



SUPREME AUDIT INSTITUTION OF INDIA
लोकहितार्थं सत्यनिष्ठा
Dedicated to Truth in Public Interest

**Report of the
Comptroller and Auditor General of India
on State Revenues
for the period ended March 2023**



**Government of Karnataka
Report No. 5 of 2025
(Compliance Audit - Civil)**

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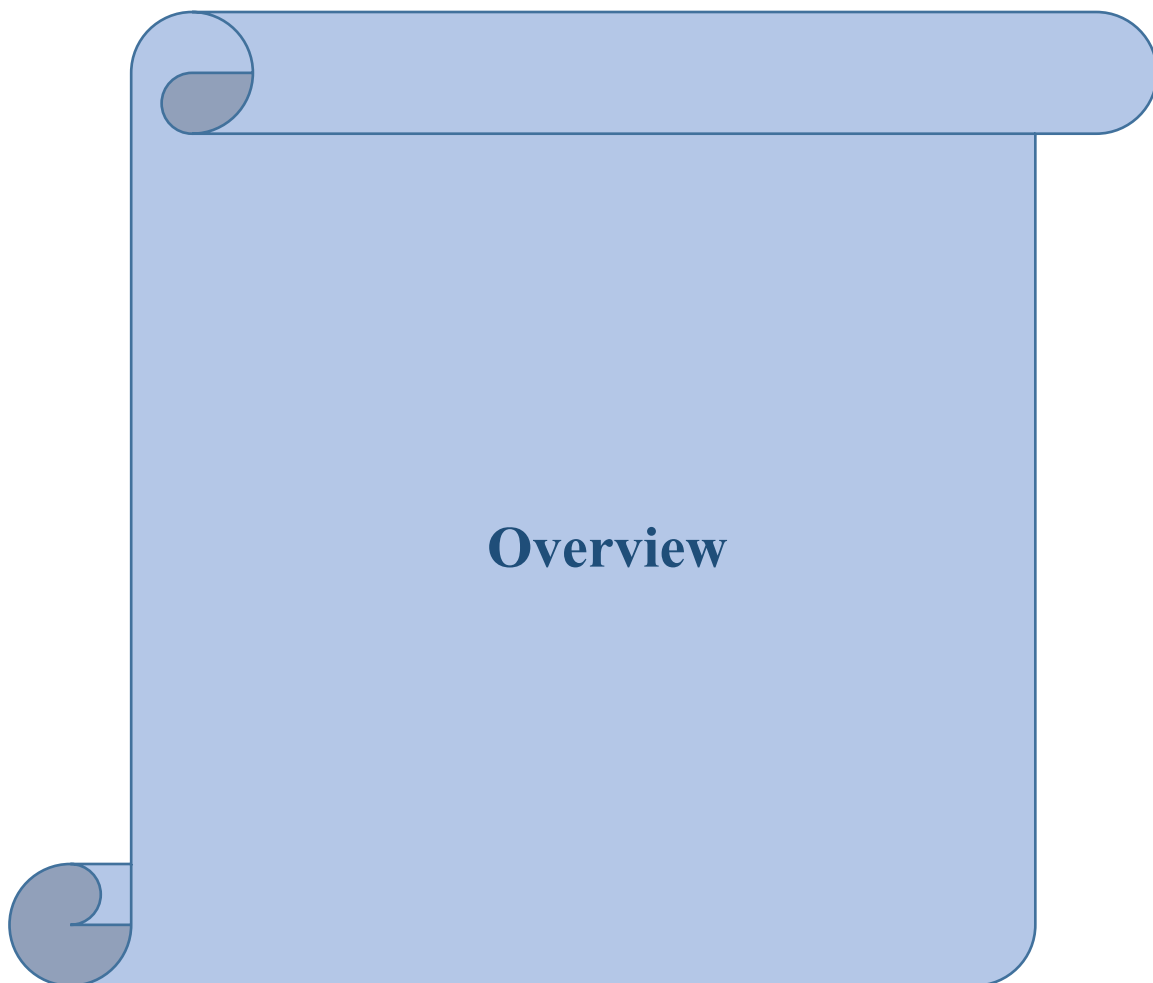
Preface

This Report of the Comptroller and Auditor General of India for the year ended 31 March 2023 has been prepared for submission to the Governor of Karnataka under Article 151 (2) of the Constitution to be tabled in the State Legislature.

The Report contains significant results of the Compliance Audit of the Departments of the Government of Karnataka under Revenue Sector including Commercial Taxes Department, Department of Stamps and Registration, State Excise Department and Transport Department.

The instances mentioned in this report are those which came to notice in the course of test audit for the period 2022-23 as well as those, which came to notice in earlier years, but could not be reported in the previous Audit Reports. Instances relating to period subsequent to 2022-23 are also included, wherever found necessary.

Audit was conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.



Overview

This Report of the Comptroller and Auditor General of India (C&AG) contains 13 paragraphs including three Subject Specific Compliance Audits. These paragraphs contain observations relating to non/Short levy of tax, revenue foregone, *etc.*, amounting to ₹ 1,260.41 crore. Some of the major findings are mentioned below:

General

Total revenue receipts of the State Government for the year 2022-23 amounted to ₹ 2,29,079.74 crore against ₹ 1,95,761.84 crore for the previous year. Of this, 69 *per cent* was raised by the State through tax revenue (₹ 1,43,701.93 crore) and non-tax revenue (₹ 13,914.13 crore). The balance 31 *per cent* was received from the Government of India as State's share of divisible Union taxes (₹ 34,596.18 crore) and grants-in-aid (₹ 36,867.50 crore).

(Paragraph 1.1)

A total of 1,226 Inspection Reports, containing 3,901 observations, involving money value of ₹ 2,009.39 crore, were pending with the Departments for settlement at the end of June 2023.

(Paragraph 1.5)

Test-check of 779 cases and records of 10 LGSTOs relating to Goods and Services Tax, 58 unit offices under Department of Stamps and Registration and 20 unit offices under State Excise Department conducted during the year 2022-23 showed under-assessment/short levy/loss of revenue aggregating to ₹ 3,520.04 crore.

(Paragraph 1.8)

Goods and Services Tax

Subject Specific Compliance Audit on Department's oversight on GST payments and returns filing

The oversight function was deficient in all the selected 10 LGSTOs for monitoring returns filing and demand recovery from non-filers/late filers.

(Paragraphs 2.4.6.1 and 2.4.6.2)

The department's scrutiny of returns was slow, and the MIS reports on the same were not capturing year-wise pendency cases. In addition to this, the non-recording of case wise details of the scrutiny notices resulted in ineffective monitoring of follow-up procedures.

(Paragraph 2.4.6.3)

Audit observed compliance deficiencies in the filing of GSTR-10 in 179 out of 200 test-checked cases across 10 LGSTOs and the follow-up on non-filing of GSTR-10 by the department was inadequate.

(Paragraph 2.4.6.4 (b))

32 out of the 180 test-checked taxpayers had filed GSTR-1 for 146 tax periods but had not filed GSTR-3B. As a result, they passed on ITC credit without discharging the output tax.

(Paragraph 2.4.6.4 (c))

Audit noticed deviations from the provisions of the Act such as mismatch of ITC, availing ITC in cases where the supplier has not paid tax or issued invoices after cancellation and incorrect discharge of tax liability in 208 cases amounting to ₹ 1,143.58 crore.

(Paragraph 2.4.7.2)

The granular records of the taxpayers were not produced by the department to audit in 71 out of 80 cases selected for detailed audit, out of which in 48 cases mismatch in ITC amounting to ₹ 393.04 crore were observed.

(Paragraph 2.4.8.1 (a))

Out of the nine cases where records were produced, Audit observed compliance deficiencies amounting to ₹ 0.17 crore in three cases. The deficiencies were caused due to incorrect claim of exemptions and non-discharge of tax liability on reverse charge basis.

(Paragraph 2.4.8.1 (b))

Subject Specific Compliance Audit on E-Waybills system under GST

Test-check of 99 E-Waybills pertaining to 48 taxpayers revealed the following:

An amount of ₹ 1.92 crore was payable by six taxpayers who have generated E-Waybills after the effective date of cancellation of registration. Three taxpayers who generated E-Waybills did not file GSTR-3B and did not pay tax amounting to ₹ 4.42 crore.

(Paragraph 2.5.11)

Audit noticed shortcomings in the Common Portal. The portal allowed generation of E-Waybills by non-filers of return and taxpayers whose registrations were cancelled. One taxpayer continued under Composition Scheme despite having undertaken inter-state supply of goods.

(Paragraphs 2.5.11.1 to 2.5.11.3)

Audit of the E-Waybills related functions of the preventive units of the department revealed the following:

Out of 250 cases reviewed, 47 taxpayers have paid their due taxes and penalties in their cash ledgers. However, the amounts paid were not debited, resulting in a total non-debit amount of ₹1.42 crore.

(Paragraph 2.5.16.1 (a))

In one instance, the successful bidder paid ₹ 0.29 crore for goods auctioned after departmental confiscation, but this amount was not debited from the electronic cash ledger.

(Paragraph 2.5.16.1 (b))

State Excise
Subject Specific Compliance Audit on the functioning of the Distilleries, Breweries and Microbreweries.

Guidelines issued by the Department of food and Public Distribution assigns the responsibilities of storage, validation of quality and quantity, certification of production, *etc.*, of spirit to the State Excise Department. However, the controls and systems in this regard were not defined by the Department and not in place.

(Paragraph 3.4.6.1 (a))

Bottling Tie up Agreements entered by unlicensed brands with licensed brands in Karnataka were not formalised under the Rules and the scope of levy of fees on such Agreements not operated.

(Paragraph 3.4.6.1 (b))

Import of foreign liquor by KSBCL without CL-11A licence resulted in non-levy of licence fee of ₹ 11.50 crore.

(Paragraph 3.4.6.1 (d))

Revision of Declared Price (DP) was implemented belatedly due to time lag in communication to KSBCL for updating it in its software. Consequent delay in adoption of revised DP resulted in short levy of duty of ₹ 42.46 crore in eight distilleries and five breweries.

(Paragraph 3.4.6.2 (a))

Unreasonable delay in processing the approval of re-labeling of 7,972 cases of beer led to its expiry and destruction of the bottles. Consequent loss of Duty (ED and AED) amounting to ₹ 88.46 lakh.

(Paragraph 3.4.6.2 (c))

Rules framed by the State Government, for collection of fee for label approval, were modified by the Excise Commissioner, without the concurrence of the Government. Resultant short levy of Label Approval Fee amounted to ₹ 31.50 lakh.

(Paragraph 3.4.6.2 (d))

As per the statistics collected from Distilleries currently, prescriptions for raw materials for production of spirit, its strength and the rules regulating production, reprocessing, claim of wastages in manufacturing and transportation of IML were outdated and needs revision.

(Paragraphs 3.4.6.3 and 3.4.6.4)

FSSAI prescriptions for manufacture of blended whiskey and brandy were not adhered to in three cases and the list of ingredients in the label was violated in one case. Such compromises in quality may result in poor rating of IML in the domestic and international market.

(Paragraphs 3.4.6.3 (b) and 3.4.6.3 (c))

Karnataka Excise Act, 1965, does not have enabling, provisions to levy duty on Annual Installed capacity of the Microbreweries. Besides, brewing cycle of 14 days fixed by the Excise Department was on the higher side for 80 *per cent* of the beer produced by the Microbreweries.

(Paragraph 3.4.6.5)

Unauthorised transfer of control of CL-9 licenses to Microbreweries was noticed in six cases and serving of IML in Microbreweries and draught beer in CL-9 premises, which was not allowed, were common.

(Paragraph 3.4.6.6)

Chemical analysis of the beer produced was not done in 23 out of the 25 Microbreweries checked. Activities of fermentation, maturation, *etc.*, and related parameters which determine the yield and strength of the beer manufactured were not monitored. Lack of periodical inspections by the Department, and the non-recording of crucial parameters led to sparse control over the production and quality of beer manufactured in microbreweries.

(Paragraph 3.4.6.7 (a))

Stamp Duty and Registration Fee
--

Misinterpretation of the transaction depicted in a sale deed resulted in short levy of stamp duty and registration fee of ₹ 4.17 crore.

(Paragraph 4.4)

Misclassification of a Joint Development Agreement as a Sale Agreement led to short levy of stamp duty and registration fee of ₹ 1.48 crore.

(Paragraph 4.5)

Non-adherence to special instructions of market value guidelines prescribed by the Central valuation committee observed in nine cases led to short levy of stamp duty and registration fee of ₹ 1.13 crore.

(Paragraph 4.6)

Non-disclosure of existence of building, power of attorney and non-reckoning of advance amounts received as part of consideration led to short levy of stamp duty and registration fee amounting to ₹ 68.16 lakh in eight cases.

(Paragraph 4.7)

In three cases relating to amalgamation of companies, additional stamp duty amounting to ₹ 1.32 crore was not levied.

(Paragraph 4.8)

Registration of documents with expired challans, challans of lesser amounts and challans that were not generated in Khajane resulted in non-collection of government revenue amounting to ₹ 2.01 crore in 269 cases.

(Paragraph 4.9)

Adoption of incorrect rates and non-consideration of enhanced value for converted lands, commercial complexes, sites abutting main roads, *etc.*, in 69 Joint Development Agreements led to short levy of stamp duty and registration fee amounting to ₹ 8.94 crore.

(Paragraph 4.10)

Undervaluation of properties due to adoption of incorrect guidance values, non-adherence to Special Instructions, *etc.*, in 74 documents led to short levy of SD and RF amounting to ₹ 13.77 crore.

(Paragraph 4.11)

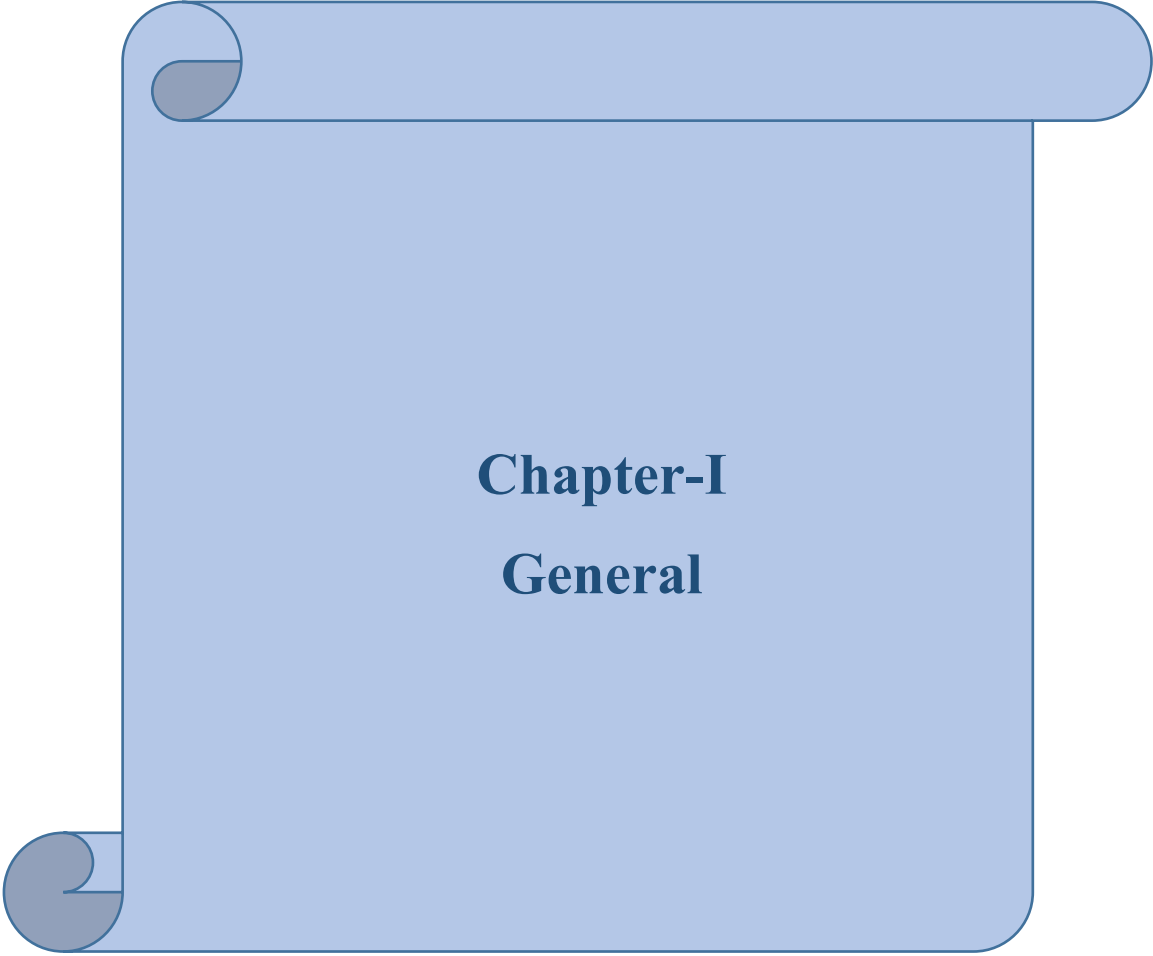
In three settlement deeds related to a trust, stamp duty and registration fee was not levied at the rate of conveyance even though the properties disposed were not settled among family members, resulting in short levy of ₹ 10.51 crore.

(Paragraph 4.12 (a))

Taxes on Motor Vehicles

Adoption of lower rates of tax on 83 Private Service Vehicles resulted in short collection of quarterly tax amounting to ₹ 1.87 crore.

(Paragraph 5.4)



Chapter-I

General

Chapter-I

General

1.1 Trend of revenue receipts

The tax and non-tax revenue raised by the Government of Karnataka during the year 2022-23, the State's share of net proceeds of divisible Union taxes and duties assigned to the State and Grants-in-aid received from the Government of India during the year together with the corresponding figures for the preceding four years are mentioned in **Table 1.1.1**.

Table 1.1.1
Trend of revenue receipts

(₹ in crore)						
Sl. No.	Particulars	2018-19	2019-20	2020-21	2021-22	2022-23
1.	Revenue raised by the State Government					
	• Tax revenue	96,829.71	1,02,362.79	97,052.54	1,20,738.79	1,43,701.93
	• Non-tax revenue	6,772.87	7,681.47	7,893.84	11,777.04	13,914.13
	Total	1,03,602.58	1,10,044.26	1,04,946.38	1,32,515.83	1,57,616.06
2.	Receipts from the Government of India					
	• Share of net proceeds of divisible Union taxes and duties ¹	35,894.83	30,919.00	21,694.11	33,283.58	34,596.18
	• Grants-in-aid	25,481.25	34,479.53	30,075.92	29,962.43	36,867.50
	Total	61,376.08	65,398.53	51,770.03	63,246.01	71,463.68
3.	Total revenue receipts of the State Government (1 and 2)	1,64,978.66	1,75,442.79	1,56,716.41	1,95,761.84	2,29,079.74
4.	Percentage of total revenue raised by the State Government to total revenue receipts (1 to 3)	63	63	67	68	69

Source: State Finance Accounts 2022-23.

The above table indicates that during the year 2022-23, the revenue raised by the State Government (₹ 1,57,616.06 crore) was 69 *per cent* of the total revenue receipts. The balance 31 *per cent* of the receipts during 2022-23 came from the Government of India.

¹ Figures under the major heads of account 0005-Central Goods and Service Tax, 0020-Corporation Tax, 0021-Taxes on Income other than Corporation Tax, 0037-Customs, 0038-Union Excise Duties, 0044-Service Tax and 0045-Other taxes and Duties on Commodities and Services - Minor head-901, as share of net proceeds assigned to States booked in the Finance Accounts of the Government of Karnataka for 2022-23, under 'A-Tax Revenue' have been excluded from the revenue raised by the State Government and included in the State's share of divisible Union taxes.

1.1.2 The details of the tax revenue raised during the period 2018-19 to 2022-23 are given in **Table 1.1.2**.

Table 1.1.2
Details of Tax Revenue

(₹ in crore)

Sl. No.	Head of revenue	2018-19		2019-20		2020-21		2021-22		2022-23		Percentage of increase (+) / decrease (-) in 2022-23 over 2021-22	
		BE	Actual	BE/RE	Actual	BE	Actual	BE	Actual	BE	Actual	BE	Actual
1.	Taxes on sales, trade, etc.	13,532.05	14,003.06	15,149.00	16,424.32	17,783.00	16,027.59	16,791.00	19,273.70	17,640.00	19,082.45	5.06	(-)0.99
2.	State Goods and Services Tax (SGST)	41,649.95	41,956.03	42,748.00	42,147.23	47,319.00	37,711.18	45,947.00	49,929.02	53,220.00	61,403.30 ²	15.83	22.98
3.	State Excise	19,750.00	19,943.93	20,950.00	21,583.95	22,700.00	23,332.10	24,580.00	26,377.68	29,000.00	29,920.37	17.98	13.43
4.	Stamp Duty and Registration Fee	10,400.00	10,774.69	11,828.00	11,308.34	12,655.00	10,576.43	12,655.00	14,019.66	15,000.00	17,726.07	18.53	26.44
5.	Taxes on Vehicles	6,656.42	6,567.67	7,100.00	6,762.58	7,114.84	5,606.99	7,514.80	6,915.26	8,006.69	10,611.18	6.55	53.45
6.	Others	3,832.37	3,584.33	3,038.98	4,136.37	3,162.99	3,798.25	2,979.18	4,223.47	2,866.07	4,958.56	(-)3.80	17.41
Total		95,820.79	96,829.71	1,00,813.98	1,02,362.79	1,10,734.83	97,052.54	1,10,466.98	1,20,738.79	1,25,732.76	1,43,701.93	13.82	19.02

Source: State Finance Accounts 2022-23.

BE: Budget Estimates; RE: Revenue Estimates

1.1.3 The details of the non-tax revenue raised during the period 2018-19 to 2022-23 are indicated in **Table 1.1.3**.

Table 1.1.3
Details of Non-Tax Revenue

(₹ in crore)

Sl. No.	Head of revenue	2018-19		2019-20		2020-21		2021-22		2022-23		Percentage of increase (+) / decrease (-) in 2022-23 over 2021-22	
		BE	Actual	BE	Actual	BE	Actual	BE	Actual	BE	Actual	BE	Actual
1.	Non-ferrous mining and metallurgical Industries	3,000.00	3,026.58	3,550.00	3,629.03	3,750.00	3,893.45	4,000.00	6,308.31	6500.00	5,945.77	62.50	(-)5.75
2.	Other Non-tax receipts	5,180.94	3,746.29	4,505.41	4,052.44	4,017.24	4,000.39	4,258.37	5,468.73	4,440.57	7,968.36	4.28	45.71
Total		8,180.94	6,772.87	8,055.41	7,681.47	7,767.24	7,893.84	8,258.37	11,777.04	10,940.57	13,914.13	32.48	18.15

Source: State Finance Accounts 2022-23.

1.2 Analysis of arrears of revenue

The arrears of revenue as on 31 March 2023 on some principal heads of revenue amounted to ₹ 16,470.51 crore as detailed in **Table 1.2**.

² Includes interest (₹ 241.59 crore), penalty (₹ 83.60 crore), fee (₹ 70.18 crore), input tax credit cross-utilization of SGST and IGST (₹ 22,643.26 crore), apportionment of IGST transfer-in of tax component to SGST (₹ 5,407.65 crore) and advance apportionment from IGST (₹ 2,089.65 crore).

Table 1.2
Arrears of revenue

(₹ in crore)

Sl. No.	Head of revenue	Total amount outstanding as on 31 March 2023	Replies of Department
1.	0039 State Excise Department	607.88	Out of the total arrears, ₹ 79.48 crore was stayed by courts and ₹ 230.05 crore was covered by Revenue Recovery Certificates. The remaining amount of ₹ 298.35 crore was at various other stages.
2.	0022, 0028, 0040, 0042, 0045 Commercial Taxes Department	15,636.60	Out of the total arrears, ₹ 3,696.97 crore was stayed by courts, ₹ 1,431.79 crore was before NCLAT ³ , ₹ 1,403.99 crore was under liquidation process, ₹ 111.66 crore was covered by Revenue Recovery Certificates, ₹ 8,906.15 crore was under Court and Departmental recovery, write off proposals were made for ₹ 57.97 crore and payments of ₹ 28.07 crore received were under verification.
3.	0030 Department of Stamps and Registration	226.03	Not Furnished
Total		16,470.51	

Source: Information received from the Departments concerned.

1.3 Evasion of tax detected by the Departments

The details of cases of evasion of tax detected by the State Excise Department, Commercial Taxes Department (CTD) and Department of Stamps and Registration are given in **Table 1.3**.

Table 1.3
Evasion of tax

(₹ in crore)

Sl. No.	Head of revenue	Cases pending as on 31 March 2022	Cases detected during 2022-23	Total	Number of cases in which assessment/investigation completed and additional demand with penalty etc., raised		Number of cases pending for finalisation as on 31 March 2023
					Number of cases	Amount of demand	
1.	State Excise Department	03	00	03	00	0.00	03
2.	Commercial Taxes Department	9,382	5,701	15,083	8,903	1,161.96	6,180
3.	Department of Stamps and Registration	10	00	10	01	1.03	09

Source: Information received from the Departments concerned.

As seen above, though a number of cases have been settled in CTD, a considerable number of cases are still outstanding at the end of the year. In respect of State Excise Department, there have been no disposals and only one case has been disposed in the Department of Stamps and Registration during the year 2022-23. Early action may be taken to settle these cases in the interest of revenue.

³ National Company Law Appellate Tribunal.

1.4 Pendency of refund cases

The number of refund cases pending at the beginning of the year, claims received during the year, refunds allowed during the year and the cases pending at the close of the year 2022-23 as reported by the Commercial Taxes Department, State Excise Department and the Department of Stamps and Registration are given in **Table 1.4**.

Table 1.4
Details of pendency of refund cases

(₹ in crore)

Sl. No.	Particulars	Commercial Taxes		State Excise		Stamps and Registration	
		No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
1.	Claims outstanding at the beginning of the year	2,239	1,142.88	00	00	5,851	38.69
2.	Claims received during the year	8,255	5,445.53	NF	13.40	7,379	116.79
3.	Refunds made during the year	8,065	4,368.54	NF	13.40	6,747	96.77
4.	Balance outstanding at the end of the year	2,429	2,219.87	00	00	6,483	58.71

NF - Not furnished.

Source: Information received from the Departments concerned.

1.5 Response of the Government/Departments towards Audit

The Principal Accountant General (Audit-I) conducts periodical inspection of the Government Departments to test-check the transactions and verify the maintenance of the important accounts and other records as prescribed in the rules and procedures. These inspections are followed up with the Inspection Reports (IRs) incorporating irregularities detected during the inspections and those not settled on the spot are issued to the heads of the offices inspected with copies to the next higher authorities for taking prompt corrective action.

The heads of the offices/Government are required to promptly comply with the observations contained in the IRs, rectify the defects and omissions and report compliance through initial reply to the Principal Accountant General within one month from the date of issue of IRs. Serious financial irregularities are reported to the heads of the departments and the Government.

A total of 3,901 paragraphs involving ₹ 2,009.39 crore contained in 1,226 IRs (issued upto December 2022), remained outstanding at the end of June 2023. The details along with the corresponding figures for the preceding two years are given in the **Table 1.5**.

Table 1.5
Details of pending Inspection Reports

	As of June 2021	As of June 2022	As of June 2023
Number of IRs pending for settlement	1,260	1,242	1,226
Number of outstanding audit observations	4,035	3,963	3,901
Amount of revenue involved (₹ in crore)	1,807.64	1,864.17	2,009.39

Source: Information derived from IR Registers maintained in the office of Principal Accountant General (Audit-I), Karnataka (AMG-III Group).

1.5.1 The Department-wise details of the IRs and audit observations outstanding as on 30 June 2023 and the amounts involved are given in **Table 1.5.1**.

Table 1.5.1
Department-wise details of IRs

(₹ in crore)					
Sl. No	Name of the Department	Nature of receipts	Number of outstanding IRs	Number of outstanding audit observations	Money value involved
1.	Finance	Commercial Taxes	704	2,611	1,155.03
2.		State Excise	44	56	10.92
3.	Revenue	Stamp Duty and Registration Fee	478	1,234	843.44
Total			1,226	3,901	2,009.39

Source: Information derived from IR Registers maintained in the office of Principal Accountant General (Audit-I), Karnataka.

1.5.2 Departmental Audit Committee meetings

The Government issued (March 1968) instructions to constitute 'Adhoc Committees' in the Secretariat of all the Departments to expedite the clearance of audit observations contained in the Inspection Reports (IRs). These Committees are to be headed by the Secretaries of the Administrative Departments concerned and attended by the designated Officers of the State Government and a nominee of the Principal Accountant General. These Committees are to meet periodically and, in any case, at least once a quarter.

The details of adhoc committee meetings held and paragraphs settled during the year 2022-23 were as under **Table 1.5.2**.

Table 1.5.2
Departmental Audit Committee meetings

(₹ in crore)			
Department	No. of meetings held	No. of paragraphs settled	Money value
Department of Commercial Taxes	1	123	31.48
Department of Stamps and Registration	1	88	15.24

Source: Information received from the vetting sections of office of Principal Accountant General (Audit-I), Karnataka.

Adhoc committee meetings were not convened by the State Excise Department. Action may be taken by the State Government to convene Departmental Audit Committee meetings for clearance of outstanding IRs and audit observations.

1.5.3 Non-production of records to Audit for scrutiny

The programme for local audit of Tax Revenue Offices is drawn up and intimations sent sufficiently in advance, to enable them to keep the relevant records ready for audit.

During 2022-23, 136 Offices under Finance and Revenue Departments were taken up for audit. Out of these, in two Offices, the following records were not produced for audit:

Table 1.5.3
Details of non-production of records

Sl. No.	Name of the Office/ Department	Details of records not produced to audit
1.	Department of Stamps and Registration	SRO, Belagavi
2.		Remittance challans for 248 documents pertaining to the period 2018-19 to 2021-22.
3.		SRO, Kalaburgi
4.		Information regarding bimonthly inspection conducted by District Registrar for the period 2011-22.
5.	Department of Commercial taxes	SRO, Gadag
		Remittance challans for 23 documents pertaining to the period 2019-20 to 2021-22.
		IGR & CS
		Log books of vehicles for the period 2021-22.
		14 LGSTOs, 2 SGSTOs 3 Audit Offices
		Granular records like sales ledger, ITC ledger, credit/debit notes of taxpayers.

Source: Information received from the vetting sections (AMG-III Group) of office of the Principal Accountant General (Audit-I), Karnataka.

1.5.4 Response of the Departments to the Draft Audit Paragraphs

Draft Paragraphs proposed for inclusion in the Audit Report are forwarded by the Principal Accountant General to the Additional Chief Secretary/Principal Secretaries of the Departments concerned through demi-official letters. According to the instructions issued (April 1952) by the Government, all Departments are required to furnish their remarks on the Draft Paragraphs within six weeks of their receipt.

13 Draft Paragraphs (which included two Subject Specific Compliance Audit relating to GST in the Commercial Taxes Department, one Subject Specific Compliance Audit relating to State Excise Department, nine observations relating to Department of Stamps and Registration and one observation pertaining to Transport Department) were proposed for inclusion in the Report of the Comptroller and Auditor General of India (State Revenues) for the year ended March 2023 and forwarded to the Additional Chief Secretary/Principal Secretaries to the Government with copies endorsed to the heads of Departments concerned between November 2023 and August 2024.

Out of the 13 draft paragraphs, nine replies have been received from the Government/Department of Stamps and Registration and one reply received from the Transport Department. In case of the remaining three SSCAs, the audit findings were discussed during the Exit conference and the replies of the Department/Government were considered during finalisation of the paragraphs.

1.5.5 Follow-up on the Audit Reports-Summarised position

According to the Rules of Procedure (Internal Working) of the Committee of Public Accounts (PAC), the Departments of Government are to furnish detailed explanations (Departmental Notes) on the audit paragraphs to the Karnataka Legislative Assembly Secretariat within four months of an Audit Report being laid on the Table of the Legislature. The Rules further require that before such submission, Departmental Notes are to be vetted by the Principal Accountant General.

Sixty five paragraphs (including Performance Audits) pertaining to the Commercial Taxes Department, State Excise Department and the Department of Stamps and Registration were included in five⁴ Reports of the Comptroller and Auditor General of India on the Revenue Sector of the Government of Karnataka which got placed before the State Legislature between February 2018 and February 2023.

As of August 2024, Departmental Notes have been received for all the paragraphs. However, they were received belatedly, with an average delay of 4 to 25 months.

1.6 Analysis of the mechanism for dealing with the issues raised by Audit

To analyse the system of compliance by the Department/Government to the issues highlighted in the Inspection Reports/Audit Reports, action taken on the paragraphs and Performance Audits included in the Audit Reports of the last 10 years for one Department is evaluated and included in this Audit Report.

The succeeding paragraphs 1.6.1 and 1.6.2 discuss the performance of the State Excise Department in respect of the cases detected in the course of local audit during the last ten years and also the cases included in the Audit Reports for the years 2013-14 to 2022-23.

1.6.1 Position of Inspection Reports

The summarised position of the Inspection Reports (IRs) issued during the last ten years, paragraphs included in these Reports and their status as of June 2024 are tabulated below in **Table 1.6.1**.

-
- ⁴ 1. Report of the Comptroller and Auditor General of India on Revenue Sector for the year ended March 2017.
 2. Report of the Comptroller and Auditor General of India on Revenue Sector for the year ended March 2018.
 3. Report of the Comptroller and Auditor General of India on Economic and Revenue Sector for the year ended March 2019.
 4. Report of the Comptroller and Auditor General of India-Compliance Audit-for the year ended March 2020.
 5. Report of the Comptroller and Auditor General of India-Compliance Audit-for the year ended March 2021.

Table 1.6.1
Position of Inspection Reports

(₹ in crore)

Sl. No.	Year	Opening Balance			Addition during the Year			Clearance during the Year			Closing Balance		
		IRs	Para-graphs	Money value	IRs	Para-graphs	Money value	IRs	Para-graphs	Money value	IRs	Para-graphs	Money value
1.	2013-14	988	1,386	433.46	18	230	13.18	12	90	56.42	994	1,526	390.22
2.	2014-15	994	1,526	390.22	38	103	21.67	23	200	21.83	1,009	1,429	390.06
3.	2015-16	1,009	1,429	390.06	31	66	9.40	38	85	11.72	1,002	1,410	387.74
4.	2016-17	1,002	1,410	387.74	30	29	7.07	15	46	17.01	1,017	1,393	377.80
5.	2017-18	1,017	1,393	377.80	27	36	4.39	819	707	316.48	225	722	65.71
6.	2018-19	225	722	65.71	55	20	2.75	5	28	7.46	275	714	61.00
7.	2019-20	275	714	61.00	10	16	1.94	6	33	12.49	279	697	50.45
8.	2020-21	279	697	50.45	11	21	2.10	211	603	35.30	79	115	17.25
9.	2021-22	79	115	17.25	0	0	0.00	11	18	2.22	68	97	15.03
10.	2022-23	68	97	15.03	0	0	0.00	15	33	4.20	53	64	10.83

Source: Information derived from IR Registers maintained in the office of Principal Accountant General (Audit-I), Karnataka.

During regular inspection of Offices, the pending IRs/paragraphs are reviewed on the spot after obtaining satisfactory replies. Settlements of IRs/paragraphs are also made on receipt of compliance from the Department.

1.6.2 Recovery in accepted cases

The position of paragraphs included in the Audit Reports of the last 10 years, those accepted by the Department and the amount recovered during the year, are mentioned in **Table 1.6.2**.

Table 1.6.2
Recovery in accepted cases

(₹ in crore)

Sl. No.	Year of Audit Report	Number of paragraphs included	Money value of the paragraphs	Number of paragraphs accepted	Money value of accepted paragraphs	Amount recovered during the year of Audit Report	Cumulative position of recovery of accepted cases
1.	2012-13	2	3.09	2	3.09	-	0.17
2.	2013-14	1	2.14	1	2.14	-	2.14
3.	2014-15	4	10.57	3	10.37	-	9.98
4.	2015-16	-	-	-	-	-	-
5.	2016-17	1 PA	132.57	-	0.55	-	0.03
6.	2017-18	-	-	-	-	-	-
7.	2018-19	-	-	-	-	-	-
8.	2019-20	-	-	-	-	-	-
9.	2020-21	-	-	-	-	-	-
10.	2021-22	-	-	-	-	-	-
Total		8	148.37	6	16.15		12.32

Source: Information derived from the watch register on audit report paras maintained in the office of Principal Accountant General (Audit-I), Karnataka.

As seen from the table above, the percentage of recovery by the State Excise Department from accepted cases in paragraphs, was 76.28 *per cent*. The Department may take further action to pursue recovery of the dues involved in accepted cases.

1.7 Audit Planning

The Auditable Units under various Departments are categorised into high, medium and low risk units according to their revenue position, past trends of the audit observations and other parameters. The annual audit plan is prepared on the basis of risk analysis which *inter-alia* includes critical issues in Government revenues, the budget speech, white paper on state finances, Reports of the Finance Commission (State and Central), recommendations of the Taxation Reforms Committee, statistical analysis of the revenue earnings during the past five years, factors of the tax administration, audit coverage and its impact during past five years, *etc.*

During the year 2022-23, there were 791 auditable units, of which 136 units were audited, which was 14.92 *per cent* of the total auditable units. The details are shown in **Table 1.7**.

Table 1.7
Details of units audited

Sl. No.	Department	Number of units		
		Auditable Units during the year 2022-23	Units planned for audit during 2022-23	Units audited during 2022-23
1.	Commercial Taxes	458	58	58
2.	Stamps and Registration	291	58	58
3.	State Excise	42	20	20
Total		791	136	136

Source: Information received from the Coordination and vetting sections of AMG-III of office of the Principal Accountant General (Audit-I), Karnataka.

