissioners of Excise (DCOE) at the district level and the Superintendents of Excise, Deputy Superintendents of Excise, Inspectors of Excise (IOE) and other sub-ordinate officers at the distilleries and range offices.

3.2 Internal audit

The Internal Audit Wing (IAW) is functional in the Department since 1990. It is headed by an Accounts Officer on deputation from the Office of the Principal Accountant General (Accounts & Entitlements) under the overall control of the Commissioner.

As per the information furnished by the Department, out of 109 offices due for audit during 2014-15, only five (5.59 *per cent*) were audited. The shortfall in coverage of offices was attributed to the shortage of staff in the Wing. Year wise details of the number of objections raised, settled and pending along with tax effect, as furnished by the Department, are as under:

Table 3.1
Year wise details of observations raised by IAW

Year	Observations raised		Observations settled		Observations pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
Upto 2010-11	424	508.44	22	6.47	402	501.97
2011-12	37	39.52	16	31.09	21	8.43
2012-13	75	1153.05	5	6.59	70	1146.46
2013-14	0	0	0	0	0	0
2014-15	6	2.87	0	0	6	2.87
Total	544	1706.88	47	49.15	505	1666.73

As seen from above, the number of paragraphs and amount do not tally. Further, during the year, only 47 objections (8.6 *per cent*) involving ₹ 49.15 lakh (2.88 *per cent*) were cleared out of the 544 objections involving ₹ 1706.88 lakh. The inconsistency in figures, low coverage of offices and large pendency in the outstanding observations indicate that the Department is not according due importance to internal audit.

It is recommended that measures may be taken expeditiously to strengthen IAW, as internal audit is an important mechanism to ensure the compliance of the department with the applicable laws, regulations and approved procedures.

3.3 Results of audit

Test check of records of 30 offices of the State Excise Department during the year 2014-15 revealed non/short levy of licence fee, non-levy of transfer fee, non levy of penalty on short lifting of Indian Made Liquor (IML) and other irregularities amounting to ₹ 11.96 crore involving 57 cases:

Table 3.2
Results of Audit

Sl. No.	Category	No. of cases	(₹ in crore)
			Amount
1	Non-levy of penalty for short lifting of IML	12	7.76
2	Short levy of transfer fee	17	2.60
3	Non/short levy of licence fee	6	0.72
4	Other irregularities	22	0.88
	TOTAL	57	11.96

During the course of the year 2014-15, the Department accepted under assessment of ₹ 3.55 crore in 18 paragraphs and recovered ₹ 7.40 crore involved in 57 paragraphs pointed out in earlier years.

A few illustrative cases involving ₹ 10.57 crore are mentioned in the following paragraphs.

3.4 Short lifting of IML

According to rule 14(2)¹ of the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968, the licensees holding retail shop licences in Form CL-2 and Bar licences in Form CL-9 shall lift for sale, from a distributor licensee, the minimum quantity of liquor fixed per month for the shop. The minimum limit is based on the licence fee prescribed for each type of licence, overheads, other expenses incurred, location of the shop, area of operation, sale of liquor in the previous years and similar factors, to ensure that illicit liquor is not obtained by the licensees and sold in the shop and to ensure that no attempt is made to undersell the liquor and thereby wholesome liquor obtained from authorised sources alone is sold to customers. In case, the licensee fails to lift the minimum quantity of liquor fixed for the month, he shall be liable to pay ₹ 100 for every bulk litre on the quantity short lifted.

To watch the actual monthly lifting of IML by each licensee against the minimum quantity fixed as per the rule, the range offices maintain a 'consumption register'. It was observed that the same was not periodically reviewed by the officers concerned to identify and correct instances of short lifting in a timely manner.

¹ Rule 14(2) of the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968, was deleted through amendment of the Rule with effect from 1 August 2014.