1.8 Results of Audit

Position of local audit conducted during the year

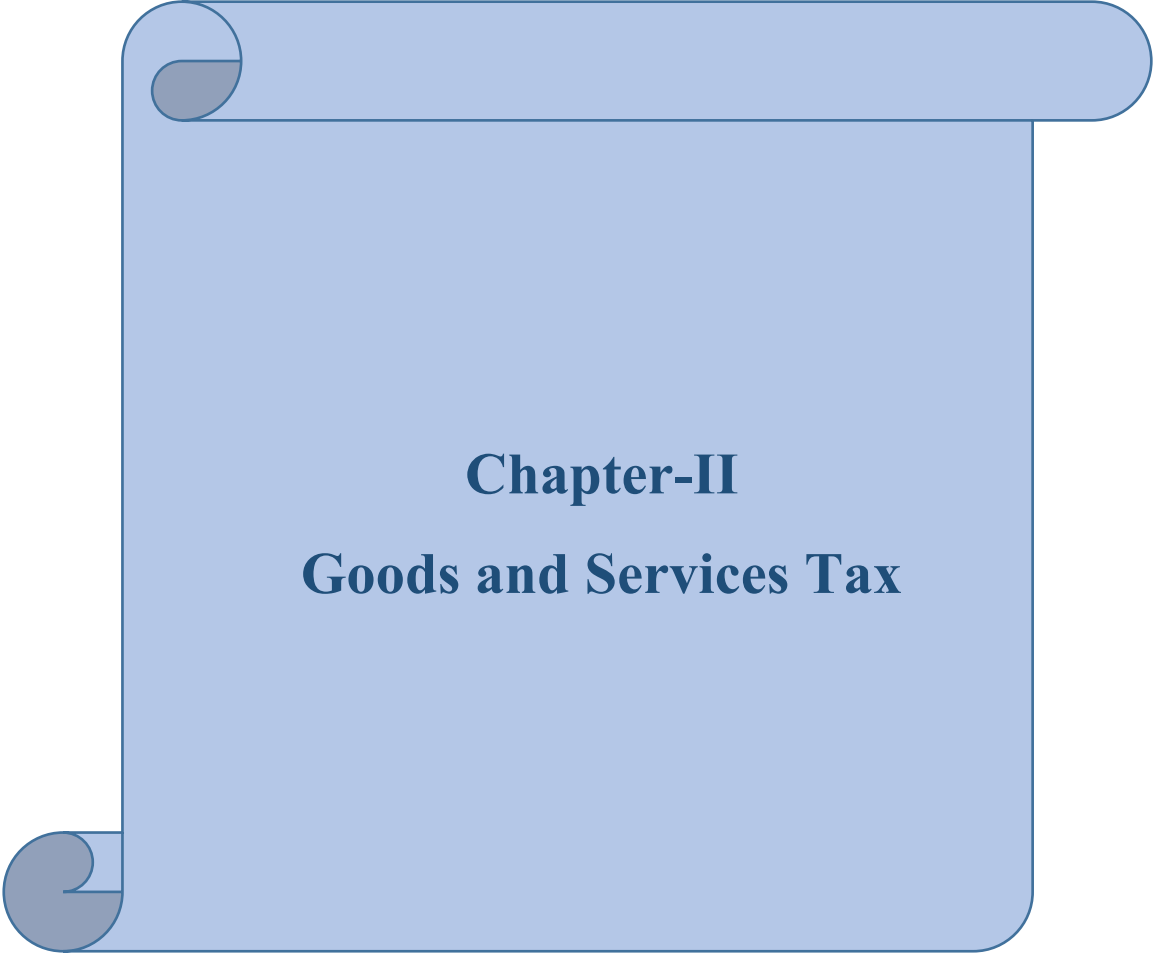
During the year 2022-23, test-check of the records of 699 cases under centralised audit, 80 cases under detailed audit and 10 LGSTOs under Range audit relating to the Commercial Taxes Department showed under assessment/short levy/loss of revenue aggregating ₹ 3,269.80 crore in 790 cases. In respect of Department of Stamps and Registration, Audit conducted test-check of records of 58 unit offices and noticed under assessment/short levy/loss of revenue aggregating ₹ 146.23 crore which were pointed out through 174 paragraphs. During the course of the year, the Department accepted and recovered an amount of ₹ 40.66 crore relating to 31 paragraphs pointed out during earlier years. In respect of State Excise Department, Audit conducted test-check of records of 20 unit offices and noticed short levy/loss of revenue aggregating ₹ 104.01 crore which were pointed out through 25 paragraphs. During the course of the year, the

Department accepted and recovered an amount of ₹ 1.41 crore relating to 20 paragraphs pointed out during earlier years.

1.9 Coverage of this Report

This Report contains 13 paragraphs selected from the audit observations made during the local audit referred to above and during earlier years, (which could not be included in earlier reports) involving financial effect of ₹ 1,260.41 crore.

The Departments/Government had accepted audit observations in 715 cases involving ₹ 525.81 crore, out of which ₹ 5.05 crore had been recovered in 43 cases. The final replies in the remaining cases had not been received (November 2024). These are discussed in succeeding Chapters II to V.



Chapter-II

Goods and Services Tax

Chapter-II

Goods and Services Tax

2.1 Tax Administration

On introduction of Goods and Services Tax (GST), the organisational set-up of the Commercial Taxes Department (CTD) continued as in the Value Added Tax (VAT) regime. The erstwhile Local VAT Offices (LVOs) were re-designated as Local GST Offices (LGSTOs), erstwhile VAT Sub-Offices (VSOs) were re-designated as Sub GST Offices (SGSTOs) and the Audit Offices continued as such. The applicable laws and Rules are administered at the Government level by the Additional Chief Secretary, Finance Department. The Commissioner of Commercial Taxes (CCT) who is the head of the Commercial Taxes Department is assisted by 14 Additional Commissioners. There are 13 Divisional Offices, 13 Appeal Offices, 13 Enforcement/Vigilance Offices and one Minor Acts Division in the State managed by 42 Joint Commissioners (JCCTs). There are 123 Deputy Commissioners (DCCTs), 321 Assistant Commissioners (ACCTs) and 526 Commercial Tax Officers (CTOs) in the State. At the field level, the tax is being administered through 118 Local GST Offices and Sub GST Offices headed by ACCTs and CTOs respectively. The DCCTs, ACCTs and CTOs head 266 Audit Offices where assessments/re-assessments are finalised by the Department.

2.2 Internal Audit

As per the information furnished by the Department, the Internal Audit Wing (IAW) has been functioning since the year 2011-12. During the year 2022-2023, 337 Offices were due for audit, of which, 50 Offices were audited. Year-wise details of the number of objections raised, settled and pending along with tax effect, as furnished by the Department, are given in **Table 2.1**.

Table 2.1
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 2018-19	22,708	472.77	2,134	76.12	20,574	396.65
2019-20	6,670	50.33	3,506	21.61	3,164	28.72
2020-21	15,055	215.71	8,879	35.50	6,176	180.21
2021-22	8,341	114.82	3,646	19.47	4,695	95.35
2022-23	6,104	242.56	265	15.68	5,839	226.88
Total	58,878	1,096.19	18,430	168.39	40,448	927.80

Source: Information furnished by the Department.

As seen from the table, 40,448 cases involving ₹ 927.80 crore were pending for settlement as on 31 March 2023. Early action may be taken to settle pending observations.

2.3 Results of Audit

Subject Specific Compliance Audit (SSCA) on 'Department's Oversight of GST payments and Returns Filing Phase II' covering the returns of 2018-19 to 2020-21 which included check of 699 cases under Centralised Audit, 80 cases under Detailed Audit pertaining to 95 LGSTOs and 10 LGSTOs under Range Audit of the Commercial Taxes Department revealed non/short payment of taxes, interest, risk of mismatch of ITC, risk of undischarged tax liability.

In addition to this, an SSCA on E-Waybills system under GST was also conducted wherein 99 E-Waybills pertaining to 48 taxpayers and 50 booked cases each from five out of nine divisions were audited. The results of the above two SSCAs are as detailed below:

Table 2.2
Results of Audit

Sl. No.	Category	No. of cases	(₹ in crore)
			Amount
1.	SSCA on DoRF Phase II–Centralised Audit	407	3,234.66
2.	SSCA on DoRF Phase II–Detailed Audit	15	14.36
3.	SSCA on DoRF Phase II–Office Audit	368	20.78
4.	SSCA on E-Waybills system under GST (Audit Objective I)	10	7.00
5.	SSCA on E-Waybills system under GST (Audit Objective II)	50	1.80
Total		850	3,278.60

Important audit observations from the above Subject Specific Compliance Audits are brought out below:

2.4 Subject Specific Compliance Audit on 'Department's oversight on GST Payments and Return filing – Phase II'

2.4.1 Introduction

Introduction of Goods and Service Tax (GST) has replaced multiple taxes levied and collected by the Centre and States. GST, which came into effect from 01 July 2017, is a destination-based consumption tax on the supply of goods or services or both levied on every value addition. The Centre and States simultaneously levy GST on a common tax base. Central GST (CGST) and State GST (SGST)/Union Territory GST (UTGST) are levied on intra state supplies, and Integrated GST (IGST) is levied on inter-state supplies.

Section 59 of the Karnataka Goods and Services Tax (KGST) Act, 2017, stipulates GST as a self-assessment-based tax, whereby the responsibility for calculating tax liability, discharging the computed tax liability and filing returns is vested on the taxpayer. The GST returns must be filed online regularly on the common GST portal, failing which penalties will be payable. Even if the business has had no tax liability during a particular tax period, it must file a nil return mandatorily. Further, Section 61 of the Act read with rule 99 of KGST Rules, 2017, stipulate that the Proper Officer (PO) may scrutinize the return and related particulars furnished by taxpayers, communicate discrepancies to the taxpayers and seek an explanation.

This Subject Specific Compliance Audit (SSCA) was taken up considering the significance of the control mechanism envisaged for tax compliance and the oversight mechanism of the Commercial Taxes Department (Department), Karnataka in this new tax regime.

2.4.2 Audit Objectives

This audit was oriented towards providing assurance on the adequacy and effectiveness of systems and procedures adopted by the Department with respect to tax compliance under GST regime. Audit of 'Department's oversight on GST Payments and Return filing' was taken up with the following audit objectives to seek an assurance on:

- i. Whether the rules and procedures were designed to secure an effective check on tax compliance and were being duly observed by taxpayers; and
- ii. Whether the scrutiny procedures, internal audit and other compliance functions of the Local GST Offices (LGSTOs) were adequate and effective.

2.4.3 Audit methodology and scope

This SSCA was predominantly conducted based on data analysis, which highlighted risk areas and red flags pertaining to the period April 2018 to March 2021. Through data analysis, a set of 16 deviations were identified across the domains of Input Tax Credit, Discharge of tax liability, Registration and Return filing. Such deviations were followed up through a centralized audit⁵, whereby these deviations were communicated to the relevant jurisdictional Local GST Offices (LGSTOs) and action taken by the jurisdictional LGSTOs on the identified deviations was ascertained without involving field visits. The centralised audit was supplemented by a detailed audit involving field visits for verification of records available with the LGSTOs. Returns and related attachments and information were accessed through the BOWEB - the back-end application system of the Department, as much as feasible to examine data/documents relating to taxpayers (*viz.*, registration, tax payment, returns and other departmental functions). The detailed audit also involved accessing relevant granular records from the taxpayers such as invoices through the respective LGSTOs. This apart, compliance functions of the LGSTOs such as scrutiny of returns, action on non-filers and late filers, cancellation of GSTINs were also reviewed in selected 10 LGSTOs.

The review of the scrutiny of returns by the Department and verification of taxpayers' records covered the period from April 2018 to March 2021, while the audit of the functions of selected LGSTOs covered the period 2020-21⁶. The field audit was conducted from April 2023 to October 2023.

⁵ Centralised Audit did not involve seeking taxpayer's granular records such as financial statements, related ledger accounts, invoices, agreements, *etc.*

⁶ Scrutiny cases done up to March 2023 were considered in respect of scrutiny of returns under Section 61 of the KGST Act, 2017.

2.4.4 Audit sample

A data driven approach was adopted for planning, as also to determine the nature and extent of substantive audit. The sample for this SSCA comprised of a set of deviations identified through data analysis for centralised audit that did not involve field visits, a sample of taxpayers for detailed audit that involved field visits and scrutiny of taxpayer's records at departmental premises, and a sample of LGSTOs for evaluating the compliance functions of the LGSTOs.

This SSCA has three distinct parts as under:

(i) Part I - Audit of LGSTOs

10 LGSTOs⁷ with jurisdiction over more than one selected sample of cases for Detailed Audit were considered as the sample of LGSTOs for evaluation of their oversight functions.

(ii) Part II - Centralised Audit

Audit analysed GST returns data pertaining to 2018 to 2021 at GSTN premises and identified a set of deviations and logical inconsistencies between GST returns filed by taxpayers. A set of 16 parameters⁸ were identified such as mismatch of ITC availed between Annual Returns and Books of accounts, short payment of interest, ITC mismatches, *etc.* Audit selected a sample of 699⁹ high risk cases for evaluation of the adequacy and effectiveness of the scrutiny procedure of the Department. The audit review was limited to queries issued to the respective LGSTOs between April 2023 and October 2023. There was no further scrutiny of taxpayer records.

(iii) Part III - Detailed audit

Audit selected 80 cases for detailed audit which involved field visits for verification of records available with the LGSTOs. Taxpayers' records like returns and related attachments and information were accessed in Audit Offices in respect of cases already audited by the Department and through LGSTOs by requisitioning corresponding granular records of taxpayers for evaluation of the extent of tax compliance by taxpayers. Audit utilised the login credentials of 'BOWEB' provided to the maximum extent feasible to examine data/documents relating to taxpayers (*viz.*, registration, tax payment, returns and other departmental functions). Efforts were made to access the relevant granular records from the taxpayers on a risk based approach such as invoices, *etc.*, through respective LGSTOs.

Entry Conference of this SSCA was held in June 2023 with the Commissioner of Commercial Taxes in which the audit objectives, sample selection, audit scope and methodology were discussed. The Exit Conference was held on 07 October 2024 with the Commissioner of Commercial Taxes, Karnataka in which the audit findings were discussed. The views expressed by the department during the Exit Conference have been suitably incorporated in the relevant paragraphs.

⁷ LGSTOs 16, 25, 26, 40, 46, 56, 130, 131, 153 and 320.

⁸ 16 parameters are indicated in Table 2.3 (a) and (b).

⁹ 699 tax deviations of 336 taxpayers were selected for Centralised Audit under this SSCA because multiple deviations were noticed for few tax payers.

2.4.5 Audit criteria

The source of audit criteria comprises the provisions contained in the Karnataka Goods and Services Tax (KGST) Act, 2017, IGST Act, 2017, and Rules made thereunder. In addition, the notifications and circulars issued by Commercial Taxes Department relating to filing of returns, notifying the effective dates of filing of various returns, extending due dates for filing returns, rates of tax on goods and services, payment of tax, availing and utilizing ITC, scrutiny of returns and oversight of tax compliance and advisories issued on various subjects also formed part of the audit criteria.

2.4.6 Audit of LGSTOs (Part I)

Four systemic areas were identified for examination in audit *viz.*, (i) deficient monitoring mechanism and action on non-filers by LGSTOs, (ii) action on late filers by LGSTOs, (iii) effectiveness of scrutiny of returns, and (iv) cancellation of registrations.

Accordingly, relevant information was called for from the selected 10 LGSTOs. The role of LGSTOs is to ensure compliance by taxpayers in respect of the accuracy of the taxable value declared, calculation and payment of tax liabilities, filing of returns, *etc.* The LGSTOs have a broad set of functions to be exercised in this regard, which were evaluated as part of this SSCA.

The major audit findings are brought out below:

2.4.6.1 Deficient monitoring mechanism and action on non-filers by LGSTOs

Section 46 of the KGST Act, 2017, read with Rule 68 of KGST Rules, 2017, stipulates issue of a notice in Form GSTR-3A requiring filing of return within fifteen days if the taxpayer had failed to file the return within the due date. In case the taxpayer fails to file the returns even after such notice, the Proper Officer (PO) may proceed to assess the tax liability of the said person to the best of their judgment, considering all the relevant material which is available or gathered and issue an assessment order in Form ASMT-13 as stipulated in Section 62 of the KGST Act, 2017. Filing of returns is related to payment of tax as the due date for both the actions are the same, which implies risk of non-payment of tax/penalty in the case of non-filers. Rule 142 (5) of the KGST Rules, 2017, provides for issue of summary of demand order in DRC-07 for non-payment of tax determined. Rule 145 of the KGST Rules, 2017, provides for issue of notice in Form DRC-13 to third person directing them to discharge any amount due from a taxpayer to Government.

Besides, under Section 50(1) of KGST Act, 2017, every person who is liable to pay tax in accordance with the provisions of this Act or the rules made thereunder, but fails to pay the tax or any part thereof to the Government within the period prescribed, shall for the period for which the tax or any part thereof remains unpaid, pay interest at 18 *per cent* per annum.

(a) The overall filing percentage for GSTR-3B for the State as a whole was 96 *per cent* for 2020-21. As per the MIS Report for the year 2020-21, information only on percentage of filing of GSTR-3B and GSTR-1 was compiled along with number of visits to business premises of non-filers by

LGSTOs and amount collected (MIS 11, 13 and 23). No information on action taken after issue of 3A notices (notice for defaulters who have not filed GST returns), like issue of ASMT-13 (best judgement assessment under Section 62 for non-filing of returns) and DRC-07 (Summary of Demand order as a follow up of ASMT-13)/DRC-13 (Notice for third party attachment for recovery of Government revenue due) was compiled. This indicated that the monitoring mechanism for action taken on non-filers was deficient as on March 2021. Thereafter, information relating to issue of number of 3A notices, ASMT-13, DRC-07/DRC-13, cancellation of GSTIN and revocation, visit to business premises of non-filer taxpayer and amount of tax collected by all these actions was introduced in the MIS Report (MIS 12, 13 and 18) from the month of April 2022.

In the MIS 18 for April 2022, the opening balance of ASMT-13 issued in respect of non-filers for the State as on 01 April 2022 was 2,237 with tax liability of ₹ 79.19 crore. The proforma of MIS does not capture year-wise number of pending ASMT-13 to enable verifications of year-wise pendency. On this being pointed out (July 2024), the Department during the Exit Conference (October 2024) replied that necessary changes would be made in the MIS reports (December 2024).

(b) Audit verified a sample of 240¹⁰ cases out of 4,134 ASMT-13 notices issued in all 10 LGSTOs. Of the 240 cases verified, it was found that in 59 cases (25 per cent), the returns were filed with a delay ranging from 1 to 780 days after 30 days from the date of issue of ASMT-13. Audit noticed that in the intervening period of delay in these cases, the LGSTOs had not issued DRC-07/DRC-13 for recovery of taxes due/third-party attachment notice. Further, it was observed that four taxpayers had not filed returns relating to 12 tax periods as of August 2023, however, DRC-07 for recovery of taxes due was not issued. The underlying tax effect in these 12 cases as per ASMT-13 notices issued was ₹ 1.63 crore.

On this being pointed out (between July 2023 and August 2023), during the Exit Conference (October 2024) the Department replied that DRC-07s were not being issued but they had been issuing DRC-13 directly after the issue of ASMT-13. The Department further stated that it would ensure that DRC-07 was issued before the third-party attachment notice (DRC-13) (December 2024).

(c) Audit verification revealed that taxpayers had filed returns for 66¹¹ tax periods and paid ₹ 13.26 crore tax in cash after issue of ASMT-13 notices. As against the interest of ₹ 0.51 crore payable for the delay, taxpayers had paid only ₹ 0.06 crore interest relating to 15¹² tax periods. This had resulted in non-payment/short payment of interest of ₹ 0.45 crore for 56 tax periods.

On this being pointed out (July 2024), the Government (October 2024) replied that recovery of ₹ 2.86 lakh was made in 10 cases, DRC-07 was issued in five cases for ₹ 1.23 lakh, DRC-13 was issued in six cases for ₹ 1.54 lakh and

¹⁰ Audit selected the top two cases in terms of monetary value from the list of Form ASMT-13 issued for each month during the period 2020-21 from the selected 10 LGSTOs.

¹¹ This excludes 65 tax periods for which interest leviable was individually less than ₹ 10,000 and communicated to the LGSTOs concerned for necessary action.

¹² Interest was paid in full for 10 tax periods and partially in five tax periods.

recovery action initiated by issuing demand notices in 27 cases. The reply of the Government in the remaining eight cases is awaited (December 2024).

2.4.6.2 Action on late filers by LGSTOs

Government vide notifications extended due dates of filing returns for the tax period 2020-21 in view of COVID-19 and also notified concessional rates of interest for the tax periods.

Further, under Section 20(xxv) of IGST Act, 2017, the provisions of CGST Act, 2017, relating to the imposition of penalty and interest shall apply in relation to IGST also.

Calculation of interest has been automated in the GSTR returns from the tax period February 2022 onwards. Prior to this, the onus of issue of demand notices was with the LGSTOs to ensure that payment of interest was not evaded by the taxpayers. In this background, GST Prime¹³ generated an Analytic Report 3.9-3B Late Filers every month which aids in monitoring payment of interest by taxpayers.

(a) Audit verified top 20 cases of late filers in the LGSTOs based on 'Analytical Reports-3B Late Filers' in GST Prime. Of the 197¹⁴ taxpayers verified, it was observed that the taxpayers had filed returns after the due dates and discharged tax of ₹ 331.19 crore in cash. The total interest payable by 196 out of 197 taxpayers amounted to ₹ 7.48 crore. Of these, the LGSTOs had issued notices for interest of ₹ 4.31 crore in respect of 120 taxpayers. Notices were not issued for the interest due of ₹ 2.43 crore in the remaining 77 cases as on the dates of audit (August 2023). Audit verification of the notices issued revealed short demand of interest of ₹ 1.00¹⁵ crore in 76 cases. This had resulted in non/short demand of interest of ₹ 3.43 crore.

On this being pointed out (between June 2023 and August 2023), the Government stated (October 2024) that cases were referred to the LGSTOs for verification (December 2024).

(b) The LGSTOs did not have details of the number of taxpayers who had discharged the interest liability after the issue of notices and the amount recovered. Audit verification revealed that 79 out of the 196 taxpayers had discharged an interest liability of ₹ 2.28 crore as against total interest liability of ₹ 7.48 crore. The total amount pending recovery was ₹ 5.65¹⁶ crore. Further, Audit observed that although the notices demanding interest under Section 50 have been issued, the Electronic Liability Register was not updated upon the issuance of the notice.

On this being pointed out (between July 2023 and August 2023), the department during the Exit Conference stated (7 October 2024) that an offline system will be put in place to watch the payments due on the notices issued while also requesting GSTN to update the Electronic Liability Register on auto

¹³ GST Prime is a product by National Informatics Centre (NIC) to help the tax administrators of state/centre to analyse and monitor the tax collection and compliance in their jurisdiction.

¹⁴ 17 cases in LGSTO 40 and 20 cases each in the remaining 9 LGSTOs.

¹⁵ Notices issued for ₹ 2.57 crore as against ₹ 3.58 crore leviable.

¹⁶ After adjusting excess payment of interest of ₹ 0.49 crore by 28 taxpayers.

computation of interest in subsequent returns for the future. Further, the Government stated (30 October 2024) that necessary action has been initiated to issue Demand notices (December 2024).

2.4.6.3 Effectiveness of scrutiny of returns

As per Section 61 of the KGST Act, 2017, various returns filed by taxpayers have to be scrutinized by the Proper Officer (PO) for the correctness of the returns, and suitable action to rectify discrepancies or inconsistencies in the returns. Rule 99 of the KGST Rules, 2017, mandates that the discrepancies, if any, noticed during scrutiny of returns under Section 61 shall be communicated to the taxpayer in Form ASMT-10 seeking explanation.

(a) For the State as a whole, no information on scrutiny of returns was compiled in MIS reports during 2020-21 and 2021-22. MIS report from April 2022 (MIS 22) onwards captured details of ASMT-10 issued up to 31 March 2022, ASMT-10 (Notice for intimating discrepancies in the return after scrutiny) issued during the month and amount collected from initiation of proceedings including orders passed, if any, during the month.

As per MIS 20 of April 2023, the opening balance of ASMT-10, issued as on 31 March 2023 was 2,33,232 with tax liability of ₹ 654.63 crore. The MIS report compiles details of ASMT-10 issued, ASMT-10 dropped, assignments issued to LGSTOs under Section 73 and amount collected by all actions after initiation of proceedings. However, since the MIS report does not capture these details tax period-wise, Audit could not verify whether timely action was taken in respect of those tax periods for which the time limitation for issue of SCN was over.

Audit observed that the Department had not issued Standard Operating Procedure for scrutiny of returns. Audit verification of scrutiny procedures in 100 test-checked cases in the 10 LGSTOs revealed slow pace of scrutiny of returns. The time taken between issue of ASMT-10 and DRC-01A, in case of reply of taxpayer was not satisfactory ranged from 57 days to 456 days. The time gap in the issue of DRC-01A and DRC-01 ranged between 12 days and 215 days. This indicated that case-wise monitoring of the scrutiny notices for further follow-up was deficient. Of the 23 cases which had not been finalized as of July 2023, 15 cases related to the tax period 2017-18 for which the time limitation for orders under Section 73 lapsed on 31 December 2023. The remaining eight cases¹⁷ are related to the tax periods 2018-19 to 2020-21. Non-finalisation of proceedings in timely manner poses risk of no action within the limitation period prescribed for raising demands under Section 73.

In view of the above, Audit recommended that the Department may consider revising the MIS reports to capture tax period-wise pendency of scrutiny cases so as to make the monitoring of follow-up procedures more effective.

On this being pointed out (between June 2023 and August 2023), the Department during the Exit Conference stated (7 October 2024) that importance was given to the cases becoming time-barred during the review meetings along with cases with high revenue effect. Further, the Government stated (30 October 2024) that the Department will co-ordinate with GSTN and will

¹⁷ 2018-19: 2 cases, 2019-20: 3 cases, 2020-21: 3 cases.

consider the revision of MIS reports to capture the data relating to scrutiny of returns (December 2024).

(b) Audit selected 100 cases¹⁸ out of 4,729 ASMT-10 notices issued in the 10 LGSTOs upto 31 March 2023 for test-check. Audit observed that of the 47 scrutiny notices for which taxpayers had furnished replies, the LGSTOs had not finalized proceedings in respect of six cases even after the lapse of five months to more than a year of receipt of reply from the taxpayers.

On this being pointed out (between June 2023 and August 2023), the Government stated (October 2024) that the proceedings had since been finalized in five cases and one case was referred to Section 65 audit. Of the five cases finalised, reply of taxpayer was accepted and proceedings dropped in four cases and DRC-07 for interest was issued in one case (December 2024).

Out of the 100 test-checked cases, in 53 cases replies were not furnished by the taxpayers. Audit observed that in 17 cases the follow-up action was deficient. Out of these 17 cases, the LGSTOs had issued DRC-01 under Section 73 in 10 cases and DRC-01A in one case and no further action was initiated thereafter. In the remaining six cases, no follow-up action was initiated after issue of ASMT-10 notice.

On this being pointed out (between June 2023 and August 2023), the Government stated (October 2024) that the cases have been referred to the concerned LGSTOs for examination (December 2024).

2.4.6.4 Cancellation of registration

(a) Section 29(1) and Section 29(2) provide for cancellation of registration on application by taxpayer and *suo-moto* for non-filing of returns by taxpayers. Rule 22(3) of the KGST Rules, 2017, provides that where a person who has submitted an application for cancellation (REG-16) of his registration is no longer liable to be registered, the PO shall cancel the registration with effect from a date to be determined by him and notify the taxable person, directing him to pay arrears of any tax, interest or penalty including the amount liable to be paid under sub-section (5) of Section 29. In any case the effective date should not be a date earlier than the date of application for the same.

Rule 21A of the KGST Rules, 2017, states that where a registered person has applied for cancellation of registration, the registration shall be deemed to be suspended from the date of submission of the application or the date from which the cancellation is sought, whichever is later, pending the completion of proceedings for cancellation of registration. The cancellation order in REG-19 has to be issued within 30 days from the date of application (taxpayers request) or the date of reply to REG-17 in case of *suo- moto* cancellation.

Audit could not verify the adherence to the GST provisions in respect of taxpayers who had applied for cancellation of GSTINs as the LGSTOs could not provide any information.

On this being pointed out (between June 2023 and August 2023), the Government stated (October 2024) that the cancellation procedures were

¹⁸ Audit selected the top 10 cases in terms of monetary value from the list of Form ASMT-10 issued (scrutiny cases) from each of the selected 10 LGSTOs.

carried out in 2020-21 through GSTPro¹⁹ and after Karnataka transitioned to Model II State, the registration data was not migrated to the present system, that is, BOWEB.

In view of the above, Audit recommends that the Department may enable the complete transfer of registration related data to the new platform, ensuring proper follow-up on cases processed through GSTPro.

(b) As per Section 45 of the KGST Act, 2017, GSTR-10 (final return), has to be filed within three months of the effective date of cancellation or the date of order of cancellation, whichever is later.

Audit verified 200²⁰ (87 on application cancellations and 113 *suo-moto* cancellations) for non-filing of returns out of 2,677 cases of cancellation made by the 10 LGSTOs during 2020-21. Audit observed that 179²¹ of the 200 cancelled taxpayers had not filed GSTR-10.

On this being pointed out (between June 2023 and August 2023), the Government stated (October 2024) that in all REG-16 applications submitted for cancellation of registration, no stock remaining with taxpayer was declared. Hence, filing of GSTR-10 was a mere formality. In respect of *suo-moto* cancelled registrations, it was stated that GSTR-10 filing in *suo-moto* cancelled cases is again a futile exercise as CTD was not able to enforce filing of GSTR-3B and in almost all cases, 3A notices were issued. But none of the taxpayers had filed GSTR-10. Further, there was no basis for best judgment assessment under ASMT-13 as CTD should have evidence about the volume of stock held by the taxpayer as on the date of closure on which ITC is claimed and utilised.

The reply of the Government is not tenable as it contravenes the provisions of Section 45 of KGST Act, 2017, and filing of GSTR-10 is mandatory under the law irrespective of whether revenue is due to the Government or not. Further, audit recommended that the Department should verify the cases of nil stock declared in the REG-16 to avoid potential loss of revenue.

(c) Audit verification revealed that 32 out of the 180 test-checked cancelled taxpayers in the jurisdiction of nine²² LGSTOs had filed GSTR-1 for 146 tax periods but not filed GSTR-3B and hence had passed on ITC credit without discharging the output tax. The tax liability as declared by the taxpayers in the GSTR-1 filed by them amounted to ₹ 3.30 crore.

On this being pointed out (between June 2023 and August 2023), while eight²³ LGSTOs stated (between June 2023 and August 2023) that the cases would be examined. LGSTO 56 stated (August 2023) that the cases would be forwarded to the present jurisdictional office for further action. Reply of the Government is awaited (December 2024).

¹⁹ GSTPro is an online processing system to carry out all the back office processes for commercial taxes department, Karnataka.

²⁰ Audit selected 20 cancellation cases from each of the selected 10 LGSTOs.

²¹ 73 own applications and 106 *suo-moto* applications.

²² LGSTOs 16, 26, 40, 46, 56, 130, 131, 153 and 320.

²³ LGSTOs 16, 26, 40, 46, 130, 131, 153 and 320.

2.4.7 Centralised Audit (Part II)

Audit analyzed GST returns data pertaining to 2018-2021 as made available by Goods and Services Tax Network (GSTN). Rule-based deviations and logical inconsistencies between/in the GST returns filed by taxpayers were identified on a set of 16 parameters, which can be broadly categorized into two domains - ITC and Tax payments.

Out of the 14 prescribed GST returns,²⁴ the following basic returns that apply to normal taxpayers were considered for the purpose of identifying deviations, inconsistencies and mismatches between GST returns/data:

- GSTR-1: monthly return furnished by all normal and casual registered taxpayers making outward supplies of goods and services or both and contains details of outward supplies of goods and services.
- GSTR-3B: monthly summary return of outward supplies and input tax credit claimed, along with payment of tax by the taxpayer to be filed by all taxpayers except those specified under Section 39(1) of the Act. This is the return that populates the credit and debits in the Electronic Credit Ledger and debits in Electronic Cash Ledger.
- GSTR-6: monthly return for Input Service Distributors providing the details of their distributed input tax credit and inward supplies.
- GSTR-8: monthly return to be filed by the e-commerce operators who are required to deduct TCS (Tax collected at source) under GST, introduced in October 2018.
- GSTR-9: annual return to be filed by all registered persons other than an Input Service Distributor (ISD), Tax Deductor at Source/Tax Collector at Source, Casual Taxable Person, and Non-Resident taxpayer. This document contains the details of all supplies made and received under various tax heads (CGST, SGST and IGST) during the entire year along with turnover and audit details for the same.
- GSTR-9C: annual audit form for all taxpayers having a turnover above ₹ 5.00 crore in a particular financial year. It is basically a reconciliation statement between the annual returns filed in GSTR-9 and the taxpayer's audited annual financial statements.
- GSTR-2A: a system-generated statement of inward supplies for a recipient. It contains the details of all B2B transactions of suppliers declared in their Form GSTR-1/5, ISD details from GSTR-6, details from GSTR-7 and GSTR-8 respectively by the counterparty and import of goods

²⁴ GSTR-1, GSTR-3B, GSTR-4 (for taxpayers under the Composition scheme), GSTR-5 (for non-resident taxable person), GSTR-5A {for Non-resident OIDAR (Online Information Data Access and Retrieval), service providers}, GSTR-6 (for Input service distributor), GSTR-7 (for taxpayers deducting TDS), GSTR-8 (for E-commerce operator), GSTR-9 (Annual Return), GSTR-9C (Reconciliation Statement), GSTR-10 (Final return), GSTR-11 {for person having UIN (Unique Identity Number) and claiming a refund}, CMP-08, and ITC-04 (Statement to be filed by a principal/ job-worker about details of goods sent to/received from a job-worker).

from overseas on bill of entry, as received from ICEGATE Portal of Indian Customs.

The data analysis pertaining to the Karnataka State on the 16 identified parameters and extent of deviations/inconsistencies observed are summarised in **Tables-2.3 (a) and (b)**.

Table 2.3 (a): Data analysis summary of sampled cases

(₹ in crore)		
Sl. No.	Parameter Algorithm Used	Amount Number of deviations()
Mismatch in availing of ITC		
1	<u>GSTR-2A vs GSTR-3B</u> ITC available as per GSTR-2A (with all its amendments) was compared with the ITC availed in GSTR-3B (Table 4A(5) for domestic supplies) after considering ITC availed in subsequent year (Table 8(C) of GSTR-9).	2,627.21 (74)
2	<u>ITC passed on without supplier remitting tax</u> ITC available from GSTR-2A was compared with Table 8A of GSTR-9 which captures ITC available figures as an auto-populated non-editable field. Table 8A figure excludes those entries in GSTR-2A where the supplier has not filed GSTR-1 by 31 October 2019/October 2020/October 2021. The difference is used to identify transactions that are not eligible for availing ITC.	443.97 (47)
3	<u>Availing ITC in GSTR-3B filed after the limitation period for availing ITC</u> ITC availed through Table 4 of GSTR-3Bs pertaining to period 2018-19 to 2020-21 filed after October of the following year.	101.35 (49)
4	<u>Mismatch of ITC under Reverse Charge Mechanism²⁵ (RCM)</u> RCM payments in GSTR-9 Table 4G (tax payable) was compared with ITC availed in GSTR-9 Table 6C, 6D and 6F (ITC availed). In cases where GSTR-9 was not available, RCM payment in GSTR-3B Table 3.1(d) was compared with GSTR-3B {4(A)(2) and 4(A)(3)}. Greater of difference in GSTR-9 and GSTR-3B considered where both were available.	356.82 (42)

²⁵ In Reverse Charge Mechanism the liability to pay tax is fixed on the recipient of supply of goods or services or both instead of the supplier or provider for certain notified categories of goods or services or both.

Sl. No.	Parameter Algorithm Used	Amount Number of deviations()
Mismatch in Annual Return and Financial Statements (FS)		
5	<u>Positive figure in GSTR-9C Table 12F</u> Higher amount of ITC claimed than credit that is due when compared between annual return and financial statements (Table 12F of GSTR-9C).	114.24 (18)
6	<u>Positive figure in GSTR-9C Table 14T</u> Higher amount of ITC claimed after reconciliation between ITC declared in annual return with expenses and in financial statement (Table 14T of GSTR-9C).	901.72 (16)
7	<u>Negative figure in GSTR-9C Table 9R</u> Lower figure of tax paid between books of accounts and annual return.	128.12 (13)
Shortfall in Tax paid or Interest and Other deviations		
8	<u>ISD credit incorrectly availed by the recipients</u> ISD received in GSTR-9 Table 6G or GSTR-3B Table 4(A)(4) of the recipients was compared with ITC transferred in GSTR-6 of the distributor.	29.29 (37)
9	<u>Tax short paid</u> Compare GSTR-1 (Table 4 to 11) or GSTR-9 (Tables 4N, 10 and 11) with tax paid details declared in Tables 9 and 14 of GSTR-9. In cases where GSTR-9 is not available, tax paid details declared in Table 3.1 (a) ²⁶ and 3.1(b) ²⁷ in GSTR-3B was compared with GSTR-1 liability. The amendments and advance adjustments declared in GSTR-1 and GSTR-9 are duly considered.	999.25 (88)
10	<u>Composition taxpayers also availing e-commerce facility</u> E-commerce GSTR-8 became effective from 1 October 2018 when TCS provisions became effective. GSTINs declared in GSTR-8 who are also filing GSTR-4 under composition scheme.	NA ²⁸ (5)
11	<u>Tax not remitted due to GSTR-3B not filed</u> Cases where GSTR-3B not filed but GSTR-1 filed indicating taxpayers had carried on the business without discharging tax.	59.67 (48)

²⁶ Outward taxable supplies (other than zero-rated, nil rated and exempted).

²⁷ Outward taxable supplies (zero-rated).

²⁸ NA: Not Assessable.

Sl. No.	Parameter Algorithm Used	Amount Number of deviations()
12	<u>Short payment of interest on delayed payments</u> Interest calculated at the rate of 18 <i>per cent</i> on cash portion of tax payment on delayed filing of GSTR-3B <i>vis-à-vis</i> interest declared in GSTR-3B Table 6.1.	37.71 (125)
13	<u>Suppression of tax liability based on E-Waybill verification</u> GSTR-3B Table 3.1 (a)+(b) was compared with taxable value declared in the E-Waybills and cases where GSTR-3B are less than E-Waybills are identified.	4,582.21 (83)
	Total	10,381.56 (645)

**Table 2.3 (b): Data analysis summary of sampled cases
(Turnover mismatch)**

(₹ in crore)		
Sl. No.	Parameter Algorithm Used	Amount Number of deviations()
Turnover mismatch in Annual Return and Financial Statements (FS)		
1	<u>Negative figure in GSTR-9C Table 7G</u> Taxable turnover that is unreconciled after adjustments made from turnover in the financial statements and turnover under GSTR-9 is lower <i>i.e.</i> , negative.	13,588.49 (19)
2	<u>Under-declaration of taxable supplies as per GSTR-3B <i>vis-à-vis</i> net amount on which TDS/TCS is recovered</u> Table 3.1(a) of GSTR-3B was compared with Table 9 of GSTR-2A. Cases where GSTR-3B values are less than that of GSTR-2A are identified.	352.46 (22)
3	<u>Mismatch of unbilled revenue in Table 5 of form GSTR-9C</u> Mismatch between closing balance of unbilled revenue of previous year (GSTR-9C Table 5H) with opening balance of current year (GSTR-9C Table 5B)	1,309.01 (13)
	Total	15,249.96 (54)

2.4.7.1 Response to Audit

Audit selected a sample of 699 from amongst the top deviations/inconsistencies in each of the 16 parameters for the period 2018-21. The audit queries were issued to the respective LGSTOs/SGSTOs between April 2023 and October 2023 without further scrutiny of taxpayers' records by Audit. The audit check in these cases was limited to verifying the Department's action on the identified deviations/mismatches communicated to them.

2.4.7.2 Results of Centralized Audit

Based on responses received from the Department to the Audit Queries, the extent to which each of the 16 parameters translated into compliance deviations is summarized in **Appendices I (a) and I (b)**.

Summary of Centralized Audit

Audit noticed deviations from the provisions of the KGST Act, 2017, in 208 cases (Column Nos. 4, 6, 8, 10 of Appendix I (a)) involving an amount of ₹ 1,143.58 crore (Column Nos. 5, 7, 9, 11) constituting 33 *per cent* of the 628 inconsistencies/mismatches in data/short or non-levy of tax/interest, for which the Department provided responses. Relatively higher rates of deviations were noticed in risk parameters such as mismatch of ITC, availing ITC in cases where the supplier has not paid tax or issued invoices after cancellation and incorrect discharge of tax liability.

In 373 cases (Column Nos. 14, 16 and 18), constituting 59 *per cent*, where the Department's reply was acceptable to Audit, data entry errors by taxpayers comprised 21 cases (Column No.14), the Dealer/Department had proactively taken action in 97 cases (Column No.16) and 255 cases (Column No.18) had valid explanations.

In 47 cases (Column No.20), constituting seven *per cent*, the Department furnished replies without proper documentary evidence and hence, was not amenable to verification by Audit.

Audit also noticed that in turnover related mismatches (Appendix I (b)), the Department provided responses in 51 cases (Column No.2). Of these in 24 cases (Column Nos. 4, 6, 8, 10) constituting 47 *per cent*, the Department had initiated action on the audit observations. In 19 (37 *per cent*) cases (Column Nos. 14, 16, and 18), replies were acceptable to audit. In eight cases (Column 20) constituting 16 *per cent*, the Department had not provided relevant documents in support of their contention and hence, reply could not be verified.

2.4.7.3 Deviations from GST law and rules

Out of the 679 responses furnished, the Department has accepted the audit observations or initiated examination in 232 cases. Out of these, the Department has recovered/ demand orders issued in 115 cases, issued show cause notices in 13 cases, issued notice conveying discrepancies to the taxpayer in form ASMT-10 in 27 cases and in the remaining 77 cases, the issue is under correspondence with the taxpayers.

A few illustrative cases are given below:

(i) Mismatch in availing of ITC between GSTR-2A and GSTR-3B

GSTR-2A is a purchase related dynamic tax form that is automatically generated for each business by the GST portal, whereas GSTR-3B is a monthly return in which summary of outward supplies along with ITC declared and payment of tax are self-declared by the taxpayer.

To analyze the correctness of ITC utilization, relevant data were extracted from GSTR-3B and GSTR-2A and the ITC paid as per suppliers' details was matched with the ITC credit availed by the taxpayer. The methodology adopted was to compare the ITC available as per GSTR-2A with all its amendments and the ITC availed in GSTR-3B in Table 4A (5)²⁹ excluding the reversals Table 4B (2)³⁰ but including the ITC availed in the subsequent year from Table 8C of GSTR-9.

Audit observed that in case of a taxpayer under LGSTO-020, Bengaluru, the ITC available as per GSTR-2A for the year 2020-21 was ₹ 389.81 crore and the ITC availed in table 4A (5) of GSTR-3B was ₹ 775.83 crore. This resulted in mismatch of ITC availed amounting to ₹ 386.02 crore. On this being pointed out (October 2023), the Government stated (October 2024) that the case was referred to Section 65 audit (December 2024).

(ii) ITC passed on without supplier remitting tax

GSTR-2A is a purchase related dynamic tax return that is automatically generated for each business by the GST portal. To analyze the extent of compliance in respect of availing of ITC under Section 16(4) of the KGST Act, 2017, an attempt has been made to identify likely cases where the ITC would have been passed on by the taxpayer without remitting the tax. For this purpose, the relevant data from GSTR-9 particularly pertaining to Table 8A of GSTR-9 was compared with the ITC data reflected in GSTR-2A.

While GSTR-2A is generated based on the disclosures made by the suppliers in their GSTR-1, the Table 8A of the GSTR-9 is auto-populated (non-editable) from Tables 3, 4, 5 and 6 of the GSTR-2A (Tables 3 and 5 of the old GSTR-2A format) and considers GSTR-2A as available on 31 October of the following financial year.

Audit observed that in case of a taxpayer under LGSTO-070, Bengaluru, the ITC available in table 8A of GSTR-9 for the year 2019-20 was ₹ 23.42 crore and the ITC available in GSTR-2A was ₹ 46.13 crore. The mismatch between the ITC in Table 8A of GSTR-9 and GSTR-2A was ₹ 22.71 crore. On this being pointed out (October 2023), the Government stated (October 2024) that case was referred to Section 65 audit (December 2024).

(iii) Mismatch of ITC under Reverse Charge Mechanism

In Reverse Charge Mechanism, the liability to pay tax is fixed on the recipient of supply of goods or services instead of the supplier or provider in respect of certain categories of goods or services or both under Section 9(3) or Section 9(4)

²⁹ All other eligible ITC.

³⁰ Other ITC reversed.

of the KGST Act, 2017, and under sub-section (3) or sub-section (4) of Section 5 of the IGST Act, 2017.

To check the correctness of ITC availed on tax paid under Reverse Charge Mechanism (RCM), the datasets pertaining to GSTR-3B and annual return GSTR-9 were compared to check whether the ITC availed on RCM was restricted to the extent of tax paid. The methodology adopted was to compare the RCM payments in GSTR-3B Table 3.1(d)³¹ with ITC availed in GSTR-9 Table 6C³², 6D³³ and 6F³⁴. In cases where GSTR-9 was not available, the check was restricted within GSTR-3B where the tax discharged part in R3B Table 3.1(d) was compared with the ITC availing part of R3B 4A (2)³⁵ and 4A (3)³⁶.

Audit observed that in case of a taxpayer under LGSTO-038, Bengaluru, the tax on inputs on RCM basis declared in GSTR-3B was ₹ 7.22 crore and the ITC availed in Table 4A (2) and (3) of GSTR-3B was ₹ 16.86 crore during the year 2019-20 resulting in mismatch of ITC availed amounting to ₹ 9.64 crore. The same mismatch was also reflected as per the figures furnished in GSTR-9 filed. On this being pointed out (August 2023), the Government stated (October 2024) that the case was assigned to the concerned LGSTO under Section 74 (December 2024).

(iv) Positive figure in GSTR-9C Table 12F (unreconciled ITC)

Table 12 of GSTR-9C reconciles ITC declared in annual return (GSTR9) with ITC availed as per audited Annual financial statement or books of accounts. Column 12F of this table deals with unreconciled ITC.

The certified reconciliation statement submitted by the taxpayer as required under the rule 80(3) of KGST Rules, 2017, in form GSTR-9C for the years 2018-19 to 2020-21 were analysed at data level to review the extent of identified mismatch in ITC declared in the Annual Return with the Financial Statements.

As per GSTR-9C filed for the year 2020-21 by a taxpayer under LGSTO-046, Bengaluru, unreconciled ITC of ₹ 8.60 crore was declared in Table 12F of GSTR-9C filed for 2020-21. The difference indicates ITC availed in GST returns in excess of eligible ITC based on financial statements. On this being pointed out (August 2023), the Government stated (October 2024) that the issue was referred for audit under Section 65 (December 2024).

(v) Negative figure in GSTR-9C Table 9R (unreconciled payment)

In order to review the extent of identified mismatch in tax paid reported in the Annual Return *vis-à-vis* the Financial Statements, the relevant data points pertaining to Table 9 of the GSTR-9C reconciliation statement submitted by the taxpayer as required under rule 80(3) of KGST Rules, 2017, for the years 2018-19 to 2020-21 was analyzed at data level.

³¹ Inward supplies (liable to reverse charge).

³² Inward supplies received from unregistered persons liable to reverse charge.

³³ Inward supplies received from registered persons liable to reverse charge.

³⁴ Import of services.

³⁵ Import of services.

³⁶ Inward supplies (liable to reverse charge).

Table 9 of GSTR-9C attempts to reconcile the tax paid by segregating the turnover rate-wise and comparing it with the tax discharged as per annual return GSTR-9. The unreconciled amounts could potentially indicate tax levied at incorrect rates, incorrect depiction of taxable turnover as exempt or incorrect levy of CGST/SGST/IGST. There can also be situations, wherein supplies/tax declared, are reduced through amendments (net of debit notes/credit notes) in respect of the transactions carried out in the subsequent year from April to September. In order to rule out the possibility of incorrect disclosure of the tax paid amount in GSTR-9C, the amount was also compared with actual tax payment details in GSTR-9.

Audit observed in case of a taxpayer under LGSTO-035, Bengaluru, the tax liability determined as per books of accounts in Table 9P of GSTR-9C filed for the period 2020-21 was ₹ 63.79 crore. The total tax discharged as per annual return GSTR-9 was ₹ 48.75 crore resulting in short discharge of tax of ₹ 15.04 crore. On this being pointed out (December 2023), the Government stated (October 2024) that the case was referred for audit under Section 65 (December 2024).

(vi) ISD credit incorrectly availed by the recipients

To analyse whether the ITC availed by the taxpayer was in excess of that transferred by the Input Service Distributor (ISD), ITC availed as declared in the returns of the taxpayer was compared with the ITC transferred by the ISD in their GSTR-6. The methodology adopted was to compare Table 6G³⁷ of GSTR-9 or Table 4(A)(4)³⁸ of GSTR-3B of the recipient taxpayers under the jurisdiction of this State with the sum of Table 5A³⁹, Table 8A⁴⁰, and Table 9A⁴¹ of GSTR-6 of the respective ISD.

Audit observed that in case of a taxpayer under LGSTO-016, Bengaluru, the ITC availed in Table 6G of GSTR-9 of 2018-19 was ₹ 10.79 crore and the ITC transferred by the ISD in Table (5A+8A+9A) of GSTR-6 was ₹ 8.00 crore. This resulted in mismatch of ITC between ISD claimed and that transferred by the ISD by ₹ 2.79 crore. On this being pointed out (November 2023), the Government stated (October 2024) that adjudication order under Section 73 was issued (December 2024).

(vii) Tax short paid

To analyse the undischarged tax liability, relevant data was extracted from GSTR-1, and GSTR-9, and the higher of the tax payable in these returns was compared with the tax paid declared in GSTR-9. Wherever GSTR-9 was not available, a comparison of tax payable between GSTR-1 and GSTR-3B was resorted to. The amendments and advance adjustments declared in GSTR-1 and GSTR-9 were also considered for this purpose. For the algorithm, Tables 4 to 11 of GSTR-1 and Tables 4N, 10 and 11 of GSTR-9 were considered. The greater of tax liability between GSTR-1 and GSTR-9 was compared with the

³⁷ ITC received from ISD.

³⁸ Inward supplies from ISD.

³⁹ Distribution of the amounts of eligible ITC for the tax period.

⁴⁰ Mismatch of ITC reclaimed and distributed.

⁴¹ Redistribution of ITC distributed to a wrong recipient.

tax paid declared in Tables 9 and 14 of GSTR-9 to identify the short payment of tax. In the case of GSTR-3B, tables 6.1 minus Table 3.1(d) were taken into account.

Audit observed that in case of a taxpayer under LGSTO-072, Bengaluru, the tax liability as per GSTR-1 for the year 2019-20 was ₹ 51.08 crore and the tax liability declared as per Table 4N of GSTR-9 (excluding RCM liability) was ₹ 44.26 crore. This resulted in mismatch of tax liability of ₹ 6.82 crore. On this being pointed out (October 2023), the Government stated (October 2024) that the issue was referred for audit under Section 65 (December 2024).

(viii) Tax not remitted due to GSTR-3B not filed

Section 38 of the KGST Act, 2017, mandates that every registered taxpayer has to file the statement of all outward supplies in GSTR-1 on or before 15th of the succeeding month and summary of all outward and inward supplies in GSTR-3B on or before 20th day of the succeeding month. GSTR-3B return is the instrument through which the liability can be offset, and ITC is credited in the ledger. The very availability of GSTR-1 and non-filing of GSTR-3B indicates that the taxpayers had undertaken/carried on the business during the period but have not discharged their tax liability.

Audit observed that a taxpayer under LGSTO-152, Bengaluru, had obtained registration in July 2018 and had not filed GSTR-3B for any tax period until *suo-moto* cancellation of the registration on 21 October 2019 for non-filing of returns. The taxpayer had filed GSTR-1 from July 2018 to March 2019 with tax liability of ₹ 13.01 crore but had not filed GSTR-3B. On this being pointed out (August 2023), the Government stated (October 2024) that DRC-07 along with interest/penalty of ₹ 14.55 crore was issued (December 2024).

(ix) Short payment of interest on delayed payments

Section 50 of the Act stipulates that every person liable to pay tax in accordance with the provisions of this Act or the rules made there under but fails to pay the tax or any part thereof to the Government within the period prescribed, shall for the period for which the tax or any part thereof remains unpaid, pay interest at the rate notified.

The extent of short payment of interest on account of delayed remittance of tax was identified using the tax paid details in GSTR-3B and the date of filing of the GSTR-3B. Only the net tax liability (cash component) has been considered to work out the interest payable.

Audit observed that in case of a taxpayer under LGSTO-050, Bengaluru, the returns (GSTR-3B) pertaining to the months of April 2019 to March 2020, were filed belatedly between May 2019 to June 2021. As against the interest liability of ₹ 1.38 crore, the taxpayer had not paid any interest due on the cash component of the tax liability for the delayed payments. This resulted in non-payment of interest amounting to ₹ 1.38 crore. On this being pointed out (August 2023), the Government stated (October 2024) that DRC-13 was issued (December 2024).

(x) *Suppression of taxable value based on E-Waybill verification*

Every registered taxpayer has to generate E-Waybill for movement of goods giving details of purchaser GSTIN, if applicable, invoice number, taxable value and tax amount. In order to analyse the extent of short payment of tax, relevant data related to tax liability declared in GSTR-3B for the year was compared with disclosures made in E-Waybill. For the algorithm, the cases where GSTR-3B Table 3.1 (a) + (b) tax payable were less than the tax liability declared in the E-Waybills were chosen.

Audit observed that in case of a taxpayer under LGSTO-038, Bengaluru, the taxpayer had generated E-Waybills with tax amount of ₹ 124.49 crore during the year 2018-19. The tax liability declared in GSTR-3B for the year 2018-19 under Tables 3.1 (a) and 3.1 (b) was ₹ 52.03 crore. This had resulted in mismatch of tax liability of ₹ 72.46 crore. On this being pointed out (December 2023), the Government stated (October 2024) that the case was assigned to the LGSTO under Section 74 (December 2024).

(xi) *Negative figure in GSTR-9C Table 7G (unreconciled taxable turnover)*

Table 7 of GSTR-9C is the reconciliation of taxable turnover. Column 7G of this table captures the unreconciled taxable turnover between the annual return GSTR-9 and that declared in the financial statement for the year after the requisite adjustments.

Audit observed that in the case of a taxpayer, under LGSTO-038, there was a difference of taxable turnover as declared in Table 7G of GSTR-9C filed for 2020-21 amounting to ₹ 165.16 crore. On this being pointed out (December 2023), the Government stated (October 2024) that ASMT-10 was issued (December 2024).

(xii) *Under-declaration of taxable supplies as per GSTR-3B vis-à-vis net amount on which TDS/TCS is recovered*

TDS and TCS details are declared in GSTR-7 and GSTR-8 respectively by authorities/taxpayers authorized to do TDS/TCS and a certificate generated in the common portal. This is communicated to the registered person and on acceptance of the TDS/TCS certificate by the registered taxpayer, the TDS/TCS amount is credited to the cash ledger of the taxpayer. The TDS/TCS amount is reflected in Table 9 of GSTR-2A. The cases where the taxable value declared on account of outward taxable supplies (other than zero rated, nil rated and exempted) in GSTR-3B were less than the net amount liable for TCS and TDS credit as per Table 9 of GSTR-2A have been identified.

Audit observed that in case of a taxpayer under LGSTO-480, Chitradurga, the taxpayer had accepted the TDS certificates during 2019-20 with TDS tax amount of ₹ 0.43 crore at one *per cent* each under CGST and SGST. The taxable turnover involved in the TDS certificate amounted to ₹ 21.20 crore against which the taxpayer had declared outward supplies of ₹ 0.10 crore in the GSTR-3B filed. This resulted in suppression of taxable turnover of ₹ 21.10 crore. On this being pointed out (June 2023), the Department stated (August 2023) that ASMT-10 seeking the reasons for the discrepancy had been issued (December 2024).

(xiii) Mismatch of unbilled revenue in Table 5 of form GSTR-9C

In order to review the extent of identified mismatch in taxable turnover reported in the Annual Return *vis-à-vis* the Financial Statements, the relevant datapoints pertaining to Table 5 of the GSTR-9C reconciliation statement pertaining to disclosures of unbilled revenue submitted by the taxpayer as required under rule 80(3) of KGST Rules, 2017, for the years 2018-19 to 2020-21 was analyzed at data level.

Table 5B figures of GSTR-9C for the years 2018-19 to 2020-21 which captures the unbilled revenue at the beginning of the financial year was compared with Table 5H of the previous GSTR-9C returns which captures the unbilled revenue of the end of the year to review the extent of identified mismatch in turnover declared in the Annual Return with the Financial Statements.

Unbilled revenue accounts for that part of transactions that are recorded in the books of accounts on an accrual basis but against which no invoices have been issued till the close of the financial year. The taxpayers have been provided with an option of not declaring these figures separately and just reporting the adjustments in 5O. Cases where both 5B and 5H figures are declared were considered to verify the correctness of discharge of tax on closing balance of unbilled revenue in the subsequent year.

Audit observed in respect of a taxpayer under the jurisdiction of LGSTO-020, Bengaluru, that the taxpayer had declared closing balance of unbilled revenue of ₹ 134.06 crore in Table 5H of GSTR-9C filed for 2019-20 but had not shown any opening balance of unbilled revenue in Table 5B of GSTR-9C filed for 2020-21. On this being pointed out (October 2023), the Government stated (October 2024) that the case was referred for audit under Section 65 (December 2024).

2.4.8 Detailed audit (Part III)

In a self-assessment regime, the onus of compliance with law is on the taxpayer. The role of the Department is to establish and maintain an efficient tax administration mechanism to provide oversight. With finite level of resources, for an effective tax administration, to ensure compliance with law and collection of revenue, an efficient governance mechanism is essential. An IT driven compliance model enables maintaining a non-discretionary regime of governance on scale and facilitates a targeted approach to enforce compliance.

From an external audit perspective, Audit also focused on a data driven risk-based approach. Thus, apart from identifying inconsistencies/deviations in GST returns through pan-India data analysis, a detailed audit of GST returns was also conducted as a part of this review. A risk-based sample of 80 taxpayers under the jurisdiction of 35⁴² LGSTOs was selected for this part of the review. The methodology adopted was to initially conduct a desk review of GST returns and financial statements filed by the taxpayers as part of the GSTR-9C and other records available in the back-end system to identify potential risk areas, inconsistencies/deviations and red flags. Desk review was carried out in the office of Principal Accountant General, Karnataka. Based on desk review

⁴² LGSTOs 15, 16, 17, 20, 21, 25, 26, 36, 40, 45, 46, 56, 63, 75, 90, 91, 100, 111, 121, 130, 131, 140, 152, 153, 180, 195, 200, 260, 290, 310, 320, 330, 420, 480 and SGSTO 421.

results, detailed audit was conducted in LGSTOs by requisitioning corresponding granular records of taxpayers such as financial ledgers, invoices *etc.*, to identify causative factors of the identified risks and to evaluate compliance by taxpayers.

2.4.8.1 Scope limitation (non-production of records)

Audit utilised the information available in the backend system of the State GST Department such as various returns filed, GSTR-9, GSTR-9C and the financial statements uploaded with GSTR-9C and identified the risk areas and requisitioned for granular records such as financial ledgers, invoices, agreement copies, *etc.* In spite of requisitions and follow up (between July 2023 and September 2023), the LGSTOs/departmental audit offices did not produce any taxpayers' granular records in 71 out of the sampled 80 cases. Consequently, in these cases, audit was restricted to the information available in the returns filed by the taxpayers. 26⁴³ out of 35 LGSTOs did not call for the granular records against the risks identified and stated (between September 2023 and October 2023) that the LGSTOs are not empowered to call for books of accounts under Section 61 of the KGST Act, 2017.

On this issue on non-production of granular records brought to the notice of the Government (between October 2023 and November 2023), the Government stated (November 2023) that CAG Audit should align itself with the provisions of the CAG's Duties, Powers and Conditions of Service (DPC) Act, 1971 and the Department lack the power to procure accounts for CAG audit under GST Law. The reply of Government is not tenable as the Constitutional provisions read with the CAG's DPC Act, 1971, and Regulations on Audit and Accounts 2020 envisage production of all records/information required for CAG audit and as per the Regulations, information includes 'any Information relating to any private body which can be accessed by a public authority under any law for the time being in force'. Hence, these provisions read with Rule 56(18) of the KGST Rules, 2017, which stipulates that "every registered person shall, on demand, produce the books of accounts which he is required to maintain under any law for the time being in force" mandates that the LGSTOs seek and provide granular records for the identified risk which is communicated to the LGSTO by the audit team.

(a) Out of the 71 cases of non-production, if the ITC of the previous year availed during the current year and the ITC reversals made during the year were considered (as per details available on the returns filed online), in 48 cases mismatch in ITC amounting to ₹ 393.04 crore⁴⁴ were observed.

On this being pointed out (July 2024), the Government stated (October 2024) that demand notices had been issued in eight cases out of which an amount of ₹0.85 crore was collected in six cases. The remaining 40 cases are under verification by the Department (December 2024).

⁴³ LGSTOs 15, 16, 17, 20, 21, 26, 36, 40, 45, 46, 56, 63, 90, 111, 121, 130, 131, 140, 152, 180, 260, 290, 320, 420, 480 and SGSTO 421.

⁴⁴ In the 71 cases of non-production, a mismatch of ₹ 2,362.06 crore was arrived without considering ITC claimed in the current year as per Table-8C of GSTR-9 of the previous year and ITC reversed under Table 4B(2) of GSTR-3B during the current year.

(b) Out of the nine cases where records were produced, Audit observed compliance deficiencies amounting to ₹ 0.17 crore in three cases. The deficiencies were caused due to incorrect claim of exemptions and non-discharge of tax liability on reverse charge basis.

On this being pointed out (between August 2023 and September 2023), the Government stated (October 2024) that two cases have been taken up for adjudication under Section 73 of the KGST Act, 2017, and in another case, the taxpayer has paid an amount of ₹ 0.07 crore (December 2024).

2.4.9 Conclusion

The Subject Specific Compliance Audit (SSCA) on Department's Oversight on GST Payments and Return Filing was undertaken in the context of varying trend of return filing and continued data inconsistencies with an objective of assessing the adequacy of the system in monitoring return filing and tax payments, extent of compliance and other departmental oversight functions.

This SSCA was predominantly based on data analysis, which highlighted risk areas, red flags and in some cases, rule-based deviations and logical inconsistencies in GST returns filed for the period 2018-21. The SSCA entailed assessing the oversight functions of State Jurisdictional formation at two levels, at the data level through global data queries and at the functional level with a deeper detailed audit both of the LGSTOs and of the GST returns, which involved accessing taxpayer records. The audit sample therefore comprised 10 LGSTOs, 699 high value inconsistencies across 16 parameters selected through global queries and 80 taxpayers selected on risk assessment for detailed audit of GST returns for the period 2018-21.

Further, out of the 699 high value data inconsistencies identified by Audit the Department responded to 679 cases. Audit noticed deviations from the provisions of the Act in 232 cases {Column No.12 of Appendices I (a) and I (b)} involving an amount of ₹ 1,143.58 crore {Column No.13 of Appendix I (a)} constituting 34 *per cent* of the 679 inconsistencies/mismatches in data/short or non-levy of tax/interest, for which the Department provided responses. Relatively higher rates of deviations were noticed in risk parameters such as mismatch of ITC, availing ITC in cases where the supplier has not paid tax or issued invoices after cancellation and incorrect discharge of tax liability.

Detailed audit of GST returns also suggested significant non-compliance. At the outset, the taxpayers' granular records were not obtained and furnished by the department in 71 out of 80 cases, which constituted a significant scope limitation. Out of the 71 cases of non-production, in 48 cases mismatch in ITC amounting to ₹ 393.04 crore were observed. Out of the nine cases, where taxpayer records were produced, audit observed three compliance deficiencies with a revenue implication of ₹ 0.17 crore. The main causative factors were availing of ineligible exemption and non-discharge of tax under RCM.

Considering the significant rate of compliance deficiencies, the Department must initiate remedial measures before they get time barred. From a systemic perspective, the Department needs to strengthen the quality of documentation and reinforce the institutional mechanism in the LGSTOs to establish and maintain effective oversight on return filing, taxpayer compliance, tax

payments, follow-up of MIS Analytic reports, cancellation of registrations and recovery of dues from defaulters.

2.5 Subject Specific Compliance Audit on E-Waybills System under Goods and Services Tax

2.5.1 Introduction

Goods and Services Tax (GST) was implemented with effect from 01 July 2017 on supply of goods or services. GST subsumed a wide range of Indirect taxes based on the paradigm of ‘One Nation One Tax’. One of the intended objectives of GST regime was to improve efficiency in movement of goods and services by reducing process-related time delays.

Electronic-Waybill (EWB) was a feature present even in pre-GST regimes wherein movement of goods was administered through manually governed (revenue) check posts. Goods entering a particular State was levied an ‘Entry Tax’ which has been subsumed under GST.

EWB is conceived as a shift from Government-monitored tax administration model to a self-reporting model by the taxpayer. The Government’s key objective behind introduction of EWB is to safeguard revenue. EWB is a document required for movement of goods and is designed to capture details of goods before being moved. Automation and standardisation of the entire process was intended to help check tax evasion and shore up GST collections. EWB is also designed to dissolve the non-trade barriers, so that transit time is reduced and supply chain efficiency is improved.

In Karnataka, the EWB under GST was introduced with effect from 1 April 2018 for all inter-state and intra-state movement of goods having value exceeding ₹ 50,000. Rule 138 of Karnataka Goods and Services Tax Rules (KGST Rules), 2017 (amended from time to time) provides for the EWB mechanism. The information on the consignment is to be furnished prior to movement of goods and it is to be issued irrespective of whether the movement is in relation to supply or for reasons other than supply.

2.5.2 Organizational Structure of the Department

The Commercial Taxes Department (CTD) is headed by the Commissioner of Commercial Taxes (CCT) under the administrative control of the Additional Chief Secretary to the Government of Karnataka, Finance Department. The Commissioner of Commercial Taxes is assisted by 14 Additional Commissioners. There are 13 Divisional Offices, 13 Appeal Offices, 13 Enforcement/Vigilance Offices and one Minor Acts Division in the State managed by 42 Joint Commissioners (JCCTs). Within the CTD, there are nine⁴⁵

⁴⁵ 1. O/o Joint Commissioner of Commercial Taxes (Vigilance), Belagavi, 2. O/o Addl. Commissioner of Commercial Taxes (Enforcement), South Zone, Bengaluru, 3. O/o Joint Commissioner of Commercial Taxes (Vigilance), Bengaluru, 4. O/o Joint Commissioner of Commercial Taxes (Vigilance), Bellari, 5. O/o Joint Commissioner of Commercial Taxes (Vigilance), Dharwad, 6. O/o Joint Commissioner of Commercial Taxes (Vigilance), Kalaburagi, 7. O/o Joint Commissioner of Commercial Taxes (Vigilance), Mangaluru, 8. O/o Joint Commissioner of Commercial Taxes (Vigilance), Mysuru, 9. O/o Joint Commissioner of Commercial Taxes (Vigilance), Shivamogga.

dedicated Enforcement or Vigilance formations which perform wider anti-evasion duties, including verification of EWBs. Each of the 13⁴⁶ administrative divisions (Divisional offices) is led by a Joint Commissioner of the CTD.

2.5.3 Information Systems used for EWBs

E-Waybill system has been conceived as a fully electronic system under GST. GST Council has mandated that the common portal for generation of E-Waybill shall be <https://ewaybillgst.gov.in/>. This is different from the GST Common portal (<https://www.gst.gov.in/>) wherein the registered taxpayers perform a variety of Front Office functions. As E-Waybill Common Portal depends on the information from GSTN, one-time registration of the Consignor, Consignee and the transporter on the E-Waybill portal is required.

The E-Waybill Common portal is managed by National Informatics Centre (NIC) based in Karnataka. In March 2020, E-Waybill portal has been integrated with the VAHAN system of the Ministry of Road Transport and Highways, so that vehicle registration number can be validated at the time of generating E-Waybill. Vehicle number (RC) entered in the E-Waybill would be verified in the VAHAN database for its existence/correctness. Radio Frequency Identification Device (RFID)/FASTag has been integrated with the E-Waybill system w.e.f. 01 January 2021 and a transporter is required to have a RFID tag in the conveyance and E-Waybill details will be uploaded in the RFID tag.

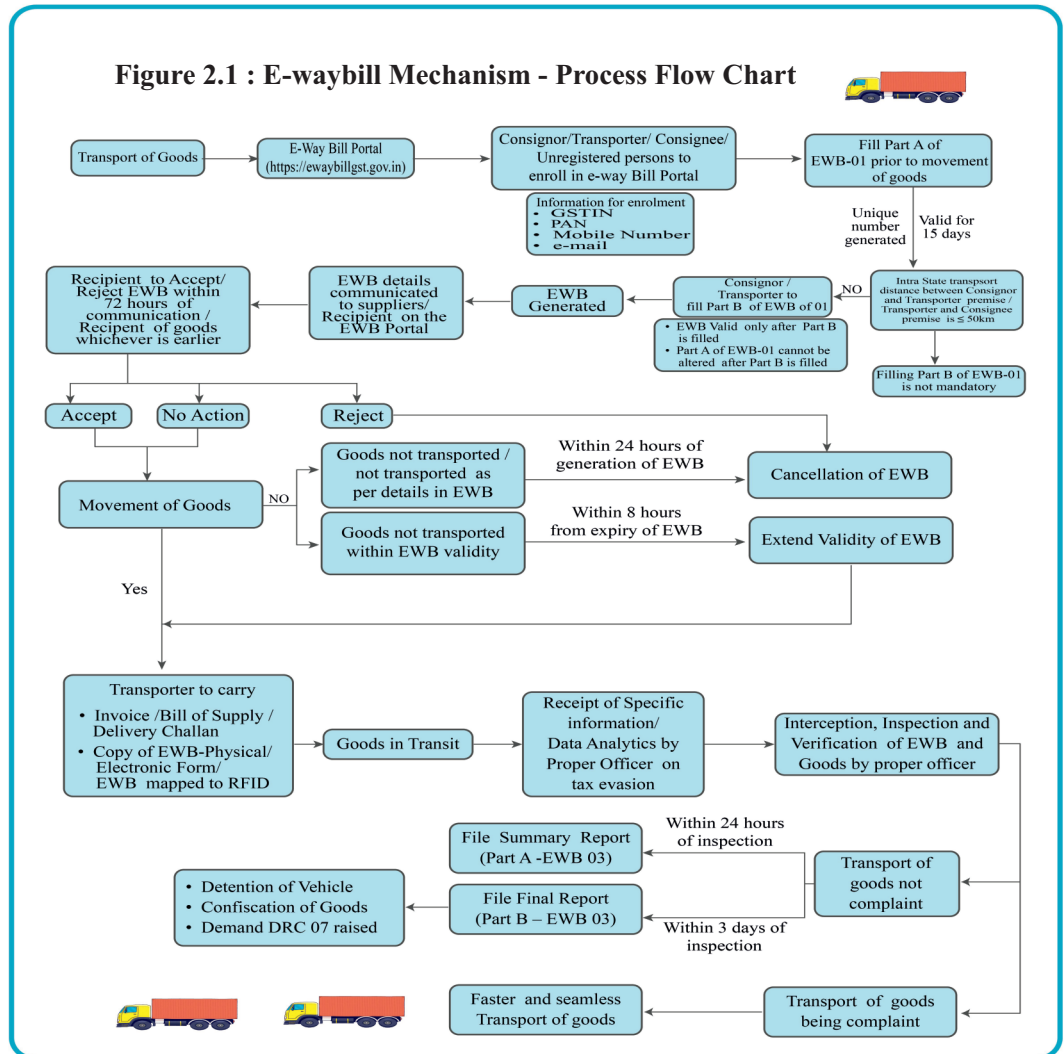
The Proper Officers⁴⁷ can discharge their duties *vis-à-vis* E-Waybills through two means:-1) Logging into E-Waybill Common Portal through a web browser using the login credentials provided; or 2) Logging into the GST E-Waybill System Mobile App. No separate devices are required for E-Waybill verification. The functions performed by the proper officer using the E-Waybill Common Portal/Mobile App are Verification of E-Waybills, Unblocking of E-Waybills, Viewing and accessing MIS reports, *etc.*

2.5.4 Processes involved in the EWB System

The EWB system includes various processes such as the enrolment of the required persons in the portal, generation of E-Waybill, extension, cancellation and rejection of the EWBs generated, *etc.* The entire process flow of E-Waybill system under GST is depicted in **Figure 2.1**.

⁴⁶ 1. Divisional Goods And Service Tax Office-1, Bengaluru, 2. Divisional Goods And Service Tax Office-2, Bengaluru, 3. Divisional Goods And Service Tax Office-3, Bengaluru, 4. Divisional Goods And Service Tax Office-4, Bengaluru, 5. Divisional Goods And Service Tax Office-5, Bengaluru, 6. Divisional Goods And Service Tax Office-6, Bengaluru, 7. Divisional Goods And Service Tax Office, Mysuru Division, Mysuru, 8. Divisional Goods And Service Tax Office, Mangaluru Division, Mangaluru, 9. Divisional Goods And Service Tax Office, Malnad Division, Shivamogga, 10. Divisional Goods And Service Tax Office, Dharwad Division, Dharwad, 11. Divisional Goods And Service Tax Office, Belagavi Division, Belagavi, 12. Divisional Goods And Service Tax Office, Gulbarga Division, Kalaburagi, 13. Divisional Goods And Service Tax Office, Davanagere Division, Davanagere.

⁴⁷ Vide Order No. ADCOM (I&C)/JDN/CR-36/2017-18 dt. 30 August 2017, the term Proper Officer refers to a designated official with specific powers and responsibilities related to the enforcement and administration of GST within the territorial jurisdiction.

Figure 2.1 : E-waybill Mechanism - Process Flow Chart

2.5.5 Audit Objectives

This Subject Specific Compliance Audit was done with the following Audit Objectives:

1. Whether EWB mechanism is effective in protecting revenue interest of the Government; and
2. Whether the Preventive/Enforcement activities of the Department in enforcing EWB provisions are efficient and effective.

2.5.6 Audit Criteria

The SSCA on E-Waybill system under GST has been evaluated against the following audit criteria:

- » Karnataka Goods and Services Tax Act (KGST Act), 2017;
- » Karnataka Goods and Services Tax Rules, (KGST Rules), 2017;
- » Notifications/Circulars/Instructions authorized by GST Council and issued by CBIC and Karnataka GSTD; and

- » Advisories/Standard Operating Procedures issued by NIC, CBIC and Karnataka GSTD.

2.5.7 Audit Scope

Compliance Audit on E-Waybill covers the period from 1 April 2018 to 31 March 2022. Audit conducted critical examination of the overall performance of E-Waybill system in the GST regime with reference to the Audit objectives. EWB data (generated) for the Audit period was extracted from Goods and Services Tax Network (GSTN) and was analysed. Movement of conveyances by roadways alone have been considered for this Audit and Railway/Airway/Seaway EWBs have been excluded from the scope of this Audit.

The scope of audit also involved evaluation of the preventive functions of the department with reference to EWBs, *viz.*, interception of vehicles, verification of documents, inspection of goods and action taken thereof.