Test check of the consumption registers maintained by 11²IOEs under DCOEs Bengaluru (North), Bengaluru (South), Bengaluru (East), Belagavi and Bellari between July 2014 and December 2014 revealed that 113 licensees (109 CL-9 and four CL-2) had short lifted 7,47,957 bulk litres of IML for the period from 2009-10 to 2013-14. Though these licensees had violated the minimum limits prescribed for lifting of IML, no action was taken by the Department to levy penalty for short lifting of IML as prescribed under the Rules. The non levy of penalty worked out to ₹ 7.47 crore.

After these cases were brought to the notice of the Department in March 2015 and referred to Government in May 2015, ₹ 18.12 lakh was collected from six licensees. In respect of the remaining cases, it was stated that notices have been issued and the recoveries were under progress (November 2015).

3.5 Short levy of fee on transfer of licences due to application of pre-revised rates

According to Rule 17-B(1) of the Karnataka Excise Licences (General Conditions) Rules, 1967, the Deputy Commissioner may, on an application by the licensee and subject to payment of transfer fee equivalent to annual licence fee and with the prior approval of the Excise Commissioner, transfer licence in favour of any person named by such licensee. As per Notification No. FD 05 PES 2013 dated 28 February.2013, the transfer fee leviable was revised to an amount equivalent to twice the annual licence fee and the same was effective from 01 March 2013.

While conducting test check of records in 11 DCOEs³ between September 2014 and March 2015, Audit noticed that in respect of 51 cases of transfer of licences, the fee levied was at the pre-revised rate (equivalent to the annual licence fee) as against the revised rate of twice the annual licence fee, though these transfers were effected on or after 01 March 2013. Fee leviable on transfer of licences at the revised rate amounts to ₹ 4.96 crore where as the fee levied was only ₹ 2.85 crore due to application of the pre-revised rate. The resultant short levy of fees works out to ₹ 2.11 crore.

Audit reported these cases to the Excise Commissioner between January 2015 and April 2015 and referred to the Government in June 2015. An amount of ₹ 6.42 lakh was recovered from two licensees. In respect of the remaining cases, it was stated that notices have been issued (November 2015).

3.6 Short levy of licence fee due to incorrect classification of licence

According to Rule 3(6-A) of the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968, a licence in the Form CL-6A shall be issued by the DCOE to Star Hotels for possession and sale of liquor. As per Explanation under this Rule, 'Star Hotel' means "the hotel recognised as such by the Ministry of Tourism, Government of India". Licence in Form CL-7, on the other hand, is applicable to 'Hotels and Boarding Houses'.

² Ashoknagar, Basavanagudi, Belagavi South, Frazer Town, Hosapete, Jayanagar, Rajajinagar, Shivajinagar, Srirampura, Ulsoor and Viveknagar

³ Bagalkot, Ballari, Bengaluru (East), Bengaluru (North), Bengaluru (South), Bengaluru (West), Dharwad, Hassan, Kalaburgi, Madikeri and Mangaluru

As per Ministry of Tourism, Government of India, four hotels in three districts⁴ were issued classification under star hotel category from different dates mentioned against each hotel in the table below. A test check of records of the DCOEs in the three districts, between August 2014 and January 2015, however, revealed that these hotels obtained licences in Form CL-7 which was applicable to 'Hotels and Boarding Houses' instead of the appropriate licences in Form CL-6A. The Department did not ascertain the status of the hotels while renewing the licences. Thus, incorrect classification of licenses has resulted in short levy of ₹ 78.74 lakh as detailed below:

Table 3.3
Short levy of licence fee due to incorrect classification

(₹ in lakh)