2.5.8 Audit Sampling Methodology

A Problem-centric approach has been attempted for this audit as EWB generation under GST is a necessary condition to precede any movement of goods subject to the threshold limit. Samples for Audit Objective-1 were evolved based on the Key Problem Areas (KPAs)/Risk Dimensions identified. The KPAs that constrain revenue realisation for the Government are provided in Table 2.4. Under this Audit Objective total 99 EWBs, generated by 48 taxpayers, were verified.

Audit Objective-2 evaluated the problems associated with enforcement/preventive activities *viz.*, Operational Preparedness, Effectiveness of Anti-Evasion measures and Intra-Department and Inter-Department coordination. For Audit Objective-2, 50 *per cent* of the preventive units were taken as sample on stratified random sampling method. Out of the total nine Enforcement/Vigilance divisions, audit selected five divisions⁴⁸ for Audit Objective-2. Further, in each division audit selected 50 EWB-03 Part-Bs issued or cases booked by Enforcement/Vigilance wing of the CTD, Karnataka for violating EWB rules using Stratified Random Sampling for detailed Audit during the field visit.

Further, certain KPAs/Risk Dimensions has been extracted as totality from the entire E-Waybill universe. Other than the E-Waybills selected for substantive audit, the remaining objected totality E-Waybills has been issued as Audit Observations for necessary action from their end.

⁴⁸ 1. O/o Joint Commissioner of Commercial Taxes (Vigilance), Belagavi;
2. O/o Addl. Commissioner of Commercial Taxes (Enforcement), Bengaluru;
3. O/o Joint Commissioner of Commercial Taxes (Vigilance), Bengaluru;
4. O/o Joint Commissioner of Commercial Taxes (Vigilance), Kalaburagi; and
5. O/o Joint Commissioner of Commercial Taxes (Vigilance), Shivamogga.

2.5.9 Acknowledgement

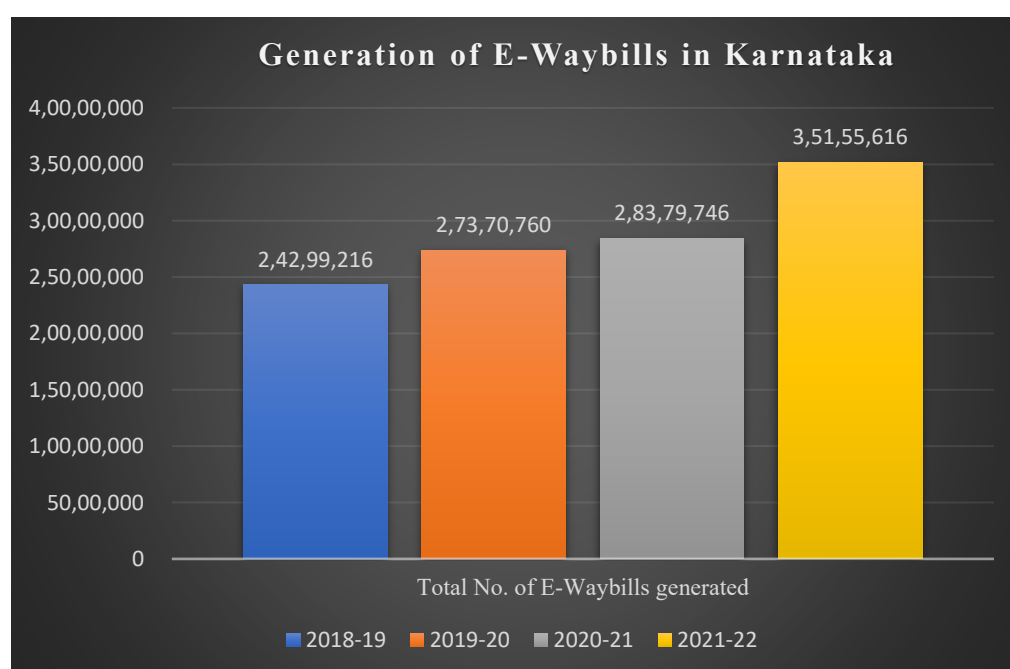
Audit acknowledges the co-operation and assistance extended by the Commercial Tax Department, Bengaluru, E-governance wing and all the test-checked LGSTOs and the Enforcement/Vigilance divisions in conducting the Audit. An entry meeting was held on 22 February 2023 in which audit objectives, criteria, scope and methodology were explained. The exit conference was held on 23 February 2024 with the Commissioner of Commercial Taxes, Karnataka in which the audit findings were discussed. The views expressed by the Department during the exit conference and the written replies to the draft report have been suitably incorporated in the relevant paragraphs.

2.5.10 Trend Analysis of EWBs

The generation of EWB before causing the movement of goods was made mandatory for all inter-State supplies exceeding threshold goods with effect from 1 April 2018 and extended to inter-State supplies also in phased manner. The total number of EWBs generated in Karnataka during the period of Audit from April 2018 to March 2022 is detailed in the chart below:

Chart-2.1

Generation of E-Waybills in Karnataka



The E-Waybill system is supporting the growing volume of E-Waybills generated on a daily basis. National Informatics Centre (NIC), Bengaluru has developed an application, E-waybill portal which has deployed various upgradations and feature enhancements to the E-Waybill system.

The E-Waybill regime envisages a standardised process documentation for movement of goods and the E-Waybill system captures various data points during the transportation process. The officer module of E-Waybill system developed by NIC, Bengaluru steadily provides visibility of the E-Waybill data

to departmental officers with a range of data analytic MIS Reports, which can enhance functional and operative effectiveness.

Audit findings have been categorized into two broad perspectives viz., systemic issues and compliance issues, based on the objectives of audit. While the systemic issues aim to bring out the shortcomings relating to adequacy and effectiveness of the E-Waybill system, the compliance issues highlight deviations and violations of provisions of Act and Rules and the resultant leakage of revenue. The results of the analysis are placed below:

2.5.11 Audit Findings – Systemic and Compliance Issues

As per Section 37 of the KGST Act, 2017, every registered person other than composition taxpayers shall furnish the details of outward supplies of goods or services or both effected during a tax period in GSTR-1 and discharge tax liability thereon in GSTR-3B. In respect of taxpayers who have opted for the composition scheme, shall pay tax in GSTR-4/GST-CMP-08.

During the Audit, tax compliance by the taxpayers was verified with GST returns and other records relating to those taxpayers as available with GSTN. Audit selected sample cases of 99 EWBs pertaining to 48 taxpayers, by using the Risk Model, for conducting Substantive Audit⁴⁹. The systemic and compliance issues noticed during the Audit are discussed under each Key Problem Area (KPA) to provide the impacts of the risks identified and are as detailed in the table below:

Table-2.4
Summary of Compliance Deviations with monetary impact

(₹ in lakh)

Sl. No.	Key Problem Area	No. of taxpayers (TPs)	Assessable Value involved	Tax Value	Department Response	
					No. of TPs	Tax involved
1	Generation of Inter-State EWBs by Composition taxpayers	1	367.55	66.16	1	66.16
2	Generation of EWBs by Cancelled Taxpayers	6	3,217.68	192.17	6	192.17
3	Generation of EWBs by Non-filers of GST Returns	3	2,525.60	441.65	3	441.65

The observations are discussed in detail in the following paragraphs:

2.5.11.1 Ineligible taxpayers continuing under Composition Scheme

In terms of Section 10 (1) of the KGST Act, 2017, a registered person whose aggregate turnover in the preceding financial year did not exceed the threshold

⁴⁹ Substantive Audit are cases to be pursued in detail for cause analysis and ascertain current developments.

limit⁵⁰ may opt to pay tax under composition scheme. Further, in terms of Section 10(3) of the KGST Act, 2017, the option availed by a registered person for composition scheme shall lapse with effect from the day on which his aggregate turnover during a financial year exceeds the limit specified.

Section 10(2)(c) of the KGST Act, 2017, however, provides that he shall not be eligible to opt for composition scheme, if he is engaged in making any inter-State outward supplies of goods.

As per Section 61 of the KGST Act, 2017, various returns filed by the taxpayers have to be scrutinized by the proper officer to verify the correctness of the returns, and suitable action has to be taken on any discrepancies or inconsistencies reflected in the returns.

Audit observed that one taxpayer out of three composite taxpayers was continuing to be under Composition Scheme despite having undertaken inter-state outward supply of goods. Audit observed that there is no mechanism in the system to alert the Composition Levy Scheme (CLS) taxpayers and departmental officer for generating E-Waybill for inter-State supply. This was brought to the notice of the Department in April 2023. Final reply is awaited (December 2024).

Further, when Audit scrutinised the taxpayer and the related documents in detail, it was found that the taxpayer was registered under GST on 23 September 2018 under the jurisdiction of LGSTO-27 and the registration was cancelled *suo-moto* on 21 August 2020. During this period the taxpayer has raised invoices for outward supplies for taxable value of ₹ 367.55 lakh with GST amount of ₹ 66.16 lakh. However, the taxpayer did not file the returns nor paid any tax on the outward supplies. It was also noticed that the department failed to identify these omissions and take remedial action.

On this being pointed out (September 2023), the department intimated (September 2023) that DRC-01A has been issued under Section 74(5) (December 2024).

2.5.11.2 Generation of EWBs by the taxpayers who are non-filers of GST returns

In terms of Section 29 of the KGST Act, 2017, the proper officer may cancel the registration of the taxpayer when a composition taxpayer has not furnished returns for three consecutive tax periods; or any other registered person has not furnished returns for a continuous period of six months.

As per Section 61 of the KGST Act, 2017, various returns filed by the taxpayers have to be scrutinized by the proper officer to verify the correctness of the returns, and suitable action has to be taken on any discrepancies or inconsistencies reflected in the returns. As per Section 62 of the Act *ibid*, where a registered person fails to furnish the returns even after service of a notice, the proper officer may proceed to assess the tax liability of the said person to the best of his judgement taking into account all the relevant material which is available or which he has gathered and issue an assessment order.

⁵⁰ Threshold limit per year for becoming eligible for composition scheme was ₹ 1.00 crore for the period between 01 April 2018 to 31 March 2019 and ₹ 1.50 crore thereafter.

Rule 138E of KGST Rules, 2017, imposes restriction on persons including consignors, consignees, transporter or an E-Commerce operator or a courier agency to generate EWBs in respect of a registered person who has not filed relevant GST Returns for prescribed consecutive periods⁵¹. The blocking functionality has been enabled on the EWB Common Portal with effect from 01 December 2019.

Audit observed that three taxpayers out of 48 taxpayers under LGSTO-27 and LGSTO-111 had not filed Returns for consecutive two tax periods; but effected outward supplies by generating EWBs. This indicates that co-ordination between two agencies viz., EWB Common Portal and the GST Common Portal was not sufficient enough for effective validation controls in EWB Common Portal so as to block the EWB generation facilities for these taxpayers. This was brought to the notice of the Department in April 2023. Final reply is awaited (December 2024).

An illustrative case is detailed below:

A taxpayer was registered under GST on 1 July 2017 under the jurisdiction of LGSTO-27 and the registration was cancelled *suo-moto* on 27 February 2019. During this period the taxpayer has raised 897 invoices for outward supplies for taxable value of ₹ 14.39 crore with GST amount of ₹ 2.57 crore. On verification, it was found that the taxpayer has neither filed any returns nor paid any GST resulting total non-payment of GST amounting to ₹ 2.57 crore.

On this being pointed out (September 2023), the Department intimated (September 2023) that DRC-01A has been issued under Section 74(5) (December 2024).

2.5.11.3 Generation of EWBs by cancelled taxpayers

As per Section 63 of the KGST Act, 2017, where a taxable person whose registration has been cancelled; but who was liable to pay tax, the proper officer may proceed to assess the tax liability of such taxable person to the best of his judgement. A cancelled taxpayer cannot generate E-waybills, as he will be passing on ITC without filing returns, resulting in non-payment of tax.

During the Substantive Audit, it was observed that 50 EWBs pertaining to six out of 48 taxpayers pertaining to LGSTO-27 and LGSTO-495 were generated after the effective date of cancellation of GST Registration. This indicates lack of co-ordination between two agencies viz., EWB Common Portal and the GST Common Portal and missing validation controls in EWB Common Portal to block the EWB generation facilities for these taxpayers. This is a system deficiency which needs to be addressed by the Department.

This was brought to the notice of the Department in April 2023. Final reply is awaited (December 2024).

An illustrative case is detailed below:

A taxpayer was registered under GST on 01 August 2018 under the jurisdiction of LGSTO-27 and the registration was cancelled *suo-moto* with effect from

⁵¹ Form GST-CMP-08 for two consecutive quarters in respect of persons paying tax under Section 10 of the KGST Act, 2017 and GSTR-3B for normal taxpayers for two consecutive tax periods as applicable.

01 August 2018. After cancellation, the taxpayer has raised 68 EWBs for outward supplies for taxable value of ₹ 24.66 crore with short discharge of tax liability amounting to ₹ 1.18 crore.

On this being pointed out (September 2023), the Department intimated (September 2023) that DRC-01A has been issued under Section 74(5) (December 2024).

2.5.12 Totality Observations detected in analysis of data of E-Waybills

For the purpose of this SSCA, apart from 99 EWBs selected for Substantive Audit, Risk based Samples were selected from the data-base relating to 76,164 EWBs pertaining to a total of 11,934 taxpayers (including 668 composition taxpayers) falling under the jurisdiction of the Commissionerate of Commercial Taxes Department. Audit analysed data on EWBs generated during the period from April 2018 to March 2022 on the basis of Key Problem Areas (KPs) and observed that discrepancies in tax compliance by the taxpayers could be ascertained directly from certain KPs. The data extracted under these KPs were forwarded to the department as Totality Observations for considering further course of remedial action at their end and summary report on action taken was called for. The summary of Totality Observations shared with the department are discussed in the following Table:

Table-2.5
Summary of Totality Observations

Sl. No.	Nature of Totality Observation	No. of EWBs	No. of taxpayers (TPs)	Assessable Value involved (₹ in crore)	Department Response			Response yet to be received
					Accepted		Not accepted	
					No. of TPs	Tax involved (₹ in crore)	No. of TPs	
1	Generation of Inter-State EWBs by Composition taxpayers	1,476	316	12.99	Detailed case wise replies are awaited. However, the views expressed by the department in the exit conference have been suitably incorporated under respective paragraphs.			316
2	Generation of EWBs by Composition taxpayers who had crossed prescribed threshold limit	1,465	12	25.39				12
3	Generation of EWBs by Non-filers of GST Returns	31,900	4,013	984.11				4,013
4	Generation of EWBs by Cancelled taxpayers	16,582	1,345	582.96				1,345
5	Generation of multiple EWBs using same Invoice	24,741	6,248	851.40				6,248
Total		76,164	11,934	2,456.85				11,934

The department may take suitable action to address these issues at system level.

2.5.12.1 Ineligible taxpayers continuing under Composition Scheme

a) Generation of Inter-State EWBs by Composition taxpayers

During the analysis of the EWB data, it was observed that 1,476 E-Waybills were generated by 316 taxpayers who were continuing to be under Composition Scheme despite having undertaken inter-State outward supply of goods. These

taxpayers were required to be brought out of the Scheme as they are liable to pay tax at normal rate with effect from the date of effecting inter-State supply at first instance.

This was brought to the notice of the department in August 2023. During the exit conference, the department stated (February 2024) that the volume of EWBs to be checked and compliance to all those cases is time consuming and tedious. However, the CCT agreed to examine a sample of cases for which compliance will be submitted (December 2024).

b) Generation of EWBs by Composition taxpayers who had crossed prescribed threshold limit

On analysis of EWB data, it was observed that 1,465 E-Waybills were generated by 12 taxpayers who were continuing to be under Composition Scheme though they have generated E-Waybills exceeding the threshold limit of turnover. These taxpayers were required to be brought out of the Scheme as they were liable to pay tax at normal rate of tax with effect from the date on which they exceeded the threshold limit of turnover.

This was brought to the notice of the Department in August 2023. During the exit conference, the Department stated (February 2024) that the volume of EWBs to be checked and compliance to all those cases is time consuming and tedious. However, the CCT agreed to examine a sample of cases for which compliance will be submitted (December 2024).

2.5.12.2 Generation of EWBs by Non-filers of GST Returns

During the analysis of the E-Waybill data, it was noticed that E-Waybills were generated by the taxpayers who defaulted in filing the returns. Though these taxpayers generated E-Waybills for supply of goods, they had defaulted in filing the return (GSTR-3B and GSTR-4). A total of 31,900 such E-waybills were generated by 4,013 taxpayers who had failed to file return.

This was brought to the notice of the department in August 2023. During the exit conference, the department stated (February 2024) that the volume of EWBs to be checked and compliance to all those cases is time consuming and tedious. However, the CCT agreed to examine a sample of cases for which compliance will be submitted (December 2024).

2.5.12.3 Generation of EWBs by Cancelled taxpayers

During the analysis of E-Waybill data, it was noticed that 16,582 EWBs were generated by 1,345 taxpayers after the effective date of cancellation of GST Registration. However, the department did not assess the tax liability under Section 63 of the KGST Act, 2017, and thereby failed to protect the revenue interest of the Government.

This was brought to the notice of the department in August 2023. During the exit conference, the department stated (February 2024) that the volume of EWBs to be checked and compliance to all those cases is time consuming and tedious. However, the CCT agreed to examine a sample of cases for which compliance will be submitted (December 2024).

2.5.12.4 Generation of multiple EWBs using same/similar invoices

As per Rule 46 (b) of KGST Rules, 2017, a tax invoice shall be issued by the registered person containing consecutive serial number, not exceeding 16 characters, unique for a financial year.

As per Para 5-1 of the User Manual issued by the NIC, the taxpayer while generating the EWB is required to enter the Document Number relating to the consignment. The Document Number entered in should be unique. Invoice Number is the Document Number in respect of consignments relating to supplies. Hence, only one EWB is required to be generated based on each invoice.

During the analysis on E-Waybills, it was observed that 6,248 taxpayers either used same invoice or similar invoices (by suffixing special characters to the invoice numbers already used) to generate 24,741 EWBs for movement of goods. Though this resulted in multiple consignments, it was noticed that the taxpayers either did not report any consignments or reported only one consignment in their returns.

This indicated lack of validation controls in the EWB Common Portal to restrict generation of multiple EWBs using same/similar invoices.

This was brought to the notice of the Department in August 2023. During the exit conference, the Department stated (February 2024) that the volume of EWBs to be checked and compliance to all those cases is time consuming and tedious. However, the CCT agreed to examine a sample of cases for which compliance will be submitted (December 2024).

2.5.13 Preventive function of the Department

The Commissionerate of Commercial Taxes Department in Karnataka is organized into nine Enforcement divisions. In Bengaluru, there are two divisions: ADCOM (Enforcement), South Zone, Bengaluru, and JCCT (Vigilance), Bengaluru. Additionally, there are seven divisions, each led by JCCT (Enforcement), located outside Bengaluru, covering various regions across the state. These regional divisions are situated in Ballari, Belagavi, Hubballi, Kalaburagi, Mangaluru, Mysuru, and Shivamogga. Year-wise tax and penalty collection by the enforcement/vigilance divisions of the Karnataka Commercial Tax Department is depicted below:

Table-2.6
Year wise Details of Taxes and Penalty collected

(₹ in lakh)

Year	No of EWB-03 Part Bs issued	CGST	SGST/UTGST	IGST	Cess	CGST Penalty	SGST/UTGST Penalty	IGST Penalty	Cess Penalty	Total
2018-19	8,960	861.24	845.62	1,141.35	259.85	1,387.31	1,780.01	1,300.81	63.89	7,640.08
2019-20	10,407	927.55	883.77	1,146.52	397.61	1,717.62	1,793.27	1,325.71	78.49	8,270.54
2020-21	12,718	1,283.02	1,145.76	1,296.01	398.96	3,042.34	4,790.42	1,543.19	79.94	13,579.64
2021-22	13,063	1,585.80	1,032.27	731.72	228.79	3,753.84	4,366.43	1,359.77	211.47	13,270.09
Total	45,148	4,657.61	3,907.42	4,315.60	1,285.21	9,901.11	12,730.13	5,529.48	433.79	42,760.35

Source: Figures furnished by the Department.

Audit findings during the field visit are briefly explained in following paragraphs:

2.5.14 Preventive/Enforcement activities of the Department in enforcing E-Waybill provisions

In connection with the Second Objective of this SSCA, Audit studied EWB related functions of the Preventive Units of the Central formations with specific focus on (i) Operational Preparedness, (ii) Effectiveness of Anti-Evasion Measures and (iii) Intra-Departmental Coordination in monitoring E-Waybill related transactions. For this purpose Audit selected five⁵² out of nine divisions based on the Stratified Random Sampling. In each division 50 EWB-03 Part Bs issued or cases booked for violating EWB rules were selected using Stratified Random Sampling for detailed Audit during the field visit. During verification, Audit noticed several deficiencies and shortcomings in the activities undertaken by the Preventive Wings which are detailed in the following paragraphs:

2.5.15 Operational Preparedness of the Department

Detailed Setup/unit

A dedicated Unit for EWB related enforcement activities like verification of EWBs during interception of vehicles and follow up action wherever required, utilizing EWB Analytical Reports in planning the EWB verification, *etc.*, will improve the efficiency of preventive functions. Audit noticed that out of five Divisions under the Commissionerate of Commercial Taxes Department in Karnataka taken up for audit, all five Divisions formed dedicated setup for EWB related enforcement activities. These formations formed Inspection Teams, whenever required, with the existing employees.

2.5.16 Effectiveness of Anti-Evasion Measures

During the Substantive Audit, 250 EWB-03 Part B issued cases, falling under five selected Enforcement/Vigilance divisions under the jurisdiction of the Commissionerate of Commercial Taxes Department, Karnataka were test-checked and the audit findings during the field visit are briefly explained in following paragraphs:

2.5.16.1 Non-debiting of Electronic Cash Ledger

As per the provisions of Section 49(1) of the KGST Act, 2017, and Rule 87(1) of the KGST Rules, 2017, every deposit made towards tax, interest, penalty, fees, or any other amount shall be credited to Electronic Cash Ledger (ECL) maintained in Form GST PMT-05 and debiting the payment therefrom towards any liability. Further under Section 49(3) of the KGST Act, 2017, and Rule 87(2) of the KGST Rules, 2017, any person on his behalf may generate a challan in Form GST PMT-06 and use amount available in the ECL for making

⁵² 1. O/o Joint Commissioner of Commercial Taxes (Vigilance), Belagavi;
2. O/o Addl. Commissioner of Commercial Taxes (Enforcement), Bengaluru;
3. O/o Joint Commissioner of Commercial Taxes (Vigilance), Bengaluru;
4. O/o Joint Commissioner of Commercial Taxes (Vigilance), Kalaburagi;
5. O/o Joint Commissioner of Commercial Taxes (Vigilance), Shivamogga.

any payment towards tax, interest, penalty, fees, or any other amount. Also, under Rule 88(1) of the KGST Rules, 2017, each credit or debit to the ECL shall be indicated by unique identification number.

Mere availability of balance in cash ledger could not be assumed for payment of tax liability unless it was debited for discharging the specific liability. The date of payment of tax/other dues is the date of debit of the ECL. Whatever the balance available in the 'Electronic Cash Ledger', the same is the property of the GST Registrant and they can claim refund of the balance in 'Electronic Cash Ledger' at any point of time as per the GST provisions. Whereas the amount will go to the Government Exchequer only when the amount is debited from the ECL towards liability. Hence, mere generation of e-challans is inconsequential unless the 'debit' towards actual liability is made electronically in the ECL.

a) Non-debiting of Electronic Cash Ledger for payment made under Section 129(1) of the KGST Act, 2017

Under Section 129(1) of the KGST Act, 2017, the proper officer may detain both the goods and the conveyance if they are being transported in contravention of the provisions of the Act or Rules. Following the issuance of a notice within seven days, outlining the grounds for detention and affording the owner of the goods or the conveyance an opportunity to present their case, the authorized officer may release the goods and conveyance upon payment of the applicable tax and penalty by the owner of the detained goods or the person responsible for the conveyance.

During the Audit, it was observed that in respect of 47 out of 250 cases, the taxpayers have paid the due tax and penalty in their respective cash ledger. However, the amount paid in the cash ledger was not debited. Total amount of non-debit amounted to ₹ 141.87 lakh. As per the provisions of the Act, unless the GST Registrant debits his ECL towards tax and penalty liability, it cannot be considered as tax payment made.

On this being pointed out (between June 2023 and August 2023), the Department intimated (between September 2023 to April 2024) that recovery of ₹ 55.99 lakh was initiated in respect of 16 cases. For the remaining 31 cases, replies are awaited (December 2024).

An illustrative case is detailed below:

On verification of the files maintained for the booked cases (EWB-03 Part Bs issued) in the office of the Additional Commissioner of Commercial Taxes, South Zone, Enforcement, Bengaluru, it was noticed that the taxpayer has paid the due tax and penalty amounting to ₹ 25.08 lakh in the cash ledger. However, the amount so paid in the cash ledger was not debited by the concerned taxpayer in the ECL. On this being pointed out (August 2023), the Department intimated (September 2023) the recovery of ₹ 25.08 lakh through DRC-03 (December 2024).

b) Non-debiting of Electronic Cash Ledger for payment made under Section 130 of the KGST Act, 2017

Under Section 130(7) of KGST Act, 2017, the proper officer may, after satisfying himself that the confiscated goods or conveyance are not required in any other proceedings under this Act and after giving reasonable time not

exceeding three months to pay fine in lieu of confiscation, dispose of such goods or conveyance and deposit the sale proceeds thereof with the Government.

It was observed that in one out of 250 cases, the taxpayer has paid an amount of ₹ 28.73 lakh for successfully bidding the highest amount for the confiscated goods in the cash ledger. However, the amount so paid in the cash ledger was not debited by the concerned taxpayer. As per the provisions of the Act, unless the GST Registrant debits his Electronic Cash Ledger towards tax and penalty liability, it cannot be considered as tax payment made.

On this being pointed out (August 2023), the Department stated (April 2024) that there were technical issues with online demand booking in the initial stages of GST implementation. As a result, the amount paid remained in the dealer's Electronic Cash Ledger. Further, the Department stated that necessary action on all such cases had already been taken. Upon verification, it was found that the taxpayer had debited the liability amount from the Electronic Cash Ledger after it was pointed out by Audit (December 2024).

2.5.16.2 Non-collection of GST for Auction made under Section 130 of KGST Act, 2017

Vide Notification No. 36/2017-Central Tax (Rate) and Notification No. 37/2017-Integrated Tax (Rate) both dated 13 October 2017, it has been notified that intra-state and inter-state supply respectively of used vehicles, seized and confiscated goods, old and used goods, waste and scrap by the Central Government, State Government, Union territory or a local authority to any registered person, would be subject to GST on reverse charge basis as per which tax is payable by the recipient of such supplies. Further, as per the provisions of Section 130 of KGST Act, 2017, and Rule 140 and 142 of KGST Rules, 2017, read with corresponding CGST Rules, 2017, if any person supplies or receives any goods in contravention to the provisions of the Act or Rules, with the intention to evade tax, or does not account for any goods in his books, which are liable to tax, with the intention to evade tax, then such goods or conveyance used for such transportation may be liable to confiscation.

During the Audit, it was observed that in respect of two out of 250 cases as detailed in the table below, GST was not levied on reverse charge basis while auctioning the goods confiscated by the office of the Joint Commissioner of Commercial Taxes (Enforcement), Belagavi Division.

Table 2.7
Non-collection of GST on Auction

(Amount in ₹)

Sl. No.	Date of Issue of GST-MOV-11/Date of Auction	Total value of the sold commodity	Amount of Non-collection of GST
1.	11 April 2019/ 22 July 2019	75,44,799	3,77,240
2.	10 August 2018/ 03 December 2021	1,01,15,788	5,05,789
Total non-collection of GST			8,83,029

The non-compliance with the Act by not levying GST on auctioned confiscated goods resulted in a direct revenue loss for the government. Department may take immediate action to recover the outstanding GST dues.

On this being pointed out (June 2023), the Department stated (January 2024) that in one case they have recovered ₹ 5.05 lakh along with interest of ₹ 1.36 lakh. Reply is awaited in the other case (December 2024).

2.5.17 Conclusion

The audit report on the E-Waybill system uncovers substantial shortcomings and non-compliance with the KGST Act, 2017, highlighting areas of immediate concern necessitating corrective actions. Issues like ineligible taxpayers under the Composition Scheme and the generation of E-Waybills by non-filers as also cancelled taxpayers necessitates better monitoring and enforcement.

While the Department has taken steps to recover from ineligible taxpayers under the Composition Scheme, prompt action is essential for accurate taxation of inter-State outward supplies effected by dealers claiming benefit under Composition Scheme. Similarly, instances where taxpayers generating E-Waybills after their registrations were cancelled, demand a more proactive approach to prevent revenue leakage.

The audit findings emphasize the urgent need to address anti-evasion measures, especially regarding non-debiting of the Electronic Cash Ledger for payments under Sections 129 and 130 of the KGST Act, 2017. The Department may promptly tackle these issues and implement preventive measures to bolster the E-Waybill system's effectiveness.

2.5.18 Recommendations

Recommendation 1: The Department may consider to incorporate validation control in the E-Waybill system to alert the CLS taxpayer as well as the departmental officer for generating E-Waybill for inter-state supply.

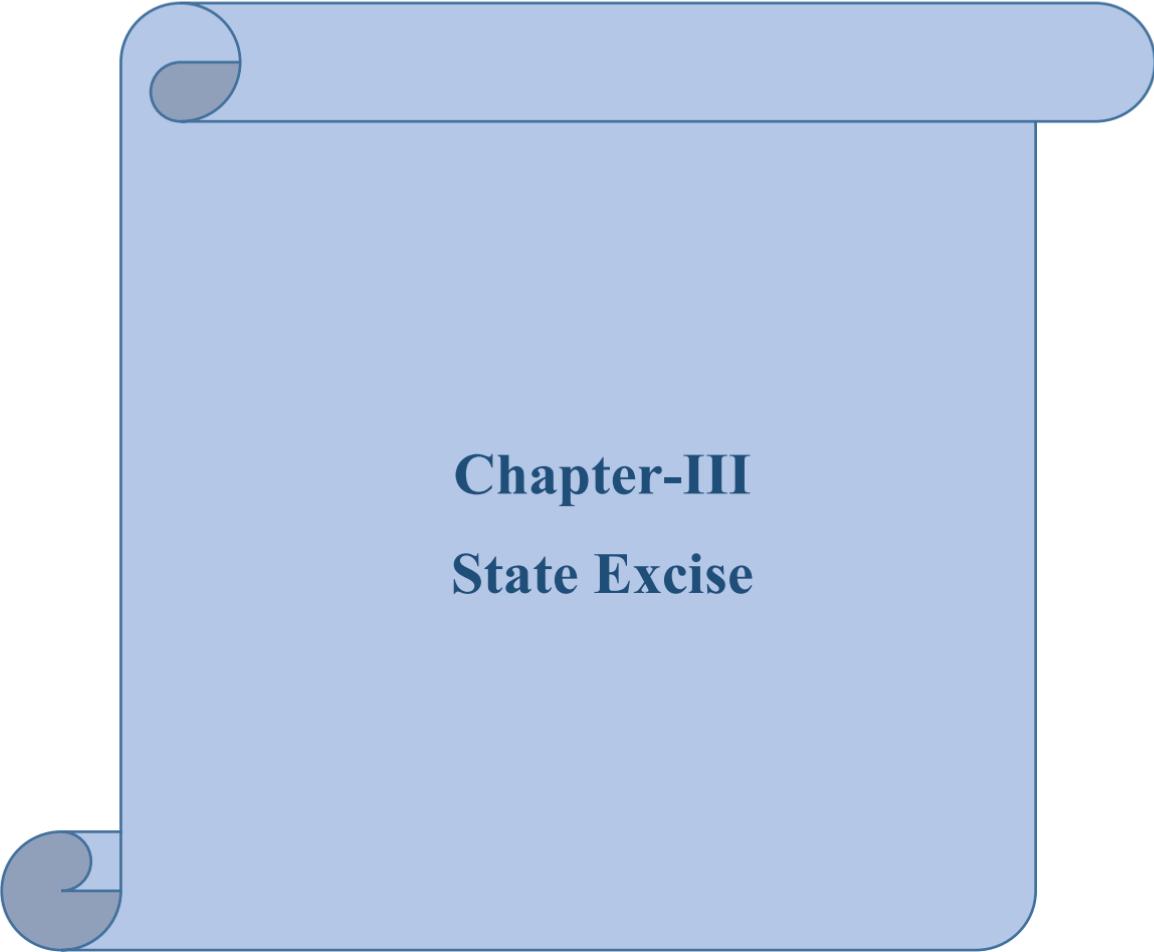
Recommendation 2: The Department should integrate E-Waybill portal with the GST registration database to cross-verify the GST Registration status of taxpayers.

Recommendation 3: The Department should ensure that the eligibility of taxpayers for the Composition Scheme is regularly reviewed and updated based on their annual turnover.

Recommendation 4: The Government may put in place a system to enforce stricter controls on the E-Waybill system to prevent generation of multiple E-Waybills using the same invoices.

Recommendation 5: The Department should strictly follow GST rules by ensuring that tax payments and penalties are linked to the date of debiting from the Electronic Cash Ledger, following the proper e-challan generation process, and rectifying situations where funds from the ledger were incorrectly used for other GST liabilities to comply with regulations.

Recommendation 6: GST provisions should be complied strictly by the Department at the time of auctioning of goods.



Chapter-III
State Excise

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) has been functional in the Department since 1990. As per the information provided by the Department, none of the 471 offices due for audit in 2022-23 were audited due 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 given in **Table 3.1**.

Table 3.1
Year-wise details of observations raised by IAW

(₹ in crore)

Year	Observations raised		Observations settled		Observations pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
Up to 2017-18	542	17.04	62	0.65	480	16.39
2018-19	0	0.00	0.00	0.00	0.00	0.00
2019-20	0	0.00	0.00	0.00	0.00	0.00
2020-21	0	0.00	0.00	0.00	0.00	0.00
2021-22	0	0.00	0.00	0.00	0.00	0.00
2022-23	0	0.00	0.00	0.00	0.00	0.00
Total	542	17.04	62	0.65	480	16.39

Source: Information furnished by the Department.

As could be seen from the table above, it is clear that the activities of IAW in the Department have reduced to a greater extent and virtually to nil in the last five years. This indicates that the Department is not according due importance to internal audit.

It is recommended that due importance may be accorded to strengthen IAW, as internal audit is an important mechanism to ensure compliance by the Department of the applicable laws, regulations and approved procedures.

3.3 Results of Audit

Test-check of records of 20 Offices of State Excise Department during the audit period revealed observations related to issue of licenses, loss of revenue in the form of short levy of duties, claim of wastages and regulation of production of Spirit, Beer and Liquors, taxation and functioning of the Microbreweries and other irregularities amounting to ₹ 104.01 crore in 25 cases. Details are given in **Table 3.2**.

Table 3.2
Results of Audit

Sl. No.	Category	(₹ in crore)	
		No. of Paragraphs	Amount
1.	Non-levy of penalty for excess/inadmissible wastage claimed	3	12.68
2.	Short levy of excise duty and additional excise duty	14	10.02
3.	Short collection of license fee/ transfer of license fee	5	53.71
4.	Miscellaneous	3	27.60
Total		25	104.01

During the year an amount of ₹1.41 crore was recovered in 20 paragraphs pointed out in the earlier years.

Important audit observations from the Subject Specific Compliance Audit are brought out below:

3.4 Subject Specific Compliance Audit on the functioning of Distilleries, Breweries and Microbreweries

3.4.1 Introduction

The Constitution of India, vide Entry No.51 of List II of Article 246, vests the power to levy duty on alcoholic liquors for human consumption and narcotics with the States. The scope of the State Excise Department (Department) included Implementing State Excise policies and procedures by regulating manufacture, transport, possession, sale and other activities of the trade in spirit, spirituous preparations, potable liquor and other intoxicants, and monitoring collection of associated taxes. The objectives of the Department were to:

- Generate optimal revenue for the State exchequer;
- Regulate manufacture, transport, possession and sale of all excisable articles;
- Effective enforcement and inspection to control crime; and
- Impart training for better efficiency and formulate e-governance initiatives.

The State Excise is the next major source of revenue in the State of Karnataka after the Commercial Taxes Department and is regulated by the provisions of Karnataka Excise Act and Rules.

3.4.2 Organisational set-up

The State Excise Department (SED) is under the administrative control of the Finance Department. The SED is headed by the Excise Commissioner. The functioning of the Distillery and Brewery are being monitored by the Excise Officers stationed at the premises of the respective Distillery and Brewery. While the Distillery and Breweries are auditable units having designated DDO code, the Microbreweries are functioning under the jurisdiction of the Range Office headed by Excise Inspector.

3.4.3 Excise Revenue in the form of Excise Duty and Additional Excise Duty from Distillery, Brewery and Microbreweries

As on 1 July 2022, there were 32 Distilleries, 12 Breweries and 65 Microbreweries in the State of Karnataka. The revenue in the form of Excise Duty (ED) is levied at rate of ₹ 50 per Bulk Liter (BL) of Indian Made Liquor (IML) and ₹ 10 per BL for Beer. The Additional Excise Duty (AED) is also levied at the slab rates based on the declared price of IML and at the rate ranging from 150 *per cent* to 185 *per cent* on the declared price for Beer. In respect of Microbreweries, Excise Duty and Additional Excise Duty was levied at rate of ₹ 10 and ₹ 25 per BL respectively and 50 *per cent* of the duties was to be paid in advance at the time of renewal / grant of licence. In addition to levy of Excise Duty and Additional Excise Duty, the Department also collects Licence Fee at ₹ 45 lakh for Secondary Distilleries, ₹ 27 lakh for Breweries and ₹ 2 lakh for Microbreweries. Further, Additional Licence Fee at 15 *per cent* on the Licence Fee was also levied. The details of revenue realised in the form of Excise Duty, Additional Excise Duty, Licence Fee and Additional Licence Fee during the last five years 2018-2023 was as detailed below:

Table 3.3
Revenue Collection

(₹ in crore)					
Source	2018-19	2019-20	2020-21	2021-22	2022-23
ED and AED on IML	16,894.83	17,899.01	20,217.80	22,899.10	24,663.85
ED and AED On Beer	2,396.29	3,018.90	2,438.16	2,757.30	4,460.60
Licence Fee and Addl. Licence Fee	616.77	620.89	643.87	684.10	745.84
Total Revenue	19,907.89	21,538.80	23,299.83	26,340.50	29,870.29

Source: Annual Report of the Department.

As seen from the above table, there was an increasing trend in collection of revenue in the form of Excise Duty, Additional Excise Duty, Licence Fee and Additional Licence Fee levied from Distilleries, Breweries and Microbreweries.

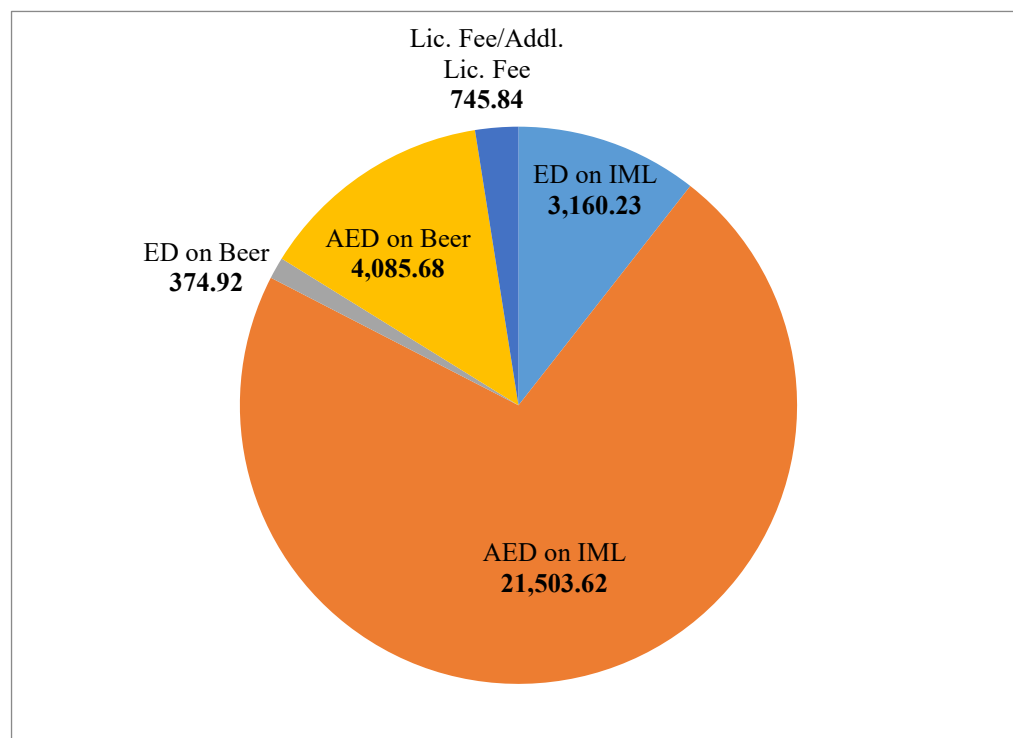
As verified, the increasing trend was attributed to increase in the rates of AED⁵³, increase in consumption of IML and Beer and also significant increase in the number of CL-7 licenses⁵⁴.

The share of the different duties of Excise for the financial year 2022-23 is shown below:

Chart 3.1

Source-wise Excise Revenue for the Financial Year 2022-23

(₹ in crore)



Source: Annual Report of the Department.

The prominence of AED on IML in the share of revenue is amply clear from the chart above.

3.4.4 Audit Objectives

The main objectives of this Audit, besides check and verification of statutory records/ registers and expenditure accounts, were to ascertain whether;

- the controls over manufacture of potable liquor in Distilleries, Breweries and Microbreweries were being exercised optimally;
- the potable liquors were manufactured with a valid licence on payment of proper license fee and were allowed to be removed from Distilleries/ Breweries/ Micro-breweries only after proper assessment and collection of duties and/ or fees as may be applicable and under valid permits.

⁵³ April 2018, August 2018, April 2019, April 2020 and May 2020.

⁵⁴ Licence for Hotels and Boarding House. An increase from 981 to 2279 was noticed for the five year period from 2018-19 to 2022-23.

3.4.5 Audit Criteria, Scope and Methodology

The Audit criteria for this Subject Specific Compliance Audit included the following Act and Rules:

1. The Karnataka Excise Act, 1965;
2. The Karnataka Excise (Distillery and Warehouse) Rules, 1967;
3. The Karnataka Excise (Excise Duties and Fees) Rules, 1968;
4. The Karnataka Excise Licences (General Conditions) Rules, 1967;
5. The Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer, Wine, or Liquors) Rules, 1998;
6. The Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968;
7. The Excise (Possession, Transport, Import and Export of Intoxicants) Rules, 1967;
8. Karnataka Excise (Brewery) Rules, 1967;
9. The Karnataka Excise (Bottling of Liquor) Rules, 1967;
10. The FSSAI Guidelines on Alcoholic Beverages, 2018; and
11. Notifications and Circulars issued by the Government and Commissioner of Excise.

The focus and scope of Audit was on the Functioning of Distilleries, Breweries and Microbreweries. The Audit conducted joint field visits to the selected Distilleries, Breweries and Microbreweries and also visited the jurisdictional offices monitoring the functioning of such units. The sample for the compliance audit included 13 Distilleries (out of 32), 7 Breweries (out of 12) and 25 Microbreweries (out of 65), selected through random sampling for field visits. The scrutiny of accounts of the Distilleries, Breweries and Microbreweries were covered for a five-year period from 2018-19 to 2022-23. An Entry meeting with the Commissioner of Excise was held on 03 March 2023 wherein the objectives of audit, sample size and the period of audit were discussed. The exit meeting was held on 07 August 2024 with the Commissioner of Excise Department, Karnataka in which the audit findings were discussed. After the exit meeting, the Excise Commissioner has submitted detailed replies on the paragraphs, which have been suitably incorporated in the Report.

3.4.6 Introduction on Functioning of the Distilleries, Breweries and Microbreweries

Distillery: A Distillery is a place where spirits are manufactured. There are three kinds of Distilleries in Karnataka *i.e.*, Primary Distillery, Secondary Distillery and Composite Distillery. Primary Distilleries are those in which Rectified Spirit, Extra Neutral Spirit, *etc.*, (which is the basic raw material for manufacture of IML) are manufactured out of molasses, grains, tapioca, sweet potato, sugar beet, cereals, sugarcane juice, *etc.*, Secondary Distilleries are those which procure Spirit manufactured in Primary Distilleries and convert to IML through the process of reduction and blending. Composite Distilleries are those

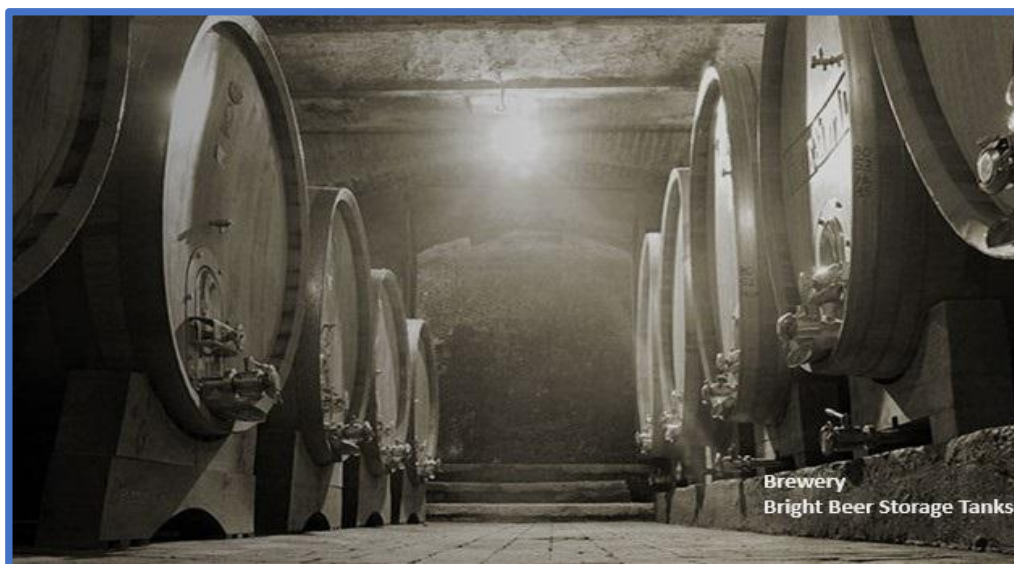
which combine the functions of both, *i.e.*, manufacture of Spirit and conversion to IML.

Figure: 3.1
Picture of Distillery



Brewery: A Brewery is a building where Beer⁵⁵ is manufactured and includes every place where Beer is stored or issued. In breweries, Beer is produced from fermentation of malt, grain, rice, oats, corn, *etc.*, by adding yeast to convert sugar in malt into alcohol. After fermentation process, the yeast would be removed through filtration and beer produced through this process would be bottled and sold.

Figure: 3.2
Picture of Brewery



Microbrewery: The Microbrewery is a small brewery with an installed capacity of not more than one thousand liters per day in a place having not less than

⁵⁵ Beer means, any liquor prepared from malt of grain with or without the addition of sugar and hops and includes ale, black beer, porter, stout and spruce beer.

10,000 square feet built-up area with spacious dining hall and parking facility, where Draught Beer⁵⁶ is manufactured and the same is served to their customers for consumption within the premises. In Microbreweries, Beer is manufactured following the same procedure in a Brewery but in small quantities. Most of the Microbreweries go under the category brewpub. Brewpubs serve newly brewed beer and also have an associated restaurant where food is served.

Figure: 3.3

Picture of Microbrewery



3.4.6.1 Issue of licenses and the related working arrangements

Licenses related to the establishment of Distilleries and Breweries are issued by the Excise Department according to the Rule 3 of the Karnataka Excise (Distillery & Warehouse) Rules, 1967, and Rule 3 of the Karnataka Excise (Brewery) Rules, 1967, respectively. Fee for grant and renewal of licenses and Additional license fee were collected in accordance with Rules 7 and 7-A and the Rules 5 and 5-A of the Rules *ibid* from the Distilleries and Breweries respectively.

The observations of Audit on the issue of licenses by the State Excise Department are detailed in subsequent paragraphs.

3.4.6.1 (a) Changes in the regulation of the Distilleries consequent to the amendment of the Industries (Development and Regulation) Act, 1951

The Industries (Development and Regulation) Act, 1951, was enacted to provide for the development and regulation of certain industries. The Industries included in the First Schedule to the said Act which included 'fermentation industries⁵⁷' was under the exclusive control of the Union Government. Thus, the licensing and control over the Distilleries manufacturing spirit (Primary Distilleries) was a subject of dispute between the Union and the State. The

⁵⁶ Draught beer is fresh beer served directly from the casks.

⁵⁷ Item 26 of the First Schedule from the year 1956.

Industries (Development & Regulation) Act, 1951, was amended⁵⁸ and the existing item of 'Fermentation Industries' in the First Schedule was substituted with 'Fermentation Industries (other than Potable Alcohol)'. With this amendment, all issues pertaining to Fermentation Industries (other than Potable Alcohol) were placed under the exclusive control of Union and those dealing with Potable Alcohol under the exclusive control of the State Government.

In view of the above, from the Excise year 2017-18 onwards, the State Excise Department discontinued issuing/renewing Primary Distillery licenses, as its final product was spirit, which was as such non-potable. The Distillery Officers stationed in the Primary Distillers were also withdrawn by the Department. Due to this, the control over the manufacturing of spirit has been discontinued by the State Government. However, as Spirit was the raw material to produce liquor (potable alcohol), the Department was duty bound to ensure that the spirit meant for non-potable purpose was not diverted for any other purpose.

The observations of Audit on the controls existing for avoiding diversion of spirit for purposes other than potable alcohol are as detailed below:

Sl. No.	Control put in place as stated by the Department	Remarks by Audit on the Controls
(a)	Primary Distilleries were required to continue to enter details in all registers which they are maintaining earlier for comparison of physical stock.	As per the New Biofuel Policy-2018 of the Union Government, Ethanol for the Ethanol Blended Programme (EBP), was allowed to be manufactured out of Sugarcane Juice, B-heavy Molasses and unused grains. However, no norms have been fixed for the yield of ethanol from such inputs. As per the extant Rules, yield was fixed only for C grade molasses. Unless the standards of yield for the new inputs are fixed, the Department may not be able to safeguard against the potential diversion of spirit. The traditional method of maintenance of books/registers may not suffice/prevent the diversion of spirit under the changed circumstances.
(b)	Deputation of specially trained Officers at Primary Distilleries for Certification of Ethanol produced from B-heavy molasses and Sugarcane Juice/Syrup.	Though Ethanol has been produced from B-heavy molasses in Karnataka, Officers were not deputed in the Distilleries for Certification. Audit asked for copies of Certification of Ethanol, to see whether certification is getting done without deputation of Officers. The certification documents submitted by the Department depicted only the invoice value and the quantity transported along with the information that the raw material was B-heavy molasses. Certificate with these details were issued by the Excise Inspector and it did not certify the yield of ethanol from the raw material utilised.

⁵⁸ Vide Notification No.27/2016 dated 14 May 2016.

		Audit noticed significant variations in yield from B- heavy molasses between different distilleries. Further, it was observed that non-fixation of yield in such cases leaves the Distilleries with margins of production, which could be misused. Fixation of yardsticks to regulate the production and movement of the manufactured spirit is necessary to exercise complete control over production of spirit, which includes raw material for alcohol industry.
(c)	Deputy Commissioners/Joint Commissioners of Excise were instructed to conduct periodic inspection of Primary Distilleries to prevent misuse or diversion of Spirit.	Out of the 59 primary distilleries in the State, the Department had submitted only three inspection Reports which were done by the Assistant Commissioners of Excise and Inspector of Excise of the respective areas. These seemed to be inadequate and only listed out the stock at the time of Inspection. Unless the inspections are regular and comprehensive, misuse or diversion cannot be detected. Stipulation of periodicity of such visits and supervisory inspections by Officers at the level of Deputy Commissioners/Joint Commissioners of Excise, may prove more effective than the regular Officers in the direct charge of the place.
(d)	Constitution of a Monitoring Committee to review and ensure the production and adequate supply of ENA to the IML manufacturers.	The Committee was constituted on 05 December 2019 and was mandated to meet once in a quarter to review the supply of Extra Neutral Alcohol (ENA). Audit noticed that the Committee did not comply with quarterly meetings mandated and met only once on 24 January 2020. Hence the intended objectives of overseeing the production of ENA and appropriate allocation to the IML Industries was not achieved by the committee. In the Exit meeting and in the reply by the Excise Commissioner, it was stated that the Committee has started organising meetings periodically from December 2023.
(e)	Compulsory Mounting of GPS devices on tankers transporting spirit within the State and on tankers transporting spirit for import/export purpose.	Department replied that instructions regarding GPS have already been issued. However, the details and progress in the installation of the GPS devices was not furnished to Audit.

As spirit is the raw material required to produce potable alcohol, proper regulatory mechanism over the same was inevitable to prevent the misuse of the spirit. According to the guidelines issued by the Department of Food and Public

Distribution in December 2020, the responsibilities of storage, validation of quality and quantity, certification of production, *etc.*, were assigned to the State Excise Department. However, audit verification revealed that the controls and systems in this regard defined by the Department were not adequate to address the issues of total control over raw material for the alcohol industry.

In reply, the Excise Commissioner stated that letters have been addressed to the State Government on 10 June 2024 and 04 October 2024 to obtain legal opinion of the Law Department on getting back the direct control of Primary Distilleries (November 2024).

3.4.6.1 (b) Lack of provisions for approval of Tie-up for manufacture of IML

According to Section 16 of the Karnataka Excise Act, 1965, the Distilleries and Breweries are to be established after obtaining permission from the Excise Commissioner and the State Government. The Karnataka Excise (Distillery and Warehouse) Rules, 1967, provides for transfer of Distillery to any person named by the licensee (Rule 4-C), shifting of the Distillery from one place to another (Rule 4-D) and subleasing of the distillery license held by the licensee in favor of any person named by such licensee (Rule 7-C). Similar provisions existed under the Rules 3-C, 5-C and 5-D of the Karnataka Excise (Brewery) Rules, 1967, for transfer, shifting and sub leasing of the Breweries.

Audit observed that seven⁵⁹ Distilleries and three⁶⁰ Breweries had entered into Manufacturing/Bottling Tie-Up Agreements for manufacture and bottling of brands owned by other Distilleries in their licensed premises. These Licensed Distilleries/Breweries were collecting bottling/manufacture charges from the tied-up other Distilleries for manufacture and bottling of brands.

The Distillery Licence holders based on the provisions in the Agreements provided space in their licensed premises for manufacturing, bottling, storage, chemical laboratories, office space, *etc.*, in favour of other tied-up Distilleries. The Manufacturing/Bottling Tie-up Agreement holders procured all the raw materials and obtained Order for supplies from M/s. Karnataka State Beverages Corporation Limited (KSBCL) for supply of Spirit and finished goods. Six instances were also noticed where the Bottling Tie-up Agreement holders were issuing invoices for supply of finished goods in their name themselves.

The Excise Commissioner had approved these Bottling Tie-up Agreements and Labels of Brands in the name of these companies manufactured and bottled in the licensed premises of the Distiller. Government⁶¹ had also directed that such Bottling Tie-up Agreement and Label approval in respect of such collaborations may be approved by the Excise Commissioner.

⁵⁹ 1) M/s. J.P. Distilleries Private Limited, 2) M/s. Unistil Alcoblend Private Limited, 3) M/s. KBD Sugars and Distilleries Limited, Hubballi, 4) M/s. Sahyadri Sugar and Distillery Private Limited, Hassan, 5) M/s. Kals Distilleries Karnataka Pvt. Limited (previously M/s. Netravathi Distilleries Pvt. Ltd., 6) M/s. KBD Sugars and Distilleries Ltd., Nelamangala, 7) M/s. Amruth Distilleries Pvt. Ltd., Bengaluru.

⁶⁰ (1) M/s. Woodpecker Distilleries and Breweries Pvt. Ltd. Brewery division, (2) M/s. United Breweries Limited, Nanjangodu, Mysuru, (3) M/s. Carlsberg India Private Limited, Nanjangodu, Mysuru.

⁶¹ Letter No. AE 20 EFL 2018 dated 05 October 2018.

Audit observed the following with this working arrangement:

- There were no provisions under Excise Act or allied Rules which provided for such an arrangement of Manufacturing/Bottling Tie-ups.
- Unpopular brand holders, with distillery licenses in Karnataka, were found engaged in such bottling tie-up arrangements with popular brand holders. Such collaboration keeps unpopular brand holders also in business and in turn contribute to Excise Revenue.
- Brands which do not have distilleries in Karnataka get a window to work in the State of Karnataka, without investing in a distillery and without a formal licence.
- Sublease of Distilleries/breweries are subject to payment of fees as prescribed in the Rules mentioned above. Though the Manufacturing/Bottling Tie-up arrangements were similar to a sub-lease, no fees were prescribed for such arrangements. It may be mentioned here that the States of Goa, Kerala, Andhra Pradesh have specific provisions for levy of fees in such cases, included in their respective Rules.

In reply, the Excise Commissioner stated that the tie up agreements were approved in accordance with the directions of the Government. The system of Bottling Tie-up Agreement has helped those Local Distillers which were in a financial loss. Such agreements were an effective way to increase the market presence of such companies. However, the Department assured that directions of the Government will be sought on framing of specific rules on levying fees on Bottling Tie-up Agreements (November 2024).

3.4.6.1 (c) Non-collection of Licence Fee and Additional Licence Fee for distilling spirit meant only for potable alcohol

Rule-7 of the of the Karnataka Excise (Distillery and Warehouse) Rules, 1967, prescribes the annual fee to be collected for grant/renewal of different kind of distillery licences as below:

- Fee of ₹ 33.75 lakh in case of distilleries which distill spirit out of molasses, any grains, tapioca, sweet potato, sugar beet and sugarcane juice (Primary Distillery).
- Fee of ₹ 45 lakh in case of distilleries which uses spirit for the manufacture of Indian Liquor (Secondary Distillery).

Additional Licence Fee at the rate of 15 *per cent* of the Licence Fee was also leviable as per Rule 7-A of the Rules *ibid*.

Audit observed from the records that M/s Amruth Distillery Private Limited, Bengaluru, had applied for issue/renewal of licence for distillation of spirit out of Malt, Grapes, Jaggery, Sugarcane Juice (Primary Distillery) and Licence for Manufacture of IML (Secondary Distillery) during the period from 2017-18 to 2022-23. The Department accorded the licenses for distillation of spirit and also for the Manufacture of Indian Liquor. Though fee was required to be collected for both the licenses, the Department had collected fee for manufacture of IML only. During the period from 2017-18 to 2022-23, the licensee had produced 11,562 BLs of spirit out of Sugar Cane juice and utilized 307 BLs of spirit for

manufacture of IML. However, the license fee and additional licence fee amounting to ₹ 2.72 crore for distilling spirit for the said purpose was not collected.

In the Exit Meeting and in the reply of the Excise Commissioner, the Department stated that Amruth Distillery Ltd have signed a MoU as a primary distillery and need not have to pay the fee after the IDR amendment as all the primary distilleries come under the purview of the Central Government. Audit pointed out that Amruth distillery does not come under the purview of the Centre as the distillery manufactures only potable liquor. The Joint Commissioner stated that the Department will have a relook at the issue (November 2024).

3.4.6.1 (d) Import of Foreign liquor without CL 11A licence resulting in loss of licence fee

According to the Section 2(14) under the Karnataka Excise Act, 1965, “import” means to bring into the State otherwise than from a Customs Station. In other words, import of liquor means bringing inside the State boundary. Further, as per Section 2(13), “Foreign liquor” includes all liquors other than Indian liquor. In other words, foreign liquor is the liquor manufactured outside India.

Government of Karnataka established M/s. Karnataka State Beverages Corporation Limited (KSBCL) as a government owned Distribution Company for the sole purpose of distribution of Liquor and Spirit from 30 June 2003. Since then, the Department of Excise issued licence in Form-CL-11 to M/s. KSBCL based on the application for the same by KSBCL.

As per Rule 3(11) of the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968, CL-11 licence is a Distributor license and such licensee is not permitted to import Foreign Liquor from outside State. Further, as per clause (d) under Rule 3(11), the Excise Commissioner may permit the licensee to sell foreign liquor imported from outside India. In short, CL-11 licensee was permitted to sell foreign liquor but not permitted to import foreign liquor. Permission to import foreign liquor was granted only under the CL-11A⁶² license, which exclusively dealt with foreign liquor, manufactured outside India. Further, as per Rule 3(11-A) import of Foreign Liquor included direct import of foreign liquor from outside India or import from other authorized agencies outside Karnataka.

On a verification of the activities of KSBCL, Audit observed that KSBCL was permitted to import foreign liquor from other authorized agencies outside the State of Karnataka. As per the conditions of the CL-11 licence, KSBCL was not permitted to import Foreign Liquor into the State boundaries of Karnataka. As stated above, such activity was permitted only with a CL-11A licence. The Department never issued a licence under CL-11A to KSBCL or demanded the annual fees of ₹ 50 lakh prescribed under Rule 8 (14(b)) of the aforesaid Rules. This resulted in unauthorized import of foreign liquor by KSBCL and loss of revenue to the tune of ₹ 11.50 crore to the State from the year 2003-04 to 2022-23.

⁶² CL-11A- Licence is granted to directly import foreign liquor from outside India or to import foreign liquor from other authorized agencies outside the State.

In reply, KSBCL replied that it was not importing Foreign Liquor directly from outside India and was merely distributing Foreign Liquor obtained from authorized agencies, by paying a privilege fee⁶³ of ₹ 18 crore. Hence there was no need to obtain CL-11A licence.

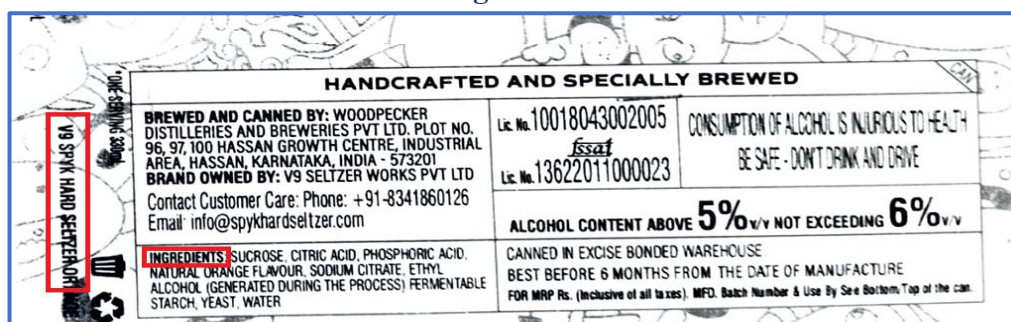
The reply from M/s. KSBCL was not acceptable as M/s. KSBCL obtaining foreign liquor from other authorized agencies outside the State, which amounts to import of liquor into Karnataka and CL-11 licence does not permit import. Further, fee for CL-11 licence was not specified under Rule 8 of the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968, and hence, privilege fee is notified and paid by the Corporation for holding the CL-11 licence. The Excise Commissioner stated to consider the reply of KSBCL, however, Audit reiterates that the reply of KSBCL is not acceptable due to the reason stated above (November 2024).

3.4.6.1 (e) Irregular manufacture of Hard Seltzer brands under brewery licence

As per the definition⁶⁴, “Beer” means, any liquor prepared from malt of grain with or without the addition of sugar and hops and includes ale, black beer, porter, stout and spruce beer.

M/s. Woodpecker Distilleries and Breweries Private Limited, Hassan, entered into a Brewing Agreement with M/s. V9 Seltzer Works Private Limited, Hyderabad, Telangana (25 February 2022) for manufacture of Hard Seltzer⁶⁵ brands⁶⁶. In the Labels approved for the brands of Hard Seltzer, the ingredients mentioned were Sucrose, Citric Acid, Phosphoric Acid, Sodium Citrate, Ethyl Alcohol (generated during the process), Fermentable Starch, Yeast and Water. Hard Seltzer brands were manufactured through fermentation of sugar or sucrose whereas Beer was manufactured in accordance with the rules through fermentation of malt of grain. Though the process of manufacture of Beer and Hard Seltzer were similar, Hard Seltzer is not Beer as per the definition under the Rules. Hence, the licensee with a Brewery license was not authorized to manufacture Hard Seltzer.

Figure 3.4



(Label depicting the ingredients in a Hard Seltzer)

⁶³ Privilege fee is levied by the State Government for grant and renewal of Distributor licence. It is determined by notification subject to such rules as may be prescribed.

⁶⁴ Rule 2 (f) of the Karnataka Excise (Brewery) Rules, 1967.

⁶⁵ Hard Seltzer is an alcoholic beverage made from fermenting sucrose.

⁶⁶ V9 Spyk Hard Seltzer Orange, V9 Spyk Hard Seltzer Mixed Berry, V9 Spyk Hard Seltzer Original and V9 Spyk Hard Seltzer Lime.

The Excise Acts and the Allied Rules provide licensing for manufacturing of “low alcoholic beverages” made from distilled spirit but do not provide for licensing of products like Hard Seltzers. Absence of such provisions led to production of brands without a valid license.

The Excise Commissioner stated that the matter will be discussed before the Technical Committee and decision taken will be informed (November 2024).

Recommendation 1: Government may:

(a) introduce necessary provision in the Rules concerned to facilitate the current working arrangements in the Distilleries;

(b) prescribe requisite fees for manufacturing/bottling Tie-up Agreements in line with the provisions of the neighbouring States in order to mobilise additional revenue.

Recommendation 2: Government may:

(a) direct the Department to develop market intelligence to be aware of the different innovative products, study their constitution and process of manufacture to introduce regulation, when felt necessary.

(b) amend the Licensing Rules to regulate the manufacture of new products and fix license fee to augment Excise Revenue collection.

3.4.6.2 Levy and collection of Excise Duty, Additional Excise Duty and other fees

Rule 2 of the Karnataka Excise (Excise Duties and Fees) Rules, 1968, states that an Excise Duty (ED) shall be levied on the excisable articles specified at the rates in the Schedules A and B of the Rules, when such excisable articles are issued from any Distillery, Warehouse or other place of storage established or licensed in the State. In addition to Excise Duty, according to Rule 2-AB of the aforesaid Rules, an Additional Excise Duty (AED) is levied on the excisable articles, which is meant for the purpose of sale within the State of Karnataka. AED is levied as per the rates prescribed in Schedule D under the Rules.

Besides, as per Rules 2-A and 2-AB, Countervailing Duty (CD) and Additional Countervailing Duty (ACD) is levied on the excisable articles imported into the State of Karnataka from the States outside Karnataka.

The observations of Audit on the levy of duties by the State Excise Department are detailed in subsequent paragraphs.

3.4.6.2 (a) Short levy of Additional Excise Duty due to delay in adoption of revised Declared Price

According to Sub-Rule (1) of Rule 2-AE of the Karnataka Excise (Excise Duties and Fees) Rules, 1968, the Distillery licensee shall declare to the Excise Commissioner, the price of the brands of liquor meant for sale in Karnataka. Such Declared Price is the basis for the levy of Excise Duty and Additional Excise Duty. Besides, as per Sub-Rule (2) of Rule 2-AE of the said Rules, if the Distillery licensee intends to make any revision in the Declared Price, they shall declare the revised price to the Excise Commissioner in Form DRP, in

quadruplicate at least one month in advance and shall give effect to such revised declared price only after approval by the Excise Commissioner.

In Karnataka, the distribution of IML to the retailers from the Distilleries was through M/s. KSBCL. Orders for supplies (OFS), as per demand from the retailers were placed by M/s. KSBCL and the point of levy of Additional Excise Duty was dispatch of IML from the Distilleries to the depots of M/s. KSBCL. On a revision of the Declared Price, the levy of AED should be based on the Revised Price, from the date made effective by the Excise Commissioner.

Audit observed that:

- In eight⁶⁷ Distilleries and five⁶⁸ Breweries there were revisions in Declared Price of their brands during the Audit Period from 2018-19 to 2022-23. However, AED was continued to be levied on the pre-revised Declared Price for 2 to 27 days, which resulted in short levy of AED of ₹ 42.46 crore in 4,41,787 cases of IML and 26,41,633 cases of beer.
- The reason of such delay in adoption of the Revised Declared Price was due to the time lag in updating the revised prices in the software of KSBCL. The revision of Declared Price approved by the Excise Commissioner, in quadruplicate in Form DRP, was issued to the Distillery, Excise Officer in the Distillery, Deputy Commissioner of Excise in the District concerned, and one copy was retained by the Office of the Excise Commissioner. KSBCL was not marked a copy and as per the procedure followed, the Distiller, after receipt of the approved copy, in turn submits the same to KSBCL. Thus, lack of direct communication by the Excise Commissioner to KSBCL resulted in the delay in adoption of Revised Price by KSBCL.

The Superintendents/Deputy Superintendents of Excise, in-charge of two⁶⁹ Breweries replied that Demand Notices for recovery of short levy of AED was issued by the Deputy Commissioner of Excise, Mysuru Rural District, Mysuru. Further, the Excise Commissioner stated that the Department has already initiated the process of approving Declared Price/Maximum Retail Price (DP/MRP) online in Version-2 software. In the first step, service pertaining to imported brands of liquor (imported from outside State/outside Country) has

⁶⁷ (1) M/s. United Spirits Limited (Sub-Lessee of M/s. Hermes Distillery Pvt Ltd), Belagavi, (2) M/s. United Spirits Limited (Sub-Lessee of M/s. KBD Sugars and Distilleries Limited), Bengaluru Rural, (3) M/s. John Distilleries Private Limited, Bengaluru, (4) M/s. United Spirits Limited (Sub-Lessee of M/s. KBD Sugars and Distilleries Limited), Hubballi, (5) M/s. J.P. Distilleries Private Limited, Makali, Bengaluru, (6) M/s. Unistil Alcoblands Private Limited, Solur, Ramanagara, (7) M/s. Sarvada Distilleries, KIADB Industrial Area, Nandikoor, Near Padubidri, Kaup Taluk, Udipi District, (8) M/s. USL-sub-lessee of Sahyadri Sugar and Distillery Private Limited, Hassan.

⁶⁸ (1) M/s. United Breweries Limited, Nanjangudu, Mysuru, (2) M/s. United Breweries Limited, Nelamangala, Bengaluru Rural, (3) M/s. Carlsberg India Private Limited, Nanjangudu, Mysuru, (4) M/s. United Breweries Ltd. Mangaluru Taluk, (5) M/s. Anheuser Busch InBev India Limited, Maliyur Village, Bannur Hobli, T Narasipur taluk, Mysuru District.

⁶⁹ (1) M/s. Carlsberg India Pvt. Ltd, (2) M/s. United Breweries, Nanjangudu.

been made online. As a second step, service pertaining to local brands of liquor (manufactured in Karnataka) will be provided online (November 2024).

3.4.6.2 (b) Short levy of Additional Excise Duty on Bottled/Canned beer

Schedule D under Rule 2-AB of the Karnataka Excise (Excise Duty and Fees) Rules, 1968, prescribes Additional Excise Duty at 175 *per cent* of the declared price for bottled beer and was 150 *per cent* of the Declared Price for Kegs⁷⁰, with effect from 01 April 2019.

Audit observed in one brewery⁷¹ that Additional Excise Duty on bottled beer was levied at 150 *per cent* instead of 175 *per cent* of the declared Price. This resulted in short levy of Additional Excise Duty for the period March 2021 to June 2023, amounting to ₹ 59.06 lakh.

The Deputy Commissioner of Excise in-charge of the Brewery and the Excise Commissioner replied that the Excise Department had given permission for a new category of packaged beer called Growlers and approval for 150 per cent AED on the packaging of unfiltered/unpasteurized beer in glass, ceramic, stainless steel or aluminium upto 2 litre. The sale of draught beer in Growlers was charged at 150 per cent. The reply is not acceptable as the amendment vide the notification referred in the reply defines take away in the form of 1.5 litre and 2 litre Growlers only, however, the observation is about 500 ml packaged beer (November 2024).

3.4.6.2 (c) Loss of revenue in the form of Excise Duty and Additional Excise Duty due to destruction of beer

An offence case⁷² was booked (9 June 2022) against M/s. Carlsberg India Private Limited, Mysuru, for incorrect printing of MRP (old MRP of ₹ 150 was printed instead of ₹ 160) on the labels of 7,972 cases Tuborg Green Beer of 650 ml, manufactured on 06 May 2022. Shelf life of the Beer was up to 5 November 2022, which was six months from the date of manufacturing.

The Deputy Commissioner of Excise, Mysuru⁷³, had sought permission (04 July 2022) from the Excise Commissioner for re-labeling the bottles, with correct MRP. The Excise Commissioner sought (01 September 2022) information relating to date of production of Tuborg Green Beer, Batch Number and Shelf Life (Expiry date) from the Deputy Commissioner of Excise, Mysuru Rural District, which was furnished on 14 September 2022.

Permission for re-labelling was not given by the Excise Commissioner till 10 January 2023. As the shelf life of the Beer had expired and the Chemical Analysis of the sample revealed that the Beer had sedimented, it was rendered unfit for human consumption. Thereafter, the Deputy Superintendent of Excise, M/s. Carlsberg India Private Limited, Mysuru⁷⁴ addressed the Deputy Commissioner of Excise, Mysuru, seeking permission to destroy/drain the

⁷⁰ A small cask or barrel having a capacity of 30 gallons or less.

⁷¹ M/s. Beerworks Restaurants and Microbrewery Private Limited, Bengaluru.

⁷² In FIR No.36/2021-22/4402DySE/440205 dated 09 June 2022.

⁷³ Vide letter No. DCE/MYSR/Brewery/05/2021-22 dated 04 July 2022.

⁷⁴ In letter No.EXE/Brewery/Carlsberg/Beer Destruction/01/2022-23 dated 05 June 2023.

expired beer, for which approval was accorded by the Excise Commissioner (September 2023).

Audit observed that the processing of the permission to re-label the bottles in the Office of the Excise Commissioner was delayed without any reason recorded in the file, till the expiry of the product and rendered the 7,972 cases of beer unfit for human consumption. Hence, unreasonable delay in processing the approval for re-labeling of bottles with correct MRP led to loss of Excise Duty amounting to ₹ 6.22 lakh⁷⁵ and Additional Excise Duty amounting to ₹ 82.24 lakh⁷⁶.

The Excise Commissioner replied that the Office accords permission for re-labelling only after verifying that the records submitted by the licensee and the jurisdictional Deputy Commissioner of Excise are in order. Incomplete applications/proposals without relevant information cannot be considered. Audit points out that though the initial request was incomplete, complete details were furnished on 14 September 2022, 22 days ahead of the expiry date. The reply of the Excise Commissioner does not mention any reason for that delay and hence the reply is not acceptable (November 2024).

3.4.6.2 (d) Issue of Circular inconsistent with the Rules framed for approval of labels

Sub-Rule (1) of Rule 10-A of the Karnataka Excise (Bottling of Liquor) Rules, 1967, states that the licensee shall pay a fee of rupees one lakh for approval of label of each brand of liquor including Beer bottled within the State. Further, Sub-Rule (3) of the said Rules states that the labels once approved shall remain in force until there is any change in the design, text, texture and composition of the label for which the licensee shall pay the prescribed fee and get the label approved afresh by the Excise Commissioner.

Audit observed that the Excise Commissioner issued a Circular in August 2017, wherein the modifications proposed to an existing label were classified as Major or Minor as detailed below:

- Any change in the Brand name, pack, design, strength, and product specifications were considered as Major changes.
- All other alteration or changes such as – label shape, size, font size, pack suppliers name, any additional pack sizes and any changes necessitated by the statutory requirement – were considered as Minor changes.
- Further, a levy of rupees one lakh was specified as fee for Major changes and ₹ 10,000 for minor changes.