Name of hotel / Date from which 3 star category was effective	Year	Licence fee and additional licence fee (₹ in lakh)		
		leviable under CL-6A	levied under CL-7	Short levy
Hotel E.A.C.Kubera Palace, Raichur/ 13.04.2012	2011-12	5.86 ⁵	4.95	0.91
	2012-13	9.20	4.95	4.25
	2013-14	9.20	4.95	4.25
	2014-15	9.20	4.95	4.25
Rock Regency Hotel Pvt. Ltd., Bellari/ 30.07.2012	2012-13	8.71 ⁶	3.22	5.49
	2013-14	9.20	3.22	5.98
	2014-15	9.20	3.22	5.98
Siddharta Resorts and Foods Pvt. Ltd, Madikeri/ 11.06.2010	2010-11	9.20	3.22	5.98
	2011-12	9.20	3.22	5.98
	2012-13	9.20	3.22	5.98
	2013-14	9.20	3.22	5.98
	2014-15	9.20	3.22	5.98
Vasavi Hotel Pvt. Ltd, Madikeri/ 19.12.2011	2011-12	6.85 ⁷	4.18	2.67
	2012-13	9.20	4.18	5.02
	2013-14	9.20	4.18	5.02
	2014-15	9.20	4.18	5.02
Total		141.02	62.28	78.74

After these cases were brought to the notice of the Department between January 2015 and April 2015 and referred to Government in May 2015, ₹ 23.40 lakh was collected in respect of three licensees. Reply in respect of the remaining case was awaited (November 2015).

3.7 Excess wastage of spirit on maturation

According to Schedule B under Rule 4 of the Karnataka Excise (Regulation of Yield, Production, etc) Rules, 1998, the maximum wastage allowable in the case of maturation of reduced, blended or compounded spirit when stored in wooden casks for manufacture of IML ranges from 3 to 22 per cent, depending upon the period of maturation from 6 to 36 months. After

⁴ Ballari, Madikeri and Raichur,

⁵ Arrived pro rata as licence fee under CL-7 till 13 April 2012 and thereafter, licence fee under CL-6A

⁶ Arrived pro rata as licence fee under CL-7 till 30 July 2012 and thereafter, licence fee under CL-6A

⁷ Arrived pro rata as licence fee under CL-7 till 19 December 2011 and thereafter, licence fee under CL-6A

maturation, further manufacturing loss allowable is five *per cent*. Rule 8 of *ibid* also empower the Excise Commissioner to levy penalty equivalent to the excise duty leviable on the quantity of liquor short produced on account of wastage in excess of the prescribed limit.

In the distillery, M/s. Khoday India Limited, Bengaluru, during the period from 2009-10 to 2013-14, the maturation loss claimed and allowed on malt spirit and neutral spirit stored in wooden casks for periods from 3 to 36 months exceeded the maximum limits by 13,083.50 proof litres of spirit. By utilising this quantity of spirit, 17,444.69 bulk litres of liquor could have been produced, even after allowing maximum permissible manufacturing loss of five *per cent*. On this, Government could have earned revenue amounting to ₹ 20.46 lakh.

After these cases were brought to the notice of the Department in May 2015 and referred to Government in June 2015, it was replied that the State cannot demand duty on spirit which is not alcoholic liquor fit for human consumption. In the case reported in the paragraph, there is no event of manufacture of IML that would attract duty. Further, the reply added that existing rules with regard to maturation under the Excise Act were framed in the year 1977 and were not comprehensive enough and needed revision. A technical committee has already been constituted by G.O. dated 17 June 2014 for this purpose and its decision was awaited.

The first part of the reply is not acceptable as the issue raised is not the levy of duty on spirit. Audit has only reiterated the rule position under Karnataka Excise (Regulation of Yield, Production, etc) Rules, 1998, and brought non compliance of the same to the notice of the Department. The revenue worked out in this respect is also as per the sub-rules framed under the aforesaid Rules. However, if in the opinion of the Department, the rules are outdated, immediate action is required as there is ample scope of misuse in claiming wastage on maturation, if no guidelines are prescribed in this respect. The committee formed in this regard may be instructed to expedite their processes so as to put in practice the new norms as soon as possible (November 2015).