The circular issued by the Excise Commissioner was in contravention of the existing Rules as the classification of changes as minor directly affected the revenue of the State Government. Further, the significant modifications in the Rules framed by the State Government, affecting the collection of Revenue, were carried out at the level of the Excise Commissioner, without the concurrence of the Government.

⁷⁵ (62,181.60 bulk litres X ₹ 10).

⁷⁶ (7,972 cases X ₹ 589.46 X 175 per cent).

Audit further observed that in six⁷⁷ Distilleries, though the changes in Label were Major, Fee was levied considering the change as Minor, which resulted in short levy of Label Approval Fee amounting to ₹ 31.50 lakh.

In reply, the Excise Commissioner stated that the differentiation into “Minor” and “Major” has clarified the grey areas in the rule which did not specify certain changes which went unnoticed earlier. The Government of Karnataka is progressively working towards simplifying the business regulatory procedures in the State. The State Excise Department has also undertaken various initiatives towards process simplification and Ease of Doing Business. However, observations made in the Audit Report have been considered positively and will be incorporated in future changes. Audit reiterates that the changes which has implications with the collection of Revenue cannot be made at the level of the Excise Commissioner but has to be executed by the Government (November 2024).

Recommendation 3: Office of the Excise Commissioner, Bengaluru, may directly forward the approval of Revision of Declared Price to M/s. KSBCL for immediate adoption of the same to avoid short collection of Additional Excise Duty.

3.4.6.3 Regulation of production of Spirit, Beer and Liquors

The Karnataka Excise (Regulation of Yield, Production, *etc.*) Rules, 1998, govern the production, yield, and related activities of liquor and spirit manufacturing in Karnataka. The Rules aim to ensure proper control over the manufacturing processes, prescribes yield from different raw materials like malt spirit, grape spirit, rectified spirit, *etc.*, prescribes wastages on transport, storage, maturation, *etc.*, and prevent evasion of excise duties.

The observations of Audit on the standards fixed for production, yield, *etc.*, are detailed in subsequent paragraphs.

3.4.6.3 (a) Need for revision of standards prescribed for manufacture of IML

Schedule A of Rule 3 of the Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer and Liquors) Rules, 1998, stipulated the standards for production or yield of Spirit, Beer, Liquors. Further, Note no.5 under Schedule-A of Rule-3 of the said Rules stipulates that ‘for the manufacture of Indian Made Liquors, the basic material is Rectified Spirit (RS) of not less than 94.84 *per cent* Alcohol⁷⁸ by Volume (ABV). RS is the lowest form of Spirit obtained during distillation. Such spirit was to be reduced to the strength of 42.82 *per cent* ABV⁷⁹ for the manufacture of IML.

⁷⁷ (1) M/s. United Spirits Limited (Sub-Lessee of M/s. Hermes Distillery Pvt. Ltd.), Belagavi, (2) M/s. United Spirits Limited, Kalaburagi, (3) M/s. United Spirits Limited (Sub-Lessee of M/s. KBD Sugars and Distilleries Limited), Bengaluru Rural, (4) M/s. Amruth Distilleries Ltd., Kambipura, Bengaluru, (5) M/s. John Distilleries Limited, Mysuru Road, Bengaluru, (6) M/s. J. P. Distilleries Private Limited, Makali, Bengaluru North Taluk.

⁷⁸ 166-degree proof.

⁷⁹ 75 Degree Proof (means 25 Degree Under Proof).

Audit observed from the following instances that Distilleries use Extra Neutral Alcohol (ENA) not Rectified Spirit (RS) for production of IML. Further, the strength of the spirit used for production of IML was not uniformly 42.82 *per cent* and depends on the blending and reduction requirements to produce the intended final product.

- 13 Distilleries⁸⁰ were utilizing Extra Neutral Alcohol (obtained from Molasses/Grains), Malt Spirit, Grape Spirit and Spirit from Jaggery/Sugarcane and not RS.
- These Distilleries were using Malt Spirit, Grape Spirit, High Bouquet Spirit and Spirit from Jaggery/Sugarcane with strength of 96 *per cent* ABV, for manufacture of IML whereas the stipulations prescribe only manufacture of IML from spirit of strength 94.84 *per cent* ABV.
- Manufacture of Mysuru Lancer Whisky in Aseptic Brick Pack of 180 ML and 90 ML was approved by the Excise Commissioner, Bengaluru⁸¹, from Spirit strength reduced to 37.14 *per cent* ABV.
- Schedule A under Karnataka Excise (Excise Duties & Fee) Rules, 1968, prescribes rate of duty for spirits of the Strength of London proof (57.10 *per cent* ABV) and 25 under proof (42.86 *per cent* ABV) whereas production is made for spirits having strengths other than those as shown above.

Figure:3.5



(Labels showing IMLs at strengths different from 42.86 percent ABV)

⁸⁰ 1) M/s. United Spirits Limited (Sub-Lessee of M/s. Sahyadri Sugars and Distilleries Ptd. Ltd.), Hassan, 2) M/s. United Spirits Ltd. (Sub-Lessee of M/s. Hermes Distilleries Limited), Belagavi, 3) M/s. KALS Distilleries, Tumakuru, 4) M/s. Amruth Distilleries, Limited, Kambipura, Bengaluru, 5) M/s. Unistil Alcoblend Private Limited, Solur, Ramanagaram, 6) M/s. J.P. Distilleries, Makali, Bengaluru, 7) M/s. United Spirits Limited (Sub-Lessee of M/s. KBD Sugars), Hubballi, 8) M/s. United Spirits Limited (Sub-Lessee of M/s. KBD Sugars), Bengaluru Rural, 9) M/s. United Spirits Limited, Kalaburagi, 10) M/s. John Distilleries, Bengaluru, 11) M/s. John Distilleries (Sub-Lessee of M/s. Vishwaraj Sugars), Belagavi, 12) M/s. Sarvada Distilleries, Udupi, 13) M/s. Bacardi India, Mysuru.

⁸¹ No. Excise-18011/12/2023 dated 07 June 2023 and in No. ECD/01/DST/Udupi/Label/2017-18 (Part-2) dated 20 June 2023.

Thus, the rates prescribed under Schedule A and specifications under Note 5 of Schedule-A needs to be reconsidered in the light of the existing market conditions.

In reply, the Excise Commissioner stated that an ideal Excise Policy has to strike a delicate balance between the twin objectives of preventing dominance in liquor trade and social degeneration on one hand and securing optimum revenue for the Government on the other, but also has to address the concerns of the four stake holders *i.e.*, the Government, the Manufacturers, the Licensees and the Consumer along with social considerations and ramifications.

Audit points out that it only intends the inclusion of ENA and different strengths of spirit in the Rules as per the evolved market situations, which is in fact in the interest of all the stake holders mentioned in the Excise Commissioner's reply (November 2024).

3.4.6.3 (b) Violations of the provisions prescribed by FSSAI for the manufacture of IML and Beer

The Standards applicable to distilled and un-distilled alcoholic beverages have been specified in the Food Safety and Standards (Alcoholic Beverages) Regulations, 2018, as detailed below:

- Regulation no. 2.8.1(ii) - **Blended malt or grain whisky** shall be a mixture of at least two *per cent* from barley malt or grain whisky, with neutral or rectified spirit.
- Regulation no. 2.1.2 - **Blended brandy** is a mixture of minimum two *per cent* of pure grape brandy with any other fruit or flower brandy or neutral spirit or rectified spirit of agricultural origin. If any other fruit brandy is used for blending, the name of such fruit shall be pre-fixed with the word 'Brandy'.

Audit, observations on the compliance of the aforesaid Regulations are detailed below:

- Bag Piper Deluxe Whisky produced in three Distilleries⁸² was blended using lesser than two *per cent* of Malt Spirit. Labels, in all these cases, mentioned "Blended with Malt Spirit".
- Labels of Original Choice Deluxe Malt Whisky and Black Pelican Malt Whisky of M/s. John Distilleries, Bengaluru, mentioned "Blended with Malt Spirit". However, it did not contain the required two *per cent* of Malt Spirit.
- Labels of Original Choice Deluxe VSOP Brandy, Bengaluru Brandy and Mont Castel Blended Brandy of M/s. John Distilleries, Bengaluru, mentioned "Blended with Grape Spirit". However, minimum required quantity of two *per cent* of Grape Spirit was not found used for production of these brands.

⁸² M/s. USL Kalaburagi, M/s. USL Nelamangala, M/s. USL Hubballi.

- Table 1 under the FSSAI Regulations, 2018, specifies 13 parameters⁸³ to be measured during the preparation of distilled Alcoholic Beverages and Beer. However, as per the records of the Excise Department's Chemical Laboratory only three⁸⁴ parameters were getting measured. Audit also found that the Distilleries and Breweries did not have the essential equipment to measure the parameters mentioned under the Regulations.

In all the above instances, production of Indian Made Liquor was found in violation to the prescribed Standards issued by FSSAI. Meticulous standards for various categories of alcoholic beverages, from spirits to wine and beer have been fixed by FSSAI regulations to ensure that consumers can enjoy their preferred beverages without compromising their well-being. The practices of the Distilleries of incorrect disclosure in the labels misled the customers and warrant strict enforcement from the Excise Department to safeguard the interests of the consumer.

In respect of Bag Piper Deluxe Whiskey, the Excise Commissioner endorsed the reply of the Excise Officers in charge of United Spirits, Bengaluru Rural and Hubli who stated that the Bag Piper Deluxe Whiskey is labelled only as whiskey and not as blended whiskey but statement/declaration "Blended with Select Indian Malts and Spirits" on the front bottom of label is merely a qualitative/perceptible description of the liquid. However, reply is not acceptable as the FSSAI standards stipulate that the malt or grain whiskeys are of two types - single malt or grain whiskey and blended malt whiskey or blended grain whiskey and the blended variety should contain at least two *per cent* malt or grain spirit. Hence, the qualification in the label with "Blended with select Indian Malts and Spirits" makes him liable to mix at least two *per cent* of grain or malt spirit. State Excise Department may enforce stricter control over such stipulations to raise the standard of the alcohol industry of the State to make it more competitive and transparent to the customer (November 2024).

3.4.6.3 (c) Violation of the approved labels and compromise in quality

In two Distilleries⁸⁵, labels of Windsor Deluxe Whisky, Raja Whisky, No.1 Highway Deluxe Whisky and Old Monk Rum mentioned malt/matured Spirit in the list of ingredients. However, Audit noticed that malt spirit was not added in 529 batches of Windsor Deluxe Whisky, 1609 batches of Raja Whisky, 113 batches of Old Monk Rum and 150 batches of No.1 Highway Deluxe Whisky during the period from 2018-19 to 2022-23. This resulted in production of these brands without adding Malt Spirit and violated the approved label attached in the bottles. Audit also observed that the Excise Inspectors stationed in the Distilleries certify the ingredients of each batch. However, the inspectors failed to point out the absence of malt spirit in any of the occasions mentioned above.

⁸³ Ethyl alcohol content, Residue on evaporation, volatile acids, higher alcohols, methyl alcohol, total esters, furfural, aldehydes, copper, lead, arsenic, cadmium, mercury in respect of distilled beverages and Ethyl alcohol, pH, carbon-di-oxide, methyl alcohol copper, iron, lead, arsenic, cadmium, total plate count, coliform count, wild yeast and Brewer's yeast in respect of beer.

⁸⁴ Ethyl Alcohol, Obnoxious Substance and Methyl Alcohol.

⁸⁵ M/s. Unistil Alcoblends Private Limited and M/s. J.P. Distilleries.

Audit observes that such practices raise questions on the quality of liquor produced in the State. This misled the customers and deceived them into buying a compromised product, through incorrect labeling. As the labels were approved by the Department, such occurrences of violations of labels and production/selling of compromised products show serious lapses on the part of the Department.

In reply, the Excise Commissioner stated that there was no compromise in the administrative control exercised by the Department during the production of IML. Periodic inspection of Distilleries is carried out by the Excise Officials. However, Audit reiterates that labels were approved by the Excise Commissioner and the Office was duty bound to verify the declaration in the label was complied with. Besides, the blend registers in the distilleries are to be counter signed by the Officers in the charge of the distillery, where the Distillery officer verifies the contents of the mixture and certifies it. Hence, the view of the Department that it has not compromised on the execution of administrative control is not acceptable (November 2024).

Recommendation 4: Government may revise standards for manufacture of IML by including use of raw materials other than RS and specify a spectrum of strengths for blending of spirits to keep up with the current market practices.

Recommendation 5: Government may prescribe and levy penalties for violations of the quality standards prescribed for alcoholic beverages. Besides, Government may fix responsibilities on Excise Inspectors stationed at Distilleries who failed to point out such violations.

3.4.6.4 Regulation of Wastage claimed during the Production of Spirit, Beer and Liquors

The standards for the maximum wastage permissible during production or processing of Spirit, Beer and Liquor are specified under Schedule B of Rule 4 of the Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer and Liquors) Rules, 1998. Schedule B allows the following types of wastages for the processes involved in the production and processing:

- i. Wastages in Transit and Storage,
- ii. Losses in the manufacture,
- iii. Maturation loss; and
- iv. Bottling and Handling losses.

Deviations from the permitted limits of the above standards which were noticed by Audit are detailed in the subsequent paragraphs:

3.4.6.4 (a) Incorrect claim of wastage in transport of spirit through pipeline

Schedule B (1) (c) prescribes maximum transit wastage of one *per cent* for transportation of rectified spirit in metal containers from the distillery to the other processing place. Besides, in case of claim of excess wastage beyond the

limits prescribed, Rule 8 of the Karnataka Excise (Regulation of Yield, Production, *etc.*) Rules, 1998, states that the Excise Commissioner can impose penalty at the rate equivalent to the rate of excise duty leviable on beer/wine or other liquor under the Karnataka Excise (Excise Duties and Fees) Rules, 1968, after examination of the report of the Distillery and after holding such an enquiry as he deems fit.

During the period from 2017-18 to 2022-23, M/s United Spirits Private Limited (Sublessee of M/s. Hermes Distillery Private Limited), Raibag Taluk, Belagavi District, had purchased Molasses Extra Neutral Alcohol and Grain Extra Neutral Alcohol from the Primary distillery unit situated in the same premises which was transported through a pipeline. M/s United Spirits Private Limited had claimed loss of Spirit of 59,788 bulk liters and the same was allowed by the Department.

Audit observed that:

- M/s. United Spirits Private Limited had claimed a transit loss of spirit transported through pipeline from the Primary Distillery in the same premise. The Rules provided for the transit loss of one *per cent* in respect of transportation through metal containers and not through pipeline.
- The Excise Officer in the Distillery did not bring this to the notice of the Deputy Commissioner of Excise, Belagavi District or to the notice of the Office of the Excise Commissioner, Bengaluru, before allowing such claim, provision for which was not available in the Rules.

Thus, allowance of claim of loss in the absence of valid provisions in the Rules, led to loss of Excise Duty and Additional Excise Duty amounting to ₹ 2.96 crore.

In reply, the Excise Commissioner stated that instructions will be issued to all the Deputy Commissioners of Excise of the Districts and Distillery officers (November 2024).

3.4.6.4 (b) Imprecise method of fixation of Transit Loss of Spirit transported in metal containers

As discussed in paragraph 3.4.6.4(a), the transit wastage of Spirit, if transported in metal containers, from the Distillery to the other processing place was fixed at one *per cent*.

Audit observed that:

- This standard of one *per cent* was prescribed in the year 1998. However, with the lapse of time and introduction of other ways of transportation and modern ways of storage, the Department had not taken any initiative to revise the norms.
- In the neighbouring and other States like Tamil Nadu (Rule 52 of The Tamil Nadu Distillery Rules) and Orissa (Rule 91 of Orissa Excise Rules, 2017), transit wastage was based on the number of days for transportation of Spirit. The specification in both the States was:
 - 0.5 *per cent* for journey of not greater duration than five days, and
 - 1.0 *per cent* for journey of greater duration than five days.

Thus, wastage will depend on the number of days of storage and transport. However, fixing one *per cent* of transit wastage of Spirit without factoring-in the distance travelled and number of days of transportation of Spirit was found to be an imprecise method of working wastages.

From the books maintained by the Distilleries, Audit also examined the transit wastages claimed by 21⁸⁶ Distilleries in Karnataka during the years from 2018-2019 to 2022-2023 and found that it ranged from zero *per cent* to 0.70 *per cent* only, which was lesser than prescribed one *per cent*. Thus, the fixation of transit wastage of Spirit in an imprecise manner may provide margin to the Distilleries for extra production, which could be channelized otherwise.

In reply, the Excise Commissioner stated that the purpose of the rule was to make a fair provision for wastage taking into account reasonable and fair operating practices. However, the same is under consideration with the departmental committee for revamping all age-old rules including rules on wastage. Audit pointed out that the sample in Audit showed that majority of the Distilleries have modernized their operations and a relook into the extant percentages may be necessary (November 2024).

3.4.6.4 (c) Need for revision of the standard fixed of wastage during manufacture

Schedule B under the Karnataka Excise (Regulation of Yield, Production, *etc.*) Rules, 1998, stipulates wastage at the rate of five *per cent* for the process of reduction, blending, storage, bottling and warehousing including loss due to evaporation and breakage.

Audit observed that the standard was prescribed during the year 1998 and there were no guidelines prescribed for periodic revision of production and wastage norms. Though significant period has elapsed, and the industry has modernized their operations and machinery in several ways, the norms set in 1998 remained the same, without undergoing any revision.

Audit examined the data from the Distilleries to understand the impact of non-revision of the norms and observed that:

⁸⁶ (1) USL-KBD Sugars and Distilleries, Hubballi, (2) J.P Distilleries, Makali, (3) Unistil Alcoblends, (4) M/s. Amruth Distillery, (5) John Distillery Vijayanagar, (6) Sarvada Distillery, Udupi, (7) ABD Blenders-Sarvada Distillery, Udupi, (8) Shashi Distilleries Pvt. Ltd., Bengaluru, (9) Blue Ocean Beverages Pvt. Ltd., Chickkaballapura, (10) Hermes Distillery Pvt. Ltd., Raibag Taluka Belagavi District, (11) M/s. USL S/L of Hermes Distillery Pvt. Ltd., Raibag Taluka, Belagavi District, (12) USL S/L of M/s. Sahyadri Sugar and Distillery Pvt. Ltd., Hassan, (13) INBREW - M/s. Sahyadri Sugar and Distillery Pvt. Ltd., Hassan District, (14) USL Kalaburagi, (15) John Distillery, Mysuru Road, Bengaluru, (16) M/s. KALS Distillery, Tumkuru District, (17) M/s. USL S/L KBD, Nelamangala, (18) M/s. Pernod Ricord India Ltd. S/L of Universal Bottlers Ltd., Nelamangala, (19) Vishwaraj Sugars Pvt. Ltd., Bellad Bagewadi, Belagavi District, (20) Vorion Distilleries, Yeshwanthpur Bengaluru, (21) M/s. Woodpecker Distilleries, Hassan.

- The wastages relating to production of IML claimed by 21⁸⁷ Distilleries in Karnataka during the years 2018-2019 to 2022-2023 ranged from zero *per cent* to 1.99 *per cent*, which was far less than the prescribed five *per cent*.

This clearly indicated that the efficiency of the operations in the Distilleries had significantly enhanced. Thus, the non-revision of norms may leave a margin of production for the Distilleries, which could be diverted through other means.

The Excise Commissioner replied that the revision of the existing norms is under consideration with the departmental committee (November 2024).

3.4.6.4 (d) Incorrect claim of wastage due to re-processing of IML

Schedule B under Rule 4 of the Karnataka Excise (Regulation of Yield, Production, *etc.*) Rules, 1998, prescribe three *per cent* loss for the process of re-distillation of Spirit. Norms for wastage or losses were not fixed for re-distillation of IML into Extra Neutral Alcohol or for conversion from one brand of alcohol to another.

(i) Re-distillation of IML into ENA

Two⁸⁸ Distilleries were granted permission by the Excise Commissioner for re-distillation of 1,61,817.11 BLs of IML into ENA. During the process of the re-distillation, 70,780.70 bulk liters of ENA was obtained, and 1,336.80 bulk liters was claimed as wastage.

(ii) Conversion from one brand to another (reprocess)

In four⁸⁹ Offices of the Deputy Superintendent of Excise, permission was accorded to four Distilleries⁹⁰ for conversion of 56,133.76 bulk liters of one brand of IML to another. During the process of conversion, the Distilleries had claimed a total wastage of 391.48 bulk liters.

Audit observes that there were no provisions under Excise Act or Rules to claim wastages mentioned in the above two circumstances.

⁸⁷ (1) USL-KBD Sugars and Distilleries, Hubballi, (2) J.P Distilleries, Makali, (3) Unistil Alcoblend, (4) M/s. Amruth Distillery, (5) John Distillery, Vijayanagar, (6) Sarvada Distillery, Udipi, (7) ABD Blenders BTW Sarvada Distillery, Udipi, (8) Shashi Distilleries Pvt. Ltd., Bengaluru, (9) Blue Ocean Beverages Pvt. Ltd., Chickaballapura, (10) Hermes Distillery Pvt. Ltd., Raibag Taluka, Belagavi District, (11) USL S/L of Hermes Distillery Pvt. Ltd., Raibag Taluka, Belagavi District, (12) USL-Sahyadri Sugar and Distillery Pvt. Ltd., Hassan, (13) INBREW - M/s. Sahyadri Sugar and Distillery Pvt. Ltd., Hassan District, (14) USL Kalaburagi, (15) John Distillery, Mysuru Road, Bengaluru, (16) M/s. KALS Distillery, Tumakuru District, (17) M/s. USL S/L KBD Nelamangala, (18) M/s. Pernod Ricard India Ltd S/L of Universal Bottlers Ltd., Nelamangala, (19) Vishwaraj Sugars Pvt. Ltd., Bellad Bagewadi Belagavi District, (20) Vorion Distilleries, Yeshwanthpur Bengaluru, (21) M/s. Woodpecker Distilleries, Hassan.

⁸⁸ M/s. John Distilleries Ltd. (Lessee of M/s. Vishwaraj Sugar Industries Ltd.), Belagavi and M/s. J.P. Distillery.

⁸⁹ Bengaluru, Ramanagaram, Mysuru and Udipi.

⁹⁰ 1) Sarvada Distilleries, Udipi, G.D. Whisky, 2) M/s. Unistil Alcoblend Pvt. Ltd., Ramanagaram, 3) M/s. Bacardi India Pvt. Ltd., Mysuru, 4) M/s. J.P. Distilleries, Pvt. Ltd., Bengaluru.

In reply, Excise Commissioner stated that permission for reprocessing of Liquor was accorded as per Notes 3 and 4 of Rule 3 of Schedule A and Schedule B of Rule 4 of the Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer, Wine or Liquors) Rules, 1998. Further, heading II of Schedule B of the said Rules prescribes the losses in the manufacture of Potable Liquors like Beer, Brandy Whisky, *etc.* In the instant case, permission for reprocessing has been given as per the rules and the said permission has resulted in generation of revenue to the State exchequer due to increase in Additional Excise Duty (November 2024).

Audit appreciates the fact that reprocessing of IML may sometimes result in additional revenue, however, the fact remains that Schedule B under Rule 4 of the Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer, Wine or Liquors) Rules, 1998, does not prescribe wastages for reprocessing of IML, it prescribes wastages for reprocessing of spirit only. The reprocessing of IML is not an usual business practice and hence may not have been anticipated and included under the Rules, which may be rectified by the Department.

3.4.6.4 (e) Excess wastage claimed for production of beer

Schedule B under Rule 4 Karnataka Excise (Regulation of Yield, Production, *etc.*) Rules 1998, specifies the following losses for the manufacture of Beer:

- seven *per cent* for fermentation, filtration, carbonation, *etc.*; and
- six *per cent* for bottling, pasteurization and labelling, crowning, and warehousing.

Rule 8 of said Rules states that for excess wastage or loss claimed as against the permissible limit, penalty at the rate equivalent to the rate of excise duty and AED leviable on beer may be imposed.

M/s. Beer Works Restaurants & Microbrewery Private Limited, Bengaluru had claimed wastage more than the percentages mentioned above in the following cases:

- An excess claim of wastage of 8,776.63 BLs was noticed under “fermentation, filtration, carbonation, *etc.*” while processing a volume of 1,56,191 BLs in 43 batches, which was above seven *per cent* allowed.
- Besides, another excess claim of 7,371 BLs of wastage was noticed under “bottling, pasteurization and labelling, crowning, and warehousing”, while processing a volume of 1,91,097 BLs in 61 batches, which was above six *per cent* allowed.

The penalty to be levied for excess claim of wastage worked out to ₹ 13.49 lakh.

In reply, the Excise Commissioner stated that the issue would be placed before the Technical Committee for examination (November 2024).

Recommendation 6: Government may consider fixing Transit wastage of Spirit after factoring in the distance between the Distillery and the Processing Units and the duration of travel.

Recommendation 7: Government may consider revision of the wastage norms fixed for production of IML to attune standards to the present working conditions.

3.4.6.5 Levy of duty based on Annual Installed Capacity of Microbreweries

A Microbrewery is a small-scale brewery that produces craft beer on smaller quantities, emphasizing quality, flavor, and unique brewing techniques over mass production. Licensing of Microbreweries is with the State Excise Department and as per the eligibility criteria, Microbreweries needed a minimum area of 10,000⁹¹ square feet. Microbreweries have to pay licence fee annually and Excise duty and Additional Excise duty as prescribed under Karnataka Excise (Brewery) Rules, 1967.

3.4.6.5 (a) Inadequacy in the provisions relating to the levy of Duty on Microbreweries

Grant of license for Microbreweries was introduced on 07 January 2011 vide insertion of the Rule 27-A under the Karnataka Excise (Brewery) Rules, 1967. According to Rule 2 the Karnataka Excise (Duties and Fees) Rules, 1968, Excise Duty was fixed at 50 *per cent* of the Annual Installed Capacity⁹² at the rate ₹ 25 per bulk liter of beer. The duty fixed had to be paid in advance at the start of the Excise year. However, there were no provisions in the Rules concerned, to collect duty, whenever the production goes beyond 50 *per cent* of the Annual Installed Capacity.

Audit points out the following aspects regarding the above mentioned manner of taxation of the Microbreweries:

- As per Section 22 of the Karnataka Excise Act, 1965, Excise Duty shall be levied on any excisable article manufactured or produced in the State. In case of Microbreweries, Duty is to be paid in Advance on Annual Installed Capacity. That means Duty is collected on excisable articles which are yet to be produced. On a test-check of Microbreweries, Audit noticed that 21 out of 25 were producing less than 50 *per cent* of the Annual Installed Capacity. In other words, 21 Microbreweries were paying duty on articles which they did not manufacture. As Excise Act stipulates levy on manufactured articles only, the levy was not in accordance with the Excise Act.
- A similar levy existed for Pan Masala under the Central Excise Act, 1944 (CEA), wherein Duty was levied on the production capacity of Masala Packing Machines. In this case, the levy was facilitated by an enabling provision under Section 3-A of the CEA Act, which granted the government the authority to impose duties based on production capacity. The Central Government, in exercise of the powers conferred by Section 3A of CEA, 1944, framed Pan Masala Packing Machines

⁹¹ Reduced to 6,500 square feet vide amendment dated 16 August 2024.

⁹² If a Microbrewery has 10 fermentation tanks with 200 litres capacity, the Annual Installed capacity works out as $(200 \times 10) \times 365 / 14$, where 14 days is the fermentation cycle fixed.

(Capacity Determination and Collection of Duty) Rules, 2008, to levy and collect the excise duty with respect to the Capacity of the Pan Masala Packing Machines.

- During the test-check of 25 Microbreweries, Audit noticed that four⁹³ were producing above 50 *per cent* of Annual Installed Capacity, which was noticed by the Department during inspection of the Microbreweries. Though there were no specific provisions, the Department collected ED and AED on actual production of Beer in three cases.

Audit appreciates the fact that overseeing the actual production in the Microbreweries was not a viable option for the Department and hence introduced the levy on Annual Installed capacity. However, the Act did not have an enabling provision to levy duty on Annual Installed capacity. Further, levy of duty on production above 50 *per cent* was not backed by provision under the Rules and has to bring in necessary amendments to regularize the levy.

Audit concludes that the present levy of duty was not in accordance with the Karnataka Excise Act, 1965 and allied Rules. Hence, the Department needs to have a relook at the provisions to avoid future litigation and cater to the present consumption trends.

In reply, the Excise Commissioner stated that the prevailing mechanism for monitoring Chemical Analysis was framed during the initial phase of Microbrewery concept implementation, when the number of Microbreweries was very few. Conducting Chemical Analysis and monitoring of reports will be strictly implemented. In this regard, the Department will issue suitable instructions in the form of Circular. The Excise Commissioner also stated that the suggestions made by Audit would be kept before the Technical Committee for consideration (November 2024).

3.4.6.5 (b) Deficiency in the formula for calculation of Annual Installed Capacity

After conducting a meeting (20 August 2014) with the representatives/Brew Masters of the Microbreweries, a Circular dated 22 May 2015⁹⁴ was issued by the Office of the Excise Commissioner, which stated the following:

- Annual Installed Capacity of the Microbreweries was fixed based on the capacity of the Fermentation Tanks; and
- Fermentation Cycle⁹⁵ was fixed at 14 days.

Fermentation cycle of 14 days was crucial in deciding the Annual Installed Capacity and the duty was based on the same. A variation in the number of days affected the Capacity and thereby had a direct impact on the calculation of duty.

⁹³ M/s. The Bier Library, M/s. Byg Brewsky Hennur Brewing Company, M/s. Brewsky Hospitality Private Limited, Sarjapura and M/s. PH4 Food and Beverages Private Limited, Bengaluru.

⁹⁴ No. ECD/44/REV/GEN/2014-15 dated 22 May 2015.

⁹⁵ Fermentation is the process by which yeast converts sugar contained in the malt or grain to ethyl alcohol and carbon-di-oxide.

When days of the fermentation cycle is lower, it results in more Annual production which increases the levy of duty and vice versa.

To determine the accuracy of duration of the fermentation cycles in the Microbreweries, Audit conducted a Joint Physical Inspection of 25 Microbreweries with the staff of the Department and observed the following:

- 1) Microbreweries produce mainly two types of Draught beer⁹⁶ - Ale⁹⁷ and Lager⁹⁸ and 80 *per cent* (approx.) of beer made by the micro-breweries were Ales.
- 2) As explained and recorded in the Joint Inspection,
 - Ale was fermented at a temperature of 18-20 degree Celsius and took three to five days for fermentation to complete; and
 - Lager was fermented at 13-15 degree Celsius and took longer time of five to seven days for fermentation.

The next step in brewing was chilling (two to three days) through which yeast was allowed to settle down and removed from the bottom of the conical portion the Fermentation tanks. After that, beer can be transferred into Bright Beer Tanks (BBT) and ready to serve. That means Ale beer was ready to serve in six to eight days and Lager was ready to serve in eight to ten days.

- 3) Brewing books of 13⁹⁹ Micro-Breweries, showed that Ale was ready and transferred to Storage Tanks in 5-10 days and for Lager, the beer was ready in nine to fifteen days.

Here, Audit points out the fermentation cycle could be lesser than 14 days, especially in respect of Ale Beer. The brew books maintained in the Microbreweries, itself proves the fact and this could result in Annual Installed Capacity much higher than the formula prescribed.

Hence, Audit is of the opinion that the calculation of annual yield capacity based on a fermentation cycle of 14 days for both Ale and Lager was not in order. As seen from the Brewing books, the fermentation cycles could be completed much earlier (max 10 days in respect of Ale). The Microbreweries can produce batches in less than 10 days also, whenever demand is high. The Department does not have real time control over production, and this leaves a margin for the Microbreweries to take advantage. Blanket fixation of the fermentation cycle at 14 days had a direct impact on the calculation of Annual Installed capacity of Microbreweries, which in turn affects the collection of Duties under the Excise Act.

In reply, the Excise Commissioner explained the difference in fermentation processes in Distillery and Microbrewery and gave a variety of reasons for having the fermentation process in Microbrewery to be temperature controlled and with specialised yeasts. The reply also stated that the Ales are assumed to

⁹⁶ Beer in bulk.

⁹⁷ Beer that's brewed at warmer temperature using top-fermenting yeast.

⁹⁸ Beer that's brewed at cooler temperature using bottom-fermenting yeast.

⁹⁹ In respect of the remaining 12 Microbreweries, the duration was not ascertainable from their Brew books.

have an average fermentation time of approximately 14 days. Lagers, on the other hand take approximately three to four weeks. The reply concludes that there was no short determination of Annual Installed Capacity of Microbrewery and short levy of Excise Duty and Additional Excise Duty.

Audit observation was not on the complexities of the fermentation process. It was primarily based on the brew registers of the Microbreweries, which recorded that Ales are fermented within five to ten days and Lagers within nine to fifteen days. The Excise Commissioner, in his reply, agrees to the point of Ales and Lagers differing in fermentation cycle but retains the position that fermentation cycle takes a minimum of 14 days. Audit observes that the differentiation in fermentation cycles between Ale and Lager was not taken care in the present formula and wants the Department to examine the brew books of the Microbreweries and place it before the Technical Committee before revising the formula to arrive at the Annual Capacity of Microbreweries.

The Excise Commissioner further stated that the suggestions made by Audit would be kept before the Technical Committee for consideration (November 2024).

3.4.6.6 Management of the Microbreweries

Rule 27-A under the Karnataka Excise (Brewery) Rules, 1967, provides for grant of licence for Microbreweries. In a Microbrewery Licence, permission was given to serve beer to the visitors of the licenced premises. Serving of IML in licensed premises was not included in Microbreweries.

Initially, Microbrewery License was allotted only to CL-7 (Lodging and Boarding Houses), CL-6A (Star hotels), CL-9 (Bar and Restaurants) or CL-4 (Clubs) licence holders. Such restriction was removed with effect from 01 April 2012, which opened up the licence of Microbrewery for others also.

3.4.6.6 (a) Unauthorized transfer of control of business of CL-9 license to Microbreweries

The New amendment in the issue of licence of Microbrewery was to decouple it from other licences. However, coupling with other licences (especially CL-9) still remained the Industry Standard as detailed below:

- Six Microbreweries¹⁰⁰ had taken transfer of control, operation, and management of CL-9 licences through Lease Agreement (five cases), and Partnership Deed (one case). In another case¹⁰¹ sales turnover of IML of CL-9 licence was included in the accounts of the Microbrewery. This was to make available IML and Craft Beer in the same premises.
- Though the transfer of CL-9 licence was prohibited, without the prior permission of the Authority, control, operation and management of CL-9 licenses were taken over by the Microbreweries without any authority. This amounted to the breach of the licence conditions, which

¹⁰⁰ 1) Peregrine Hospitality LLP, 2) M/s. BYG Brewsky Hennur Brewing Company, 3) M/s. The Bier Library – A Unit of Frothy Tales Hospitality Pvt Ltd, 4) M/s. Bengaluru Brew Works Private Limited, 5) M/s. Ethina Hospitality LLP 6) M/s. Brewsky Hospitality Pvt. Ltd., Sarjapura.

¹⁰¹ M/s. Brewsky Hospitality Pvt. Ltd., Sarjapura.

renders such CL-9 licenses for cancellation. In case, such transfers were approved by the Department vide Rule 17-B of the KE (General Conditions of Licences) Rules ¹⁰², the transfer fee leviable under such cases amounted to ₹ 103.75 lakh.

- In two Microbreweries¹⁰³, the licence was under approval during the period 2019-20 in one case and 2022-23 in another case in the Office of the Excise Commissioner, Bengaluru. Before the approval itself, the Microbrewery had tied up with a CL-9 licence near its premise and started sales of IML of the CL-9 licensee, in the Microbrewery premise. The fact of such sales was evident from the bills issued and sales data maintained by the Microbreweries. This resulted in sales of IML in the premises, which was not licenced.

3.4.6.6 (b) No demarcation between the CL-9 and Microbrewery premises

The licences were run in combination without any demarcation and cross utilization was noticed in both the premises. Beer was served in the premises of CL-9 and vice versa in the premises of Microbreweries. In one case the Microbrewery had installed a Beer dispensing tap in the premises of CL-9.



[pic-1 showing beer dispensing tap (for beer from Microbrewery) fixed in CL-9 licence premises and pic-2 showing IML stored in Microbrewery premises]

Hence, Audit concludes that the effort to open up the Microbrewery licence, by detaching it from other licences, did not materialize. Audit also verified the control of the Department to oversee the non-compliances pointed out above; it was noticed that the Commissioner had instructed¹⁰⁴ the Deputy Commissioners of Excise to conduct Joint Inspection of Microbrewery premises along with the jurisdictional Inspector of Excise at least once in a month. However, such inspections were not carried out and hence the irregularities remained unnoticed.

In reply, the Excise Commissioner stated that there was no loss of revenue to the Government exchequer, either from Microbreweries sanctioned independently as well as those Microbreweries attached to CL-4, CL-7, CL-9 or CL-6A licenses. Licensing authority in respect of transferring the CL-9 licenses is District Deputy Commissioner of Excise and in respect of transfer of Microbreweries, Excise Commissioner is the licensing authority and the Blue Print is approved by the licensing authority. Moreover, this matter is also under

¹⁰² As per Rule 17B of the K.E (General Conditions of Licences) Rules, 1967, transfer of licences are allowed by the Deputy Commissioner on payment of twice the annual licence fee.

¹⁰³ Under Range-38, J.P. Nagar and Range-02, Gokula, Bengaluru.

¹⁰⁴ As per the Circular No. ECD/44/REV/GEN/2014-15 dated 22 May 2015.

discussion at the Departmental level and appropriate guidelines will be framed in this regard (November 2024).

3.4.6.7 Operation of the Microbreweries

Rule-8A of the Karnataka Excise (Brewery) Rules, 1967, prescribes that the licensee shall establish a well-equipped Chemical laboratory within the premises of the brewery to check the Quality of raw materials used and the liquor produced. The beer produced shall be released for sale only after certification by the Chemist.

Besides, Rule 20 of Karnataka Excise (Brewery) Rules, 1967, stipulates that the Inspecting officer shall at least once in a quarter, forward the samples of the wort in fermentation to laboratory for analysis.

3.4.6.7 (a) Non-conduct of chemical analysis and regular monitoring of parameters

Audit conducted Joint Physical Inspection of 25 Microbreweries and noticed the following:

- In 15 Microbreweries, a well-equipped Chemical Laboratory was not established.
- In 23 Microbreweries, the Inspecting Officers have not forwarded samples of the wort¹⁰⁵ to the Chemical Laboratory of the Department for analysis.
- As per Condition 4, the licensee shall provide a Saccharometer and a Thermometer for testing the gravity of the wort in the Brewery and a Hydrometer for testing the strength of the draught beer. In three Microbreweries, Hydrometer for measuring gravity of the fermentation and fresh beer was not available in the premises.
- As per Condition No.5, alcohol content of the beers produced/supplied to the customers shall not exceed eight *per cent* volume by volume. In 18 Microbreweries, there were no instruments to measure strength of alcohol content.
- As per Condition No.6, pH, temperature, and gravity of the brews up to maturation stage should be recorded and the same is subject to inspection as and when called for by a Competent Authority. In 17 Microbreweries, day wise reading of pH, temperature, and gravity of the fermentation process of the brews up to maturation stage were not recorded.
- The Government vide Notification¹⁰⁶ prescribed formula¹⁰⁷ for calculation of yield or production of Beer where Potential Extract¹⁰⁸

¹⁰⁵ Wort is the liquid extracted from the mashing process during the brewing of beer.

¹⁰⁶ No. FD 09 PES 2017 (I) dated 05 July 2018.

¹⁰⁷ Volume of Beer = (Total wt. of malt/adjunct X *per cent* PE X *per cent* ME X 384)/(Excess OG of wort).

¹⁰⁸ Potential Extract of malt is the measure of sugars that will turn into alcohol during fermentation.

(PE) of the malt and Mashing Efficiency¹⁰⁹ (ME) of the mixture has to be recorded. In 16 Microbreweries, data relating to ME and PE were not recorded.

This shows that the activities of the fermentation, maturation, *etc.*, and related parameters which determine the yield and strength of the beer manufactured were not getting measured and recorded. There were no periodical inspections by the Department, though the same was mandated through notification mentioned above. In the absence of oversight and the non-recording of crucial parameters related to yield, strength and quality, the Department did not have any control over the production and quality of beer manufactured in Microbreweries. In such scenario, the chances of un-recorded production and quality compromises may occur, which may result in revenue and social impacts.

The Excise Commissioner replied that suggestions made by Audit would be kept before the Technical Committee for verification. In this regard, the Department will issue suitable instructions in the form of Circular (November 2024).

3.4.6.8 Controls over raw material and output of Microbreweries

3.4.6.8 (a) No prescription to maintain Stock Register of Malt

There was no provision in the Karnataka Excise (Brewery) Rules, 1967, for maintenance of Stock Register/Book for Malt which is the primary raw material for manufacture of Beer.

- During Joint Physical Inspection of 25 Microbreweries Audit noticed shortage of Malt of 6,596 Kilograms in two¹¹⁰ Microbreweries.
- Further, in M/s. Elixer Enterprises and Hotels Private Limited, Bengaluru, Audit noticed the presence of eight Kegs in the Microbrewery premises. Kegs are used for transportation of bulk Beer, the presence of which indicates chances of transportation of Beer produced in the Microbrewery.

Audit observes that the Department has not prescribed the Microbreweries to record actual usage of Malt for production. In the absence of the same, production/sales turnover declared to the Department could not be cross verified to ascertain the accuracy of figures reported. There was scope for underreporting of production and thereby loss to exchequer.

The Excise Commissioner replied that the suggestions made by Audit would be kept before the Technical Committee for consideration (December 2024).

¹⁰⁹ Mash efficiency refers to the extent to which the sugars can be pulled out of the malted grain and into the water.

¹¹⁰ M/s. Elixer Enterprises and Hotels Private Limited, M/s. Kidiyoor Hotels Private Limited, Udupi.

3.4.6.8 (b) No prescription of Expiry date for beer produced in Microbreweries

As per the Food Safety and Standards (Alcoholic Beverages) Regulations, 2018, in Regulation No.5.10 states that “Alcoholic beverage other than wine which contain less than 10 *per cent* alcohol shall mention the date, month and year of expiry on the label, in that order and shall precede by the words “Expiry date” or “Use by”. However, the manufacturer may use the expression “Best Before” as optional or additional information.

The Andhra Pradesh Brewery rules provides for ‘Shelf life of the drought beer as only 36 hours’. (The project report of a Microbrewery of M/s. Community India Hospitality and Resort Private Limited stated that the shelf life of the beer brewed in Microbrewery is restricted to four days).

The Karnataka Excise (Brewery) Rules, 1967, or the Circular of 22 May 2015, issued by the Excise Commissioner did not prescribe expiry date for beer produced in Microbreweries. Audit noticed that in respect 23 Microbreweries out of the 25 Microbreweries test-checked, Beer ageing more than 15 days to two months, were getting served to the customers.

As the documents mentioned above prescribe the shelf life of fresh beer as four days (as provided in the project report of the Licensee), the Department may have to ensure that the consumption of beer older than four days shall not become harmful to the health of consumers.

The Excise Commissioner, in the reply, stated that the suggestions made by Audit would be kept before the Technical Committee for consideration (November 2024).

Recommendation 8: Excise Department may make provisions to specify an Expiry Date for Beer produced in Microbreweries.

3.4.6.8 (c) Non/Short levy of Excise Duty and Additional Excise Duty on Microbreweries

The rate of Excise Duty leviable for Microbreweries was revised to ₹ 10 from rupee five and Additional Excise Duty leviable was revised to ₹ 25 from ₹ 12.50 with effect from 01 April 2019. For the Excise year 2018-2019, the Microbrewery Licence holders had to pay the revised Excise Duty and Additional Excise Duty on 50 *per cent* of the Annual Installed Capacity.

Audit on verification of records in 18 Offices of Inspectors of Excise in-charge of Range relating to 25 Microbreweries, observed short payment of duty in three Microbreweries. This was due to the fact that the duty was levied in advance at the start of the year and the revision was effected in the middle of the year and the initial levy was not revised. This resulted in short levy of Excise Duty and Additional Excise Duty amounting to ₹ 10.09 lakh.

The Excise Commissioner replied that in two cases recovery has been made and the remaining case need to be followed up for recovery of ED and AED (November 2024).

3.4.6.9 Non-obtaining of Security/Hypothecation of Microbreweries

Rule 7 of the Karnataka Excise (Brewery Rules), 1967, states that every licensee shall execute an agreement binding himself, his heirs, legal representatives and assigns to observe the conditions of the licence, hypothecating the brewery buildings, machinery, apparatus together with the stock of the Beer, *etc.*, as security for the payment of money which may be due to Government by way of duty, rents or other payment due under the provisions of his licence. If the agreement is not executed within 10 days from the date of approval of the application for licence, the licence shall be cancelled, and the licensee shall not be entitled for refund of the fee paid.

No such Agreements were executed by the Breweries and Microbreweries during the years 2018-19 to 2022-23 and licences were granted/renewed, without the Security/Hypothecation Agreements. No action was taken by the Department, in this regard, in any of the cases.

Audit would like to bring to notice that Security may become crucial in case of arrears falling due in respect of any of these Breweries or Microbreweries. The Department may have to secure Government revenue and take all measures to prevent the instances of non-collection by adhering to all the available safeguards provided in the Act and Rules.

Further, after verification of the sanction, management and operation of the Microbreweries, Audit is of the opinion that the controls and regulations in this sector remain lax on all aspects, from deficiencies in the levy of collection of duty to the point of volume of production and supply of beer. As the industry is mushrooming in the State of Karnataka, the Department needs to gear up and tighten all the aspects of regulation concerning the industry without any acts which may decelerate its growth. The target may be to levy duty on the actual production and oversee compliance of all aspects of the licence conditions.

The Excise Commissioner, in the reply, stated that this matter will be discussed with the Government (November 2024).

Recommendation 9: Government may amend the Excise Act on the lines of the Sections of CEA Act, 1944, relevant to legitimize the levy of duty on Production capacity of the Microbreweries.

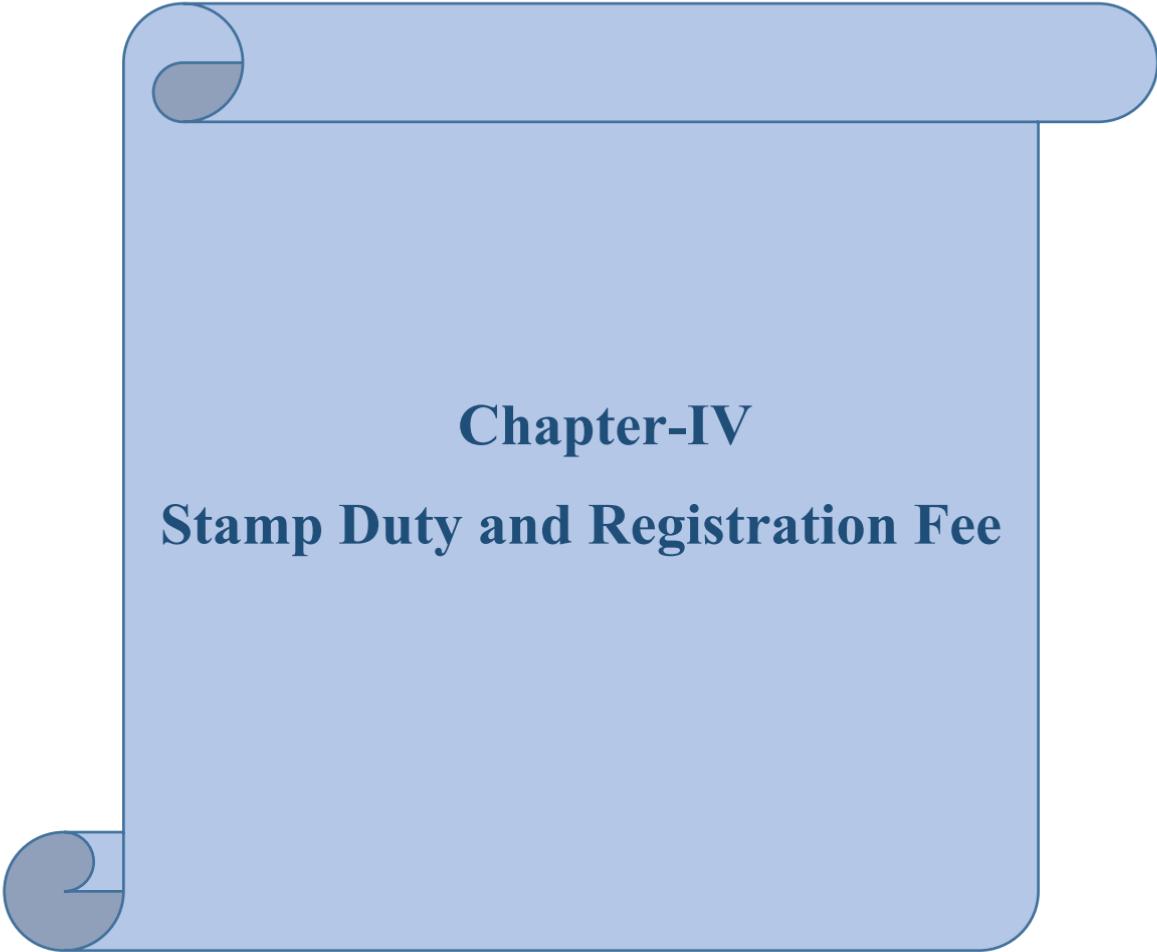
Recommendation 10: Government may fix separate Fermentation Cycles for Ale and Lager Beer.

3.4.6.10 Conclusion

The Excise Department has discontinued the complete control over the Primary Distilleries due to the amendment in the IDR Act, however, certain controls required to safeguard the non-diversion of spirit meant for potable spirit were still not in place. Though the issue of licenses and related fees has been made effectively, the Department is yet to reform certain provisions to accommodate new products introduced in the market and new marketing trends. The levy and collection of duty under excise has been working well in the Department barring a few instances like delay in the communication of revised Declared Price.

The modernization of the processes of distillation or fermentation and the related processes of bottling and transportation has brought several changes in the field of liquor business. However, the significant reduction in wastages at the levels of manufacturing, transport and storage has not been factored into the percentages allowed and hence revision under all the levels seems very imminent. The non-compliance with the FSSAI Regulations directly impacted the interest of the customers and such variations from the standards will raise questions on the quality of the Indian products in the market. Deviations from the ingredients mentioned in the approved label shows lackadaisical approach from the Department in safeguarding the customer interests.

Microbreweries are a booming business in Bengaluru and have the potential to contribute higher in future. However, the provisions for taxation in respect of this sector remains disputable and have to be revisited by the Department to avoid future litigations. Controls over the Microbreweries may have to be strengthened to capture actual sales and levy duty according to actual production.



Chapter-IV
Stamp Duty and Registration Fee

Chapter-IV

Stamp Duty and Registration Fee

4.1 Tax Administration

Receipts from Stamp Duty and Registration Fee are regulated by the Indian Stamp Act (IS Act), 1899, the Karnataka Stamp Act (KS Act), 1957, the Registration Act, 1908, and the Rules made thereunder. In Karnataka, the levy and collection of Stamp Duty and Registration Fee is administered at the Government level by the Additional Chief Secretary, Revenue Department. The Department of Stamps and Registration (DSR) under the administrative control of the Revenue Department regulates the levy and collection of Stamp Duty and Registration Fee.

4.2 Internal Audit

The Department stated that though an Internal Audit Cell was constituted in December 2012, it was still not functional due to lack of manpower. But the Department has a mechanism in place where the District Registrars are in charge of circle-wise periodic audits. The results of such audit are reported to the Inspector General of Registration and Commissioner of Stamps (IGR&CS). The position of observations is as shown in **Table 4.1**.

Table 4.1
Year-wise details of observations

(₹ in crore)

Year	Observations raised		Observations settled		Observations pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
2018-19	933	10.10	150	0.52	783	9.58
2019-20	463	2.13	241	1.14	222	0.99
2020-21	367	0.62	135	0.22	232	0.40
2021-22	543	2.03	239	0.41	304	1.62
2022-23	646	6.03	358	1.34	288	4.69
Total	2,952	20.91	1,123	3.63	1,829	17.28

Source: Information furnished by the Department.

As seen from the above, 1,829 observations involving ₹ 17.28 crore were pending settlement as on 31 March 2023. Early action may be taken to settle the pending observations.

4.3 Results of Audit

There are 291 auditable units in the Department of Stamps and Registration. Out of these, audit selected 58 units for test-check wherein 19.03 lakh documents were registered. Out of these, Audit test-checked 1.8 lakh documents (9.46 *per cent*) during the year 2022-23 and noticed 174 cases of short levy of Stamp Duty and Registration Fee due to undervaluation, non-disclosure of consideration, misclassification of documents, incorrect assessment of value of development agreements and other non-observance of provisions of Acts/Rules,

etc., involving an amount of ₹146.23 crore. These cases are illustrative only as these are based on test-check of records. The observations broadly fell under the following categories:

Table 4.2
Results of Audit

Sl. No.	Category	No. of Paragraphs	(₹ in crore)
			Amount
1.	Short levy of SD and RF due to undervaluation	80	83.77
2.	Short levy SD and RF due to non-disclosure of consideration	23	3.90
3.	Short levy of SD and RF on Development agreements	12	4.03
4.	Short levy of SD and RF due to misclassification of documents	33	48.21
5.	Other irregularities	26	6.32
Total		174	146.23

During the year an amount of ₹ 40.66 crore was recovered in 31 paragraphs pointed out in earlier years.

A few illustrative cases of non/short realisation of Stamp Duty and Registration Fee involving ₹ 44.34 crore are discussed in the following paragraphs:

4.4 Short levy of Stamp Duty and Registration Fee on conveyance of developed property

As per Section 3 of the Karnataka Stamp Act, 1957, Stamp Duty is charged on instruments as prescribed under various Articles in the Schedule of the Act, *ibid*. On presentation of a document for registration, the Sub-Registrar verifies the document and based on its contents, classifies the document under the relevant Article of the schedule. In addition, the market value of the property/properties which is the subject matter of the document, is also estimated. Thereafter, the rate prescribed in the Article is applied on the market value of the property/properties and stamp duty payable is determined.

In case of a joint development of land, a developer develops the land belonging to the owner and in return gets the right to sell a portion of the developed property (developer's share). In this arrangement, usually a Joint development agreement is executed alongwith a Power of Attorney at the beginning of the project, assigning the share of the developed property between the owner and developer and also empowering the developer to develop the property and subsequently sell the developer's share. After completion of the project, the respective shares in the developed property are sold either as a whole or individually to prospective customers by execution of sale-deeds. In such an arrangement, stamp duty is levied at two instances. The first time, on either the Joint development agreement or the Power of Attorney at lesser rates (at one *per cent* upto April 2014 and presently at two *per cent*) at the beginning of the project and then the second time on the actual Deed of conveyance through which the title of the properties are transferred to prospective buyers, at five *per cent* of the market value of the property being conveyed.

During audit of the Office of the Sub-Registrar, Kacharakanahalli, Audit noticed a sale-deed wherein stamp duty and registration fee were levied short due to misinterpretation of the transaction depicted in the document. The details of the case are as below:

A Sale-deed was executed in December 2020 between an owner and the developer through which a portion of a shopping mall was being conveyed to the developer. This deed was preceded by a joint development agreement executed during the year 2010 on which stamp duty of ₹3.01 lakh and registration fee of ₹30,000 had been paid. As per the joint development agreement, the owners's share was 38 *per cent* of the built-up area and the share of the developer was 62 *per cent* of the built-up area in the shopping mall which consisted of three basements, ground floor and five upper floors having a total area of 29,007 sq.mtr.

Now, through this sale-deed, the portion of the property identified as the developer's share was being conveyed to the developer itself. However, there was no mention of the built-up area in the schedule of the document and it was stated as conveyance of only the undivided share of the land measuring 9,598.76 sq. mtr. This was substantiated in the recitals of the document, wherein it was stated that the rights in respect of the building were already vested with the developer as per the terms of the Development Agreement. The stamp duty and registration fee were also paid on the market value of the land alone. The Sub-Registrar while estimating the value of the property conveyed through the document, accepted the position stated by the parties concerned and registered the sale-deed. This had the effect of transfer of immovable property (built-up area measuring 17,984 square metre) without levy of proper stamp duty.

In this case, the joint development agreement along with the general power of attorney authorised the developer only to sell his share and collect the proceeds of such sale. The joint development agreement does not transfer the ownership of either the undivided share of the land or the built-up area to the developer. Title to a property is transferred only through a proper conveyance. Hence the assumption of the parties that the developer already owned the built-up area and only undivided share was being transferred through the sale-deed is incorrect.

In the above case, the Sub-Registrar misinterpreted the transaction and omitted to estimate the value of the built-up area, thereby allowing the parties to pay stamp duty only on the market value of land and acquire ownership of a portion of the shopping mall. The value of the portion of the shopping mall earmarked as developer's share, based on the guidance value was ₹ 166.67 crore on which stamp duty and registration fee of ₹ 11.00 crore was payable, whereas stamp duty and registration fee of only ₹ 6.83 crore was paid on the value of the land alone. The resultant short levy of stamp duty and registration fee amounted to ₹ 4.17 crore.

In reply, the IGR&CS stated that the District Registrar concerned had initiated action under Section 46A¹¹¹ of Karnataka Stamp Act, 1957, and Section 80A¹¹² of Registration Act, 1908 (November 2024).

¹¹¹ Recovery of Stamp Duty not levied or short levied is covered under Section 46A of Karnataka Stamp Act, 1957.

¹¹² Recovery of registration fee not levied or short levied covered in Section 80A of Registration act. 1908.

Recommendation 1: The IGR&CS may issue a comprehensive guideline specifying levy of duty on different possibilities arising out of a JDA transaction as the revenue effect is significant in each case.

4.5 Short levy of Stamp Duty and Registration Fee due to misclassification of documents

As per Section 3 of the Karnataka Stamp Act, 1957, Stamp Duty is charged on instruments as prescribed under various Articles in the Schedule of the Act, *ibid*. The Stamp Duty and Registration Fee payable on a document is determined based on the value of the properties and the classification of the documents under relevant Articles of the Karnataka Stamp Act, 1957, and the Registration Act, 1908.

On presentation of a document for registration, the Sub-Registrar classifies the document under the relevant Article, estimates the value of the document and communicates the stamp duty and registration fee payable to the parties concerned. Thereafter, on payment of stamp duty and registration fee, the documents are registered.

During audit of three¹¹³ Sub-Registrar Offices (SROs) between June 2019 and January 2022, audit test-checked 167 documents titled as memorandum of understanding/sale-agreements and noticed eight cases where SD and RF were short levied due to misclassification of the documents under different Articles of the Acts mentioned above. The details are as below:

a. Joint Development Agreement classified as Sale-agreement

Joint Development Agreement (JDA) is an agreement between an owner and a developer for the purpose of development of land either as sites or for construction of building. Whereas generally, a Sale-agreement (SA) is an agreement between a seller and a purchaser for the sale of immovable property.

In case of a JDA, stamp duty is levied as per Article 5(f) of the Karnataka Stamp Act at two *per cent* on the market value of the developer's share in the land or the market value of the owner's share in the developed property, whichever is higher and Registration Fee is levied at one *per cent* on the market value of the property which is the subject matter of development as per Article III(a) of the Registration Act, 1908.

Whereas, for a sale-agreement without possession, stamp duty is levied as per Article 5 e(ii) of the Karnataka Stamp Act at 0.1 *per cent* on the market value of the property, limited to ₹ 20,000 and Registration fee is limited to ₹ 200 as per clause (a) of Note-7 under Article I of the Registration Act.

During audit of SROs, Mahadevapura and Nelamangala, audit noticed one case in each Office wherein joint development agreements were registered as sale-agreement without possession. In the first case, the recitals of the document clearly stated that it was an agreement for construction of multi-storeyed residential building with allotment of 40 *per cent* of the super-built-up area to the owner. The document also detailed the modalities of the development. In the second case also, the recitals of the document clearly stated that the parties

¹¹³ SROs-Mahadevapura, Nelamangala and Srirampura.

agreed to develop the land into a layout of residential sites and detailed the modalities of the development. It also stated that the owners share would be ₹ 1,008 *per square feet* of the developed sites. In both these cases, though the modalities of development of the land and their subsequent sharing were brought out in the documents, the SROs concerned overlooked these narrations and classified the documents incorrectly under Article 5(e)(ii) of the Karnataka Stamp Act and under clause (a) of Note-7 of Article I of the Registration Act. Consequently, SD of ₹ 500 and RF of ₹ 200 were levied, instead of ₹ 9.20 lakh and ₹ 4.60 lakh respectively, in the first case and SD of ₹ 20,000 and RF of ₹ 200 were levied instead of ₹ 89.61 lakh and ₹ 44.80 lakh respectively, in the second case. Thus misclassification of the documents as stated above, instead of classifying these documents correctly under Article 5(f) of the Stamp Act and Article III(a) of the Registration Act resulted in short levy of SD and RF of ₹ 1.48 crore.

b. Sale-agreement ‘with possession’ classified as sale-agreement ‘without possession’ while levying Registration Fee

As per the Karnataka Stamp Act, sale-agreements wherein possession of the property is handed over to the purchaser during the agreement itself are classified under Article 5(e)(i) and levied stamp duty at five *per cent* on the market value of the property. Whenever such sale-agreements are accompanied by a document of power of attorney issued by the vendor to the purchaser concerning the same property, then stamp duty is levied at nominal rate of ₹ 200 on the sale-agreement, as per explanation under the Article 5(e), provided that stamp duty at five *per cent* has been levied on the power of attorney.

For levy of Registration Fee, sale-agreements wherein possession of the property is handed over, are classified under clause (b) of Note (7) of Article (I) and levied fee at one *per cent* of the market value of the property. Documents of power of attorney with powers to sell the property are classified under Note (10) of Article (I) and also levied fee at one *per cent* of the market value of the property. The Registration Act does not provide for levy of fee at nominal rate, even if the above sale-agreements are accompanied by documents of power of attorney concerning the same property and between the same parties.

During audit of SRO, Srirampura, audit noticed six sale-agreements executed by one vendor in favour of six purchasers, wherein it was agreed to convey six different parcels of land under the ownership of the vendor. These sale-agreements were also accompanied by six documents of power of attorney issued to the above purchasers for their respective parcels of land. As per the recitals of the sale-agreements, the possession of the properties was handed over to the respective purchasers on the day of the sale-agreement itself. It was also noticed that the documents of power of attorney issued to the purchasers, granted the power to sell their respective properties.

In the above scenario, the sale-agreements were to be classified under Article 5(e)(i) and the documents of power of attorney were to be classified under Article 41(eb) of the Karnataka Stamp Act. Then, as per explanation under Article 5(e), nominal stamp duty of ₹ 200 could be levied on the sale-agreement while levying stamp duty at the prescribed rate of five *per cent* on the document of power of attorney.

Whereas, in case of the Registration Act, the sale-agreements had to be classified under clause 1(b) of Note-7 of Article (I) and were to be levied fee at one *per cent* and the documents of power of attorney had to be classified under Note-10 of Article (I) and also were to be levied fee at one *per cent*, since the Registration Act does not prescribe nominal fees either for the sale-agreements with possession or for the documents of power of attorney with powers to sell the property.

In the above cases, the sale-agreements along with the documents of power of attorney were correctly classified under the Karnataka Stamp Act and levied stamp duty at five *per cent* on the power of attorney and at nominal rate on the sale-agreements. During levy of Registration Fee, the fees were levied correctly at one *per cent* on the documents of power of attorney, however, the fee for the sale-agreements were levied at nominal rate of ₹ 200, though such provision was not available under the Registration Act. This resulted in short levy of Registration fee in the above six cases amounting to ₹ 10.36 lakh.

In reply, the IGR&CS stated that the District Registrars concerned had initiated action and passed final order for recoveries (November 2024).

4.6 Short levy of Stamp Duty and Registration Fee due to non-adherence to special instructions

As per Section 3 of the Karnataka Stamp Act, 1957, Stamp Duty is charged on instruments as prescribed under various Articles in the Schedule of the Act, *ibid*. Under Article 20, for instruments of conveyance, stamp duty is charged at five *per cent* on the market value of the property being conveyed. Market value guidelines are prescribed for properties situated in the State by the Central Valuation Committee under Section 45 B of the Act. These are general rates of properties situated in areas under the jurisdiction of each Sub-Registrar. The market value guidelines also contain a set of special instructions to be applied during valuation of the property. These special instructions prescribe the enhancement of the general rates by fixed percentages owing to any value additions in the properties conveyed. The values prescribed for each area along with the special instructions forms the basis for estimation of market value of the properties by the Registering Officer.

The market value guidelines prescribed for the period upto 2018 and for 2019-2021 contained special instructions to enhance general rates by fixed percentages for specific value additions as given in table below:

Sl. No.	Value additions in the property	Enhancement of general rates at fixed percentages
1.	Land converted for residential purpose situated outside municipal limits	65 <i>per cent</i> enhancement of the value prescribed per acre
2.	Land converted for residential purpose situated within municipal limits	40 <i>per cent</i> of the value prescribed per sq. mtr (sital rate) <i>or</i> 65 <i>per cent</i> enhancement of the value prescribed per acre; whichever is higher.
3.	Property abutting State Highway	25 <i>per cent</i> enhancement of the general rates upto 31 December 2018
		35 <i>per cent</i> enhancement of the general rates from 01 January 2019

Sl. No.	Value additions in the property	Enhancement of general rates at fixed percentages
4.	Property abutting Ring Road	50 <i>per cent</i> enhancement of the general rates
5.	Property used for commercial purpose	40 <i>per cent</i> enhancement of the general rates

During audit of six¹¹⁴ Sub-Registrar Offices (SROs) between December 2020 to November 2021, audit noticed nine cases wherein these special instructions were not adhered to, as detailed below:

In three cases, land converted for residential purpose but still undeveloped, were being conveyed. Out of the three, in two cases the lands were situated within municipal limits and the remaining one was outside the municipal limits. As per the special instructions prescribed, the general agricultural rates were to be enhanced by 65 *per cent* for lands situated outside municipal limits and for lands situated within municipal limits, either the agricultural rates were to be enhanced by 65 *per cent* or 40 *per cent* of the sital rates¹¹⁵, whichever was higher, were to be applied for estimating the value of the property being conveyed.

In three other cases, sites which were used for commercial purposes were conveyed and hence as per special instructions, these properties were to be valued by enhancing the general sital rates by 40 *per cent*. Audit also noticed three more cases where the properties being conveyed were abutting a State Highway or a Ring-road which required enhancement of general rates by 35 *per cent* or 50 *per cent* respectively and in one of the cases where the property was abutting the state highway, the property was converted for residential purpose as well.

In all these cases, as prescribed by the Central Valuation Committee through the special instructions, the market value of the properties being conveyed were to be estimated after enhancing the respective general rates based on the specific value additions. However, in all the nine cases the Sub-Registrars concerned registered the documents without adhering to the special instructions leading to undervaluation of the properties conveyed through the documents. The resultant short levy of stamp duty and registration fee amounted to ₹ 1.13 crore.

In reply, the IGR&CS stated that the District Registrars concerned had initiated action and passed final order for recoveries (November 2024).

4.7 Short levy of Stamp Duty and Registration Fee due to non-disclosure of facts

Stamp Duty is levied on instruments chargeable with duty as prescribed under various Articles in the Schedule of the Karnataka Stamp Act, 1957, and Registration Fee is levied as per the rates prescribed in the table of Registration Fee under the Registration Act, 1908.

¹¹⁴ SROs – Chickmagalur, Kadur, Sindhanoor, Srirangapatna, Varthur and Yelahanka.

¹¹⁵ Sital rates are rates fixed for small residential land sites as per the Central Valuation Committee.

The parties executing a document shall provide the details of the properties being conveyed and its market value. As per Section 28 of the Karnataka Stamp Act, 1957, the facts and circumstances affecting the chargeability of an instrument shall be fully and truly set forth by the parties. When documents are presented for registration, the Sub-Registrar shall also, make such enquiries, examine all relevant records and estimate the market value of the properties in the document.

During audit of three¹¹⁶ Sub-Registrar Offices (SROs) between August and November 2020, audit noticed eight cases of short levy of SD and RF due to non-disclosure of fact of existence of documents of Power of Attorney, existence of buildings and non-reckoning of advance amounts received as part of consideration, as detailed below:

a. Non-reckoning of Power of Attorney

For a sale-agreement without delivery of possession of the property under Article 5(e)(ii), SD is levied at 0.1 *per cent* limited to ₹ 20,000, on the consideration. But as per explanation under the Article, when a reference of a power of attorney granted by the seller to the purchaser in respect of the property which is the subject matter of the agreement, is made in the agreement, then the possession of the property is deemed to have been delivered. In such cases, SD is levied at five *per cent* on the market value of the property as prescribed under Article 5(e)(i).

Audit noticed three cases where sale-agreements were accompanied by documents of Power of Attorney which were executed on the same day and registered on the same day at the same SRO. However, neither had the parties mentioned about the execution of the Power of Attorney, in the respective Sale-agreements, nor did the Sub-Registrar reckon the existence of Power of Attorney together with Sale-agreements. This resulted in overlooking the explanatory clause under the Article 5(e)(ii), as per which the possession of the properties were deemed to have been delivered and were to be levied SD at five *per cent* of the market value. But the Sale-agreements were registered treating them as without-possession, resulting in short levy of Stamp duty amounting to ₹ 28.47 lakh.

b. Non-reckoning the advance amounts received by the vendors as part of consideration

During the course of a transaction, the parties concerned may first enter into a sale-agreement documenting the willingness and the value agreed to the transaction. The recitals of the sale-agreements would in addition to the value, also contain the advance amounts passed on from the purchaser, as on that date. Later on, the parties would execute the actual sale-deed.

Audit noticed four cases where parties had executed sale-agreements prior to execution of sale-deeds and were registered at the jurisdictional SROs. In all these cases, the purchasers concerned had passed-on certain amounts as advance to the vendors ranging from ₹ 4.5 lakh to ₹ 15.00 lakh. All these sale-agreements were succeeded by sale-deeds which were registered at later

¹¹⁶ SROs-Bidarahalli, Bommanahalli and Tarikere.

dates. While executing the sale-deeds, the parties concerned had not included the advance amounts already passed-on to the vendors, as part of the consideration. The resultant short levy of SD and RF amounted to ₹ 2.71 lakh.

c. Non-reckoning of existence of Building

During audit of SRO, Bommanahalli, audit noticed a Gift deed executed between non-family members through which immovable property measuring 32,250 sq. ft was being conveyed. As per Article 28(a) of the Karnataka Stamp Act, 1957, a gift made to a non-family member is to be treated as conveyance and stamp duty has to be levied accordingly. In this case, the tax-records pertaining to the property showed the existence of a building measuring 43,651 sq. ft on that land. However, the value of the land alone was considered during estimation, for the purpose of levy of stamp duty and registration fee. The value of the building amounted to ₹ 5.60 crore and resultant short levy of stamp duty and registration fee amounted to ₹ 36.98 lakh.

The IGR&CS replied that in five cases the District Registrar had issued notices to parties concerned. In the case of non-reckoning of existence of building, the IGR&CS replied that DR issued notice to the party concerned to produce records on the same and found that no documents were produced to prove non-existence of the building. Hence, order was passed in August 2024 to recover the said amount (November 2024).

4.8 Non-levy of additional stamp duty

As per Section 3 of the Karnataka Stamp Act, 1957, Stamp Duty is charged on instruments as prescribed under various Articles in the Schedule of the Act, *ibid*.

For instruments relating to amalgamation of Companies wherein two or more companies are merged together or a subsidiary is merged with the parent company, the stamp duty payable is prescribed as per Article 20(4)(1) at three *per cent* of the market value of immovable property of the transferor¹¹⁷ Company, situated within the State *or* at one *per cent* of the aggregate value of shares issued in exchange (or merged/cancelled in case of a subsidiary Company merging with parent Company), including amount paid for such amalgamation, whichever is higher. If there is a transfer of immovable property, Section 3B of the Act further prescribes an additional duty at 10 *per cent* of the original duty, for the purpose of various infrastructure projects across the State.

During audit of the Office of the District Registrar, Rajajinagar during November 2021, audit noticed three instruments relating to amalgamation of companies wherein additional duty was not levied.

The above three documents related to amalgamation of companies under Section 394 of the Companies Act, 1956, and were referred by the Hon'ble High Court of Karnataka/National Company Law Tribunal to the jurisdictional District Registrar, under whose jurisdiction the immovable properties of the respective companies were situated. Audit noticed that the District Registrars while comparing the value of the shares with the value of the immovable

¹¹⁷ Transferor company - The company which is dissolved and merges with another company. Transferee company - The company into which other entities merge or the resultant company in case of reconstruction.

property, had valued the shares at face value as stated in the documents of amalgamation. The market value of shares were not assessed, since the transferee companies were not listed in the Stock exchanges. In the above cases, as per the assessment of the District Registrar, the value of the immovable properties were higher than the value of shares exchanged. Hence, the District Registrar valued the document based on value of the immovable properties at ₹ 439.17 crore and levied stamp duty of ₹ 13.17 crore.

However, in all the three cases, the District Registrars concerned omitted to levy additional stamp duty even though there was transfer of immovable property from the transferor company to the transferee company.

The above omission to levy additional stamp duty led to short collection of revenue amounting to ₹ 1.32 crore.

In reply, the IGR&CS stated that amount of ₹ 1.32 crore was recovered (November 2024).

4.9 Registration of documents without collection of stamp duty

As per Section 3 of the Karnataka Stamp Act, 1957, Stamp Duty is to be paid on all instruments executed within the State, and also on those instruments executed outside the State, where it relates to any matter to be done within the State. Stamp duty and registration fee were paid by means of demand drafts, e-stamping¹¹⁸ and lesser amounts in cash as well to the Registering authority, until the introduction of Khajane¹¹⁹. Thereafter payment towards stamp duty and registration fee were made through designated banks via Khajane. From June 2021, the Inspector General of Registration and Commissioner of Stamps made payment of stamp duty and registration fee through Khajane, mandatory.

While paying stamp duty and registration fee through Khajane, firstly, the party concerned would generate a challan in Khajane portal and then make payment against the challan either through e-payment or through cash payment at the bank concerned. In the case of e-payment, the remittance was immediate, whereas the portal provided an interval of seven days for payment in cash, since the parties had to carry the challan to the bank and remit the amount in cash through the bank. Once the payment was made, the parties concerned would carry the challan to the Registering Officer as proof of payment. The Registering Officer, through his/her access to Khajane, would check the 'success report' against that particular challan reference number to ensure actual payment and then continue with the process of registration.

Note 3 under Article 329(v) of the Karnataka Financial Code prohibits a Government Officer from acting upon any challans in acknowledgement of payment, unless it is ensured that the money has been actually paid into the Government account. Further, the correctness of their subsequent remittances into the Government account were to be verified by reconciliation with the treasury schedule every month as per the above Article 329(v).

¹¹⁸ E-Stamping is a facility where authorised vendors generate e-Stamp Certificate after collection of duty.

¹¹⁹ Khajane is a web based portal providing the facility of making remittances to the Government Account.

During audit of Sub-Registrar Office, Belagavi for the period 2018-19 to 2021-22, Audit noticed differences between the amounts of stamp duty and registration fee claimed to have been remitted as per the challan numbers depicted in the document and the actual amounts as available in the treasury schedule in 269 cases. Generally, as is the practice in Sub-Registrar offices, the challans are scanned and are available with the document. Since, in this office the challans were not found with the documents, audit requested for the challans to verify and ascertain the reasons for the differences. However, the challans were not produced to audit.

Audit verified those challans based on challan reference number, in the Khajane portal and found the following:

Sl. No.	Particulars	No. of cases	Amount unpaid (in ₹)
1	Documents were registered with expired Challan	218	1,79,28,235
	In these cases, it was noticed that there were no payments made against these challans even after seven days. Hence, the status of payment was shown as “expired challan” in the Khajane portal. However, documents were registered citing these challan numbers in the above 218 cases.		
2	Documents were registered with challans of lesser amounts	36	13,31,885
	In these cases, the actual amounts for which the challans were drawn and paid were lesser than the stamp duty and registration fee payable as per the document.		
3	Documents were registered with challans not generated in Khajane.	15	8,44,564
	In these cases, the challan numbers depicted in the document for having paid the stamp duty and registration fee were not available in Khajane portal.		
Total		269	2,01,04,684

As seen from the table above, documents were registered without payment of revenue due, with payments lesser than the revenue due and also without challans for proof of payment. Audit points out that fraudulent intentions cannot be ruled out in such transactions and hence proposes a detailed investigation into the matter.

According to Audit the control failures in such transactions are listed as below:

- Failure to check whether the challan numbers depicted were actually generated through Khajane, by entering the challan number in his/her access to khajane portal;
- Failure to check the status and the success report of the challan numbers to ascertain whether the amounts were actually paid; and
- Failure to check whether the amounts paid through the challan were equal to the amount of actual stamp duty and registration fee payable for the document.

Audit also noticed that the process of reconciliation with the treasury schedule at the end of each month as envisaged, was also not being done in the

Sub-Registrar's Office, which resulted in non-detection of the above discrepancies.

The total non-collection of Government revenue in the above 269 cases amounted to ₹ 2.01 crore.

This was brought to the notice of the Sub-Registrar in December 2022 to ascertain the reasons for the above discrepancy. The IGR&CS replied that based on the audit observation, the sub-registrar concerned was suspended in February 2023 and a departmental enquiry was initiated against the Sub-Registrar. The enquiry officer was appointed in December 2023 and the enquiry is under progress (November 2024).

Recommendation 2: The IGR&CS may investigate the matter and fix responsibility. Audit further recommends that manual intervention of checking the correctness of the payments may be removed by seamless integration of Khajane with Kaveri software, where the amount actually paid through Khajane would be validated by Kaveri and then proceed with the process of registration.

4.10 Short levy of Stamp Duty and Registration Fee on Joint Development Agreements

Joint Development is an arrangement between a Developer and a Land Owner, where the Developer forms a layout or builds apartments on the land belonging to the Owner. As per the arrangement, the developed layout or the apartments are shared between the Owner and the Developer in agreed ratios mentioned in the document.

As per Article 5(f) and 41(ea) of the Karnataka Stamp Act, 1957, documents pertaining to Joint Development of property are to be levied Stamp Duty at two *per cent* on the market value of the developer's share in the land or the market value of the owner's share in the developed property, whichever is higher, including money advanced, if any. Registration Fee¹²⁰ is also leviable at one *per cent ad-valorem* on the market value of the property which is the subject matter of development or on the consideration, whichever is higher, as per Article III(a) of the Registration Act, 1908.

During audit of 13¹²¹ Sub-Registrar Offices (SROs) between November 2019 and October 2021, Audit test-checked 514 JDAs out of 785 JDAs and noticed 69 JDAs wherein Stamp Duty and Registration Fee were short levied. The details are as below:

Development of layouts/sites

In the case of formation of layouts, the land belonging to the owner would either be agricultural or land converted for non-agricultural purposes. The Developer obtains all the necessary approvals from competent authorities¹²², including

¹²⁰ Registration Fee limited to ₹ 1.50 lakh upto 14 February 2018.

¹²¹ Banasawadi, Bidarahalli, Byatarayanapura, Chamarajapete, Chitradurga, Dharwad, Hessarghatta, Hosakote, Jala, K R Puram, Koppa, Malleshwaram and Varthur.

¹²² Bengaluru Development Authority (BDA), Bengaluru Metropolitan Region Development Authority (BMRDA), Bengaluru International Airport Area Planning Authority (BIAAPA), etc.

conversion in the former case and develops a layout by forming individual sites. As per the Zoning Regulations Act, an area comprising 45 *per cent* of the initial land will have to be utilized/reserved for roads, parks and other civic amenities and sites would be formed in the remaining 55 *per cent* of the land. The market value guidelines prescribe higher values for sites approved by competent authorities compared to general sites under the jurisdiction of village panchayats.

Out of the 69 cases stated above, 38 cases pertained to development of layouts. In all these cases, incorrect rates were adopted while computing the value of sites, which led to short levy in SD and RF of ₹ 2.15 crore.

Development of apartments

In the case of construction of apartments, the developer obtains all the necessary approvals and constructs apartments to the extent approved by the competent authorities.

Out of the 69 cases, the remaining 31 cases pertained to development of apartments. The ratio of sharing between the owner and the developer was mentioned in all the documents. However, it was noticed that the floor area ratio¹²³ (FAR) to determine the total built-up area was mentioned only in 20 cases, and in one case of villa/row house approximate built up area was mentioned and in the remaining 10 cases, neither the floor area ratio nor the approximate built-up area were mentioned. The Sub-Registrars concerned had not insisted for the floor area ratio and adopted nominal values to determine the SD and RF payable. This was despite circular instructions by the IGR&CS, instructing all the Sub-Registrars to refer such documents to the jurisdictional District Registrars for further proceedings, where the FAR was not mentioned. The Sub-Registrars had also not enhanced the value for converted lands, commercial complexes, sites abutting main roads, *etc.*, as envisaged in the market value guidelines.

Audit estimated the value by applying rates as envisaged in the market value guidelines. The consequent short levy of SD and RF worked out to ₹ 6.79 crore.

Thus, the above omissions by the Sub-Registrars concerned while registering the documents pertaining to development agreements led to short levy of SD and RF amounting to ₹ 8.94 crore.

These cases were brought to the notice of the Department during September 2023 and August 2024. The IGR&CS replied that in the above 69 cases, District Registrar had issued notices and passed orders in 52 and 15 cases respectively and in one case the amount of ₹ 31.79 lakh was recovered (November 2024).

Recommendation 3: The Department may circulate guidelines with illustrations to sensitise the Sub-Registrars on correctly valuing JDA documents.

¹²³ Floor Area Ratio is the allowable built-up area for a specific parcel of land, prescribed per sq. mtr.

4.11 Short levy of Stamp Duty and Registration Fee due to undervaluation

According to Section 3 of the Karnataka Stamp Act, 1957, Stamp Duty is levied on instruments chargeable with duty as prescribed under various Articles in the Schedule of the Act, *ibid.* Under Article 20, for instruments of conveyance, Stamp Duty is charged as a percentage of the consideration or of the market value of the property, whichever is higher. Market Value Guidelines are prescribed for properties situated in the State by the Central Valuation Committee under Section 45-B of the Act. This forms the basis for estimation of market value by the Sub-Registrar, while registering documents chargeable with Stamp Duty. The market value guidelines include a set of special instructions, included as Annexure-1 to deal with specific enhancements in the nature of the property. These instructions are to be correctly applied during valuation, to arrive at the proper market value of the property.

During audit of 26 Sub-Registrar Offices¹²⁴ (SROs) between September 2020 and February 2022, Audit noticed short levy of Stamp Duty and Registration Fee amounting to ₹ 13.77 crore due to various reasons like, adoption of incorrect guidance values, non-adherence to Special Instructions, *etc.*, in 74 documents. The details are as follows.

a. Undervaluation due to non-application of special instructions

The market value guidelines contain general rates for each area under the jurisdiction of the SRO concerned. In addition, there are a set of special instructions regarding valuation, to be applied for specific enhancements in the nature of the property being conveyed. Such enhancements were not carried out in the below mentioned cases:

- In two cases, general rates were not enhanced by 10 *per cent* for properties having roads on two sides;
- In two cases, apartment units were valued at general rates instead of applying rates prescribed for super-built-up area;
- In three cases, agricultural land rates were applied instead of applying percentage of sital rates for converted but undeveloped properties;
- In one case, general rates were applied even though the property conveyed was a commercial building; and
- In one case, stamp duty was levied on the amount spent by the purchaser on the renovation of a commercial complex, instead of collecting stamp duty on the market value of the property.

In the above cases, the short levy of stamp duty and registration fee amounted to ₹ 2.88 crore. The IGR&CS replied that in eight cases, District registrars had

¹²⁴ SROs – Banasawadi, Bidarahalli, Byatarayanapura, Chamarajapete, Chikkamagaluru, Chitradurga, Devanahalli, Doddaballapura, Ganganagar, Hoskote, Humnabad, Indiranagar, Jala, Jigani, Kacharakanahalli, Koppa, K.R.puram, Kundapura, Malleswaram, Nelamangala, Sindhanur, Srirampur, Srirangapatna, Tarikere, Tavarekere and Varthur.

initiated action under Section 46-A of Karnataka Stamp Act, 1957, and in one case amount of ₹ 36.79 lakh was recovered.

b. Undervaluation due to non-application of prescribed specific rates

The market value guidelines contain general rates for all the areas under the jurisdiction of the SRO concerned. They also contain specific rates for individual properties or survey numbers, wherever possible. These rates are to be applied whenever properties in such specific areas are conveyed.

In three SROs, audit noticed 18 cases, where general rates were applied even though specific rates were prescribed in the guidelines. Out of the 18 cases, in 15 cases, agricultural properties were valued at general rates prescribed for the village, though specific rates were prescribed for the survey numbers to which they belonged. In one case, general rates pertaining to the area was considered instead of specific rates prescribed for the property by its name. In another case, even though specific rates were prescribed for a layout, the value of the property was estimated by considering the property as converted but undeveloped. In the remaining one case, the case had been referred to the District Registrar for valuation and it was stated in the orders of the DR that rates as prescribed in the guidelines were applicable. However, the DR wrongly adopted lesser rate during calculation. The short levy in these cases amounted to ₹ 7.72 crore.

In reply, the IGR&CS stated that in all the 18 cases, the District Registrars had issued notices to concerned parties initiating action under Section 46-A of the Karnataka Stamp Act, 1957 (November 2024).

c. Undervaluation due to non-referral of cases to the Central Valuation Committee

In general, lacuna noticed in the market value guidelines are to be brought to the notice of the Central Valuation Committee to immediate rectification. As per one of the instructions contained in the prescribed guidelines, in the absence of specific rates for new projects, they are to be referred to the CVC by the jurisdictional Sub-Registrar and have the value fixed for such projects.

Audit noticed two cases where general rates were applied instead of referring the cases to the CVC for fixation of specific rates. In one case, sites pertaining to a specific project were being conveyed, where specific rates were yet to be prescribed. The Sub-Registrar valued the sites at general rate of ₹ 3,000 per square meter, whereas the rates for specific projects in the area ranged between ₹ 7,700 to ₹ 17,600 per square meter. Considering the minimum rate of ₹ 7,700 pertaining to one of the project in the same jurisdiction by the same developer, the loss of stamp duty amounted to ₹ 14.16 lakh.

In another case, rates were prescribed for sites abutting State Highways, however, specific rates were not prescribed for sites abutting National Highway in the same jurisdiction. The Sub-registrar instead of referring the case to CVC for fixation of rate, valued the sites at general rates. Considering the rates prescribed for sites abutting State Highways, the short levy amounted to ₹ 19.59 lakh.

The IGR&CS replied that District registrar had issued notices to the parties concerned in the two cases (November 2024).

d. Undervaluation due to non-application of sital rates

When agricultural land or converted undeveloped land upto five guntas are conveyed, it has to be valued at full sital rates.

Audit noticed seven cases where agricultural rates were considered for estimation of market value instead of sital rates for land being conveyed which were less than five guntas. This resulted in short levy of stamp duty and registration fee amounting to ₹ 9.59 lakh.

The department replied that District Registrar had issued notices to the parties concerned in all the seven cases (November 2024).

e. Undervaluation due to non-consideration of guidance market value

As stated in the preamble, the rates prescribed by the Central Valuation Committee, in the market value guidelines are to be applied for estimation of value of the properties being conveyed. Whenever documents are brought to the Sub-Registrar for registration, the value of the properties is estimated and stamp duty and registration fee payable are communicated to the parties concerned. On payment of the stamp duty and registration fee, the process of registration is initiated.

Audit noticed 38 cases in 16 SROs, where documents were registered on the consideration stated in the documents instead of estimating the proper market value of the properties by applying the rates prescribed in the guidelines. The short levy of stamp duty and registration fee in these cases amounted to ₹ 2.74 crore.

The IGR&CS replied that District Registrar issued notices to the parties concerned in 35 cases, and in one case the amount of ₹ 13.15 lakh was recovered and in another case District Registrar passed orders for recovery of ₹ 43.89 lakh under Section 46A of Karnataka Stamp Act, 1957 and under Section 80A of the Registration Act, 1908 (November 2024).

4.12 Short levy of Stamp Duty and Registration Fees on deeds related to Trusts

A trust is a fiduciary relationship in which one party (the Grantor) gives a second party (the Trustee) the right to hold title to property or assets for the benefit of a third party (the Beneficiary).

(a) Short levy of stamp duty and Registration fee on deeds of settlement for Trust

Section 2(q) of the Karnataka Stamp Act, 1957, defines Settlement as a written, non-testamentary disposition of movable or immovable property. This includes agreements to make such a disposition, and any instruments that record the terms of the disposition, such as declarations of trust. Settlements can be made for a number of reasons, including, in consideration of marriage, to distribute property among family or dependents, and for religious or charitable purposes.

Article 48A prescribes stamp duty at the rate of a conveyance (Article 20) on the market value of the property, if the Instrument of Settlement is not for the purpose of distributing the property of the settlor among his family. However, if the Instrument is for the purpose of distributing the property of the settlor among the family members, stamp duty is leviable at the rate of ₹ 1,000. In all such cases, registration fee at the rate of one *per cent* of the market value of the property was leviable under Article I (3) of the Table of Registration Fee under the Registration Act, 1908.

Audit noticed three deeds of settlement for charitable trust in SRO Devanahalli, wherein the trustees have disposed the properties of 57,767 square meter with market value of ₹ 159.32 crore, in their name, to the Trust, Akash Educational and Development Trust, Devanahalli. As the dispositions were not settled among the family members, the documents were to be levied stamp duty at the rate of a conveyance, however, the documents were levied Stamp Duty of ₹ 1,000 and Registration Fee at ₹ 200. Consequent short levy of Stamp Duty including Registration fee works out ₹10.51 crore.

In another case, where the settlor had disposed his property to the Trust, Chandana OBC Educational and Charitable Trust, Humnabad in SRO Humnabad, stamp duty and registration fee was levied on the consideration instead of the guideline market value of the property, which was higher. This resulted in short levy of stamp duty and registration fee of ₹ 5.76 lakh.

Total short levy of Stamp Duty and Registration fees in the above cases works out to ₹ 10.57 crore.

(b) Short levy of Registration fees on Transfer deed in respect of Trusts

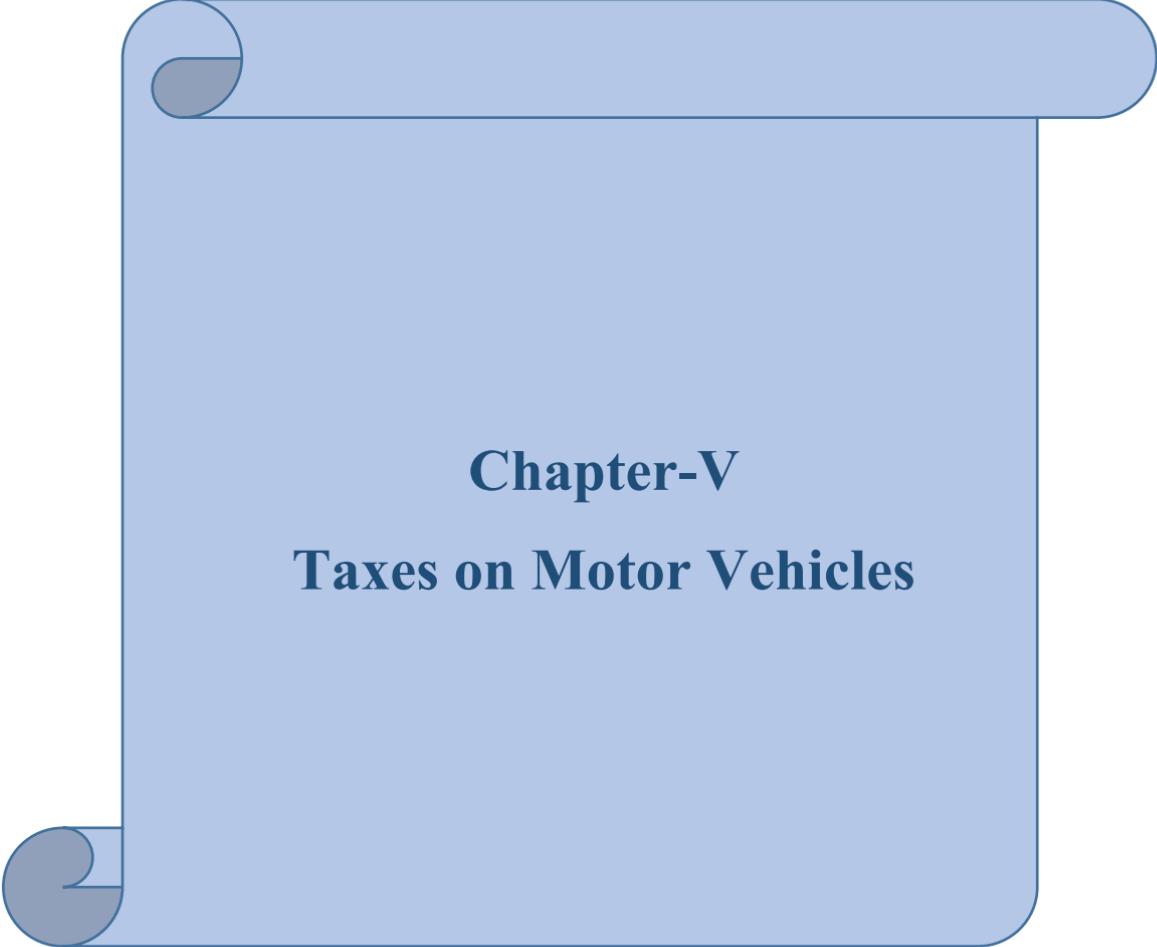
As per article 52(d) of the Karnataka Stamp Act, 1957, transfer of any trust property from one trust to another trust or from trust to trustee or beneficiary, or the transfer from trustee to trust or from trustee or beneficiary, as the case may be, the stamp duty is leviable at the rate of a conveyance on the market value of the property. But transfers in respect of public religious and charitable trusts, the duty shall be at the concessional rate of ₹1,000. No such concessional rate was prescribed in the payment of registration fees under the Registration Act, and was leviable fee at one *per cent* on the market value as per Article I(2) of the Table of Registration fees.

Audit noticed a deed of transfer in SRO Koppa, where one trust has transferred its property to another trust, both being public charitable trusts. The document was registered on levying stamp duty and registration fee of ₹ 1,000 each. Audit observed that the concessional rate was applicable only on stamp duty whereas registration fee was payable at the rate of one *per cent* on the market value of the property. Consequent short levy of registration fee works out to ₹ 17.42 lakh.

Thus, total short levy of stamp duty and registration fee in respect of the deeds related to trusts amounted to ₹ 10.74 crore.

In reply, the IGR&CS stated that in all the five cases the District Registrars had initiated action under Section 46A of Karnataka Stamp Act, 1957 (November 2024).

Recommendation 4: The IGR&CS may issue detailed clarification in respect of deeds related to Trusts to ensure the appropriate levy of Stamp Duty and Registration Fee on such deeds.



Chapter-V
Taxes on Motor Vehicles

Chapter-V

Taxes on Motor Vehicles

5.1 Tax Administration

The provisions of the Karnataka Motor Vehicles Taxation (KMVT) Act, 1957, and rules made thereunder govern the levy and collection of taxes on motor vehicles. The levy of taxes on motor vehicles is administered by the Transport Department headed by the Commissioner for Transport and Road Safety who is assisted by Joint Commissioners of Transport. There are 59 Regional Transport Offices (RTOs)/Assistant Regional Transport Offices (ARTOs) and 15 check posts in the State.

5.2 Internal Audit

The Internal Audit Wing (IAW) has been functioning in the Transport Department since 1960. There were 89 Offices due for audit during 2022-23, out of which 11 Offices were audited by IAW. The shortfall in coverage of Offices was due to the shortage of staff in the Wing. Year wise details of the number of objections raised, settled and pending along with tax effect, are as follows.

Table 5.1
Year-wise details of observations

(₹ in crore)

Year	Observations raised		Observations settled		Observations pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
2017-18	100	0.44	0	0	100	0.44
2018-19	25	0.78	0	0	25	0.78
2019-20	51	5.46	1	0.08	50	5.38
2020-21	175	10.53	0	0	175	10.53
2021-22	190	19.63	0	0	190	19.63
2022-23	NF	NF	NF	NF	NF	NF
Total	541	36.84	1	0.08	540	36.76

Source: Information furnished by the Department.

NF: Not Furnished

As seen from the above, 540 observations involving ₹ 36.76 crore were pending settlement as on 31 March 2023. Early action may be taken to settle the pending observations.

5.3 Results of Audit

In 2022-23, test-check of records in 46 Offices of Transport Department, disclosed under assessment of Tax and other irregularities amounting to ₹ 8.96 crore in 159 cases. The observations broadly fell under the following categories given in **Table-5.2**.

Table 5.2
Results of Audit

Sl. No.	Category	No. of Paragraphs	(₹ in crore)
			Amount
1.	Non/short levy of Life Time Tax	49	3.21
2.	Non demand of quarterly tax	33	3.91
3.	Other irregularities	77	1.84
Total		159	8.96

During the course of the year, the Department accepted under assessments and other deficiencies involving ₹ 5.75 crore in 141 cases and an amount of ₹ 0.85 crore was also recovered in 51 cases pointed out in earlier years.

5.4 Short collection of Quarterly Tax in respect of Private Service Vehicles

Under the Section 2(33) of the Motor Vehicles Act, 1988, ‘Omnibus’ means ‘a motor vehicle constructed or adapted to carry more than six persons excluding driver’. Also, under the Act, ‘Private Service Vehicle (PSV)’ is defined as ‘a motor vehicle constructed or adapted to carry more than six persons excluding driver and ordinarily used by or on behalf of the owner in connection with his trade or business but does not include a motor vehicle used for public purposes’. Rates of quarterly tax per square meter of floor area were prescribed for ‘Omnibuses and PSVs’ under Item No.8 of PART-A of the Karnataka Motor Vehicles Taxation (KMVT) Act, 1957, Schedule read with Section 3(1) of the KMVT Act.

With effect from 01 April 2000, Government of Karnataka introduced Item No. 8-A under PART-A of the Motor Vehicle Taxation Schedule (MVTs). Under the said item, higher rates of quarterly tax per square meter of floor area were prescribed for “Omnibuses and PSVs held under lease agreement with industrial undertakings or companies for providing conveyance to their employees from residence to factories/companies and vice versa, where such industrial undertakings or companies were holders of permit of such vehicles”.

Under the KMVT Act, in addition to quarterly tax leviable under Section 3(1), Section 3-A of the Act stipulates that cess shall be levied and collected, at the rate of 11 *per cent* of the tax levied under Section 3 on the registered motor vehicles.


However, Government of Karnataka did not prescribe any Form or Return in which the lease agreement/s entered by the owner/s of the vehicle with industrial undertakings or companies were to be reported to the Transport Department. Instead, the Department was obtaining Form 34 prescribed under Rule 60 of the Central Motor Vehicles Rules (CMVR), 1989. This practice followed by the Department was erroneous as the Form 34 of CMVR was intended to make an entry of an agreement of hire purchase, lease or hypothecation, *i.e.*, financial lease, in the Certificate of Registration. As the Form-34 collected by the Department did not reflect the details regarding the lease of these vehicles with industrial undertakings/companies, this did not serve the intended purpose.

Test-check of records in seven¹²⁵ Regional Transport Offices (RTOs) and two¹²⁶ Assistant Regional Transport Offices (ARTOs) revealed that 83 PSVs, with lease agreement, paid quarterly tax at the rate lower than that stipulated in the MVTs. Quarterly tax was being paid short for the quarters commencing from January 2014 to March 2024. However, no action was taken by the ARTOs/RTOs concerned to demand the differential amount of tax in these cases. This resulted in short collection of quarterly tax including cess amounting to ₹ 1.87 crore.

After these cases were pointed out, the Government replied (March 2024) that ₹ 13.18 lakh had been recovered in eight cases and demand notices were issued in the remaining 75 cases (November 2024).


Recommendation: The State Government may obtain all relevant details like lease agreements, seats and berths of the Private Service Vehicles and incorporate the same in VAHAN-4, for collection of tax at appropriate rates.

**Bengaluru
The**


(Vimalendra Anand Patwardhan)
Principal Accountant General (Audit-I)
Karnataka

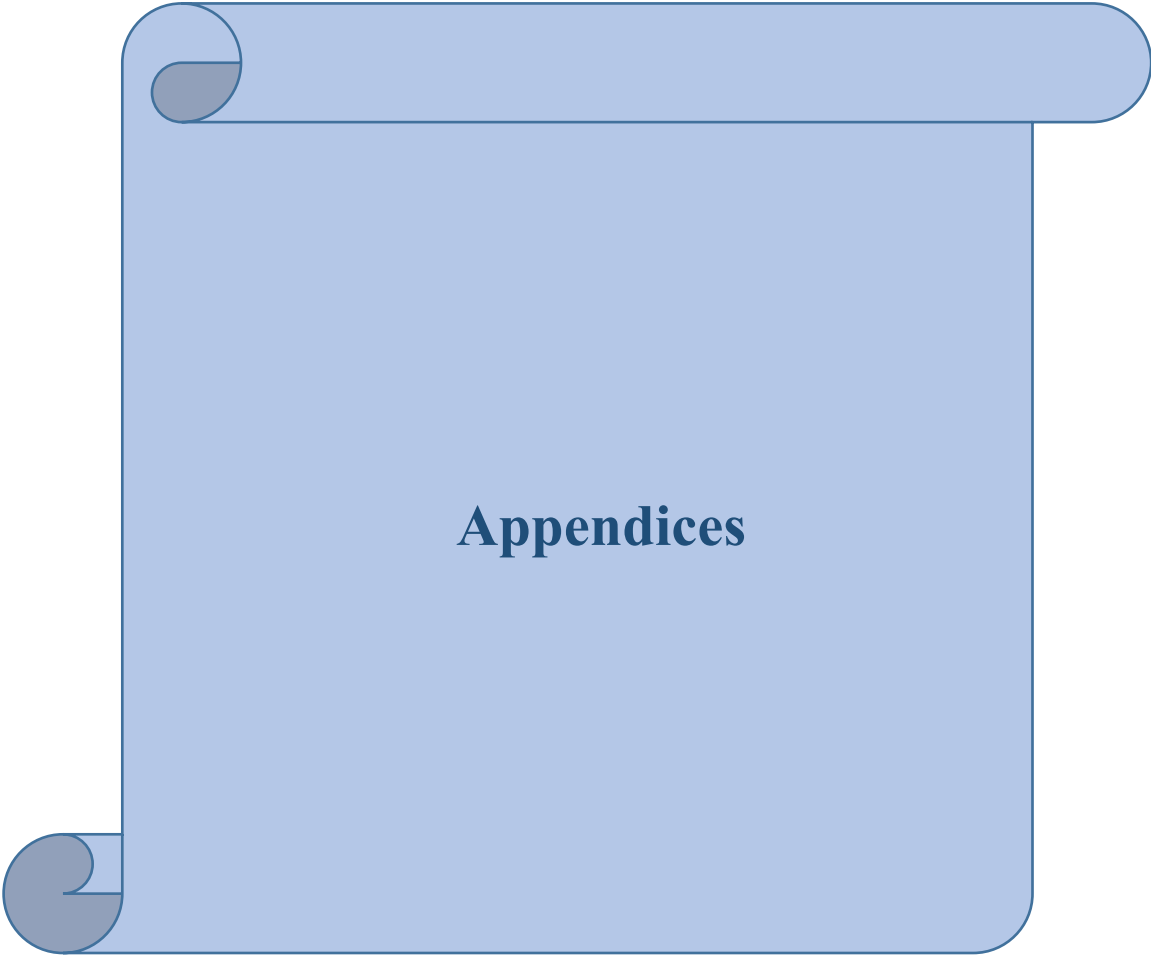
Countersigned

**New Delhi
The**


(K. Sanjay Murthy)
Comptroller and Auditor General of India

¹²⁵ Chandapura, Electronic City, Jayanagara, Jnanabharathi, Kasturi Nagar, Rajajinagar, Yelahanka.

¹²⁶ Devanahalli and Tiptur.



Appendix I (a)
Refer Para 2.4.7.2
Dimension wise summary of Deficiencies

Sl. No.	Audit Dimension	Accepted by Dept. and status of the case										Departmental reply accepted by Audit								Dept. reply not furnished with appropriate documentary evidence	
		Cases where reply received		Recovered/ Demand order issued		SCN Issued		ASMT-10		Under Correspondence with taxpayer		Total		Data entry errors		Action taken before query		Other valid explanations			
		No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount		
1		2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
Mismatch in availing of ITC																					
1	GSTR-2A vs GSTR-3B	70	2,580.15	7	180.81	2	0.70	4	68.97	12	582.78	25	833.26	1	51.91	11	251.87	26	101.70	7	194.03
2	ITC passed on without supplier remitting tax	47	443.97	3	38.03	0	0.00	2	23.78	5	62.27	10	124.08	0	0.00	4	35.48	31	274.98	2	9.43
3	Availing ITC in GSTR-3B filed after the limitation period for availing ITC	49	101.35	0	0.00	0	0.00	0	0.00	0	0.00	0	0.00	0	0.00	7	17.92	42	83.43	0	0.00
4	Mismatch of ITC under Reverse Charge Mechanism (RCM)	41	353.78	4	2.71	1	0.03	1	0.82	5	14.56	11	18.12	12	108.89	6	57.68	9	116.53	3	11.25
Mismatch in Annual Return and Financial statements (FS)																					
5	Positive figure in GSTR-9C Table 12F	17	110.94	3	7.23	0	0.00	0	0.00	2	11.48	5	18.71	0	0.00	0	0.00	6	29.86	6	25.04
6	Positive figure in GSTR-9C Table 14T	16	901.72	0	0.00	0	0.00	0	0.00	0	0.00	0	0.00	0	0.00	1	10.92	15	890.81	0	0.00
7	Negative figure in GSTR-9C Table 9R	13	128.12	1	0.54	0	0.00	0	0.00	2	15.04	3	15.58	3	33.56	2	22.21	4	48.75	1	6.34

Sl. No.	Audit Dimension	Cases where reply received			Accepted by Dept. and status of the case										Departmental reply accepted by Audit								Dept. reply not furnished with appropriate documentary evidence	
		Recovered/ Demand order issued		SCN Issued	ASMT-10		Under Correspondence with taxpayer		Total		Data entry errors		Action taken before query		Other valid explanations									
		No.	Amount		No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount						
1		2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21			
Shortfall in Tax paid or Interest and Other deviations																								
8	ISD credit incorrectly availed by the recipients	32	25.73	5	3.49	1	0.01	3	1.53	12	10.24	21	15.27	0	0.00	0	0.00	9	9.34	2	1.12			
9	Tax short paid	85	986.23	12	35.50	1	2.15	2	7.21	8	7.72	23	52.58	2	50.71	11	104.59	48	722.14	1	24.32			
10	Composition taxpayers also availing e-commerce facility	5	0.00	0	0.00	1	0.00	1	0.00	0	0.00	2	0.00	0	0.00	0	0.00	3	0.00	0	0.00			
11	Tax not remitted due to GSTR-3B not filed	48	59.67	22	37.66	3	1.06	1	0.56	7	6.99	33	46.27	0	0.00	8	8.19	3	1.69	4	3.06			
12	Short payment of interest on delayed payments	123	36.34	49	15.76	1	0.32	2	0.29	10	3.34	62	19.71	0	0.00	47	11.56	4	1.26	10	2.54			
13	Suppression of tax liability based on E-Waybill verification	82	4,581.92	3	148.45	0	0.00	6	57.40	4	78.75	13	284.60	3	1,043.16	0	0.00	55	3,226.42	11	27.68			
Grand Total *		628	5,728.00	109	321.73	10	4.27	22	103.16	67	714.42	208	1,143.58	21	245.07	97	520.42	255	2,280.49	47	277.13			

* Money value of suppression of tax liability based on E-Waybill verification is not quantified in any of the amount totals since it is not assessable.

Appendix I (b)
Refer Para 2.4.7.2
Summary of Deficiencies (Turn over mismatch)

Sl. No.	Audit Dimension	Cases where reply received				Accepted by Dept. and status of the case								Departmental reply accepted by Audit								Dept. reply not furnished with appropriate documentary evidence	
		No.		Amount		Recovered/ Demand order issued		SCN Issued		ASMT-10		Under Correspondence with taxpayer		Total		Data entry errors		Action taken before query		Other valid explanations			
								No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount		
1	Negative figure in GSTR-9C Table 7G	19	13,588.49	1	1,151.72	0	0.00	4	3,257.71	2	2,907.28	7	7,316.71	0	0.00	2	280.44	7	4,503.95	3	1,487.39		
2	Under-declaration of taxable supplies as per GSTR-3B vis-à-vis net amount on which TDS/TCS is recovered	21	341.64	3	27.19	3	42.46	1	20.07	5	114.20	12	203.92	0	0.00	6	112.76	0	0.00	3	24.96		
3	Mismatch of unbilled revenue in Table 5 of form GSTR-9C	11	1,185.55	2	52.34	0	0.00	0	0.00	3	235.88	5	288.22	0	0.00	0	0.00	4	488.28	2	409.05		
Grand Total		51	15,115.68	6	1,231.25	3	42.46	5	3,277.78	10	3,257.36	24	7,808.85	0	0.00	8	393.20	11	4,992.23	8	1,921.40		



Glossary of abbreviations

Glossary of abbreviations		
Sl. No.	Abbreviations	Full Form
1.	ABV	Alcohol By Volume
2.	ACCTs	Assistant Commissioner of Commercial Taxes
3.	ACD	Additional Countervailing Duty
4.	AED	Additional Excise Duty
5.	APMC	Agricultural Produce Marketing Committee
6.	ARTO	Assistant Regional Transport Office
7.	ASMT	Assessment
8.	BBT	Bright Beer Tank
9.	BDA	Bengaluru Development Authority
10.	BIAAPA	Bengaluru International Airport Area Planning Authority
11.	BL	Bulk Litre
12.	BMRDA	Bengaluru Metropolitan Region Development Authority
13.	CBIC	Central Board of Indirect Taxes and Customs
14.	CCT	Commissioner of Commercial Taxes
15.	CD	Countervailing Duty
16.	CEA	Central Excise Act
17.	CGST	Central Goods and Services Tax
18.	CLS	Composition Levy Scheme
19.	CMP	Composition Scheme
20.	CMVR	Central Motor Vehicles Rules
21.	CTD	Commercial Taxes Department
22.	CTO	Commercial Tax Officer
23.	CVC	Central Valuation Committee
24.	DCCT	Deputy Commissioner of Commercial Taxes
25.	DCOE	Deputy Commissioners of Excise
26.	DGSTO	Divisional Goods and Services Tax Office
27.	DP	Declared Price
28.	DRC	Demand Recovery Challan
29.	DSR	Department of Stamps and Registration
30.	EBP	Ethanol Blended Programme
31.	ECL	Electronic Cash Ledger
32.	ED	Excise Duty
33.	ENA	Extra Neutral Alcohol
34.	EWB	Electronic-Waybill
35.	FSSAI	Food Safety and Standards Authority of India
36.	GPS	Global Positioning System
37.	GST	Goods and Services Tax
38.	GSTIN	Goods and Services Tax Identification Number
39.	GSTR	Goods and Services Tax Return
40.	IAW	Internal Audit Wing
41.	IDR	Industries Development and Regulation
42.	IGR&CS	Inspector General of Registration and Commissioner of Stamps
43.	IGST	Integrated Goods and Services Tax
44.	IMFL	Indian Made Foreign Liquor

Sl. No.	Abbreviations	Full Form
45.	IML	Indian Made Liquor
46.	IOE	Inspector of Excise
47.	IR	Inspection Report
48.	ISD	Input Service Distributor
49.	IS Act	Indian Stamp Act
50.	ITC	Input Tax Credit
51.	JCCT	Joint Commissioner of Commercial Taxes
52.	JDA	Joint Development Agreement
53.	KE	Karnataka Excise
54.	KGST	Karnataka Goods and Services Tax
55.	KMVT	Karnataka Motor Vehicles Tax
56.	KS Act	Karnataka Stamp Act
57.	KSBCL	Karnataka State Beverages Corporation Limited
58.	LGSTO	Local Goods and Services Tax Office
59.	LVO	Local VAT Office
60.	ME	Mash Efficiency
61.	MIS	Management Information System
62.	MoU	Memorandum of Understanding
63.	MRP	Maximum Retail Price
64.	NF	Not furnished
65.	NIC	National Informatics Centre
66.	OFS	Order for Supplies
67.	PAC	Public Accounts Committee
68.	PE	Potential Extract
69.	PSV	Private Service Vehicle
70.	RCM	Reverse Charge Mechanism
71.	REG	Registration
72.	RFID	Radio Frequency Identification Device
73.	RS	Rectified Spirit
74.	RTO	Regional Transport Office
75.	SD and RF	Stamp Duty and Registration Fee
76.	SEZ	Special Economic Zone
77.	SGST	State Goods and Services Tax
78.	SGSTO	Sub-GST Office
79.	SoP	Standard Operating Procedure
80.	SRO	Sub-Registrar Office
81.	SSCA	Subject Specific Compliance Audit
82.	TCS	Tax Collection at Source
83.	TDS	Tax Deduction at Source
84.	UIN	Unique Identity Number
85.	UTGST	Union Territory Goods and Services Tax
86.	VAT	Value Added Tax

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