

## CHAPTER-III STATE EXCISE DEPARTMENT

### 3.1 Results of audit

Test check of records of State excise offices conducted during the year 2005-06 revealed non/short levy of duties and fees amounting to Rs. 470.67 crore in 126 cases, which broadly fall under the following categories:

(Rupees in crore)			
Sl. No.	Categories	Number of cases	Amount
1.	Non levy of interest	12	0.45
2.	Non realisation of licence fee	13	1.21
3.	Less recovery of alcohol from molasses	21	3.88
4.	Irrational fixation of MGQ	20	24.29
5.	Excess transit / storage wastage	03	0.27
6.	Loss of excise duty due to non lifting of MGQ of country liquor	11	7.14
7.	Review on “Levy, assessment and collection of taxes in State Excise Department”	01	406.40
8.	Other irregularities	45	27.03
	<b>Total</b>	<b>126</b>	<b>470.67</b>

During the year 2005-06, the department accepted under assessment etc. of Rs. 24.07 lakh involved in four cases which has been recovered.

A few illustrative cases and a review on “Levy, assessment and collection of taxes in State Excise Department” involving financial effect of Rs. 408.15 crore are given in the succeeding paragraphs:

### 3.2 Review on Levy, assessment and collection of taxes in State Excise Department

#### Highlights

- Due to failure of the department, penalty of Rs. 381.78 crore for unlawful manufacture of alcohol by a distillery was not imposed. [Para 3.2.7.1]
- Low yield of alcohol from molasses as compared to norms resulted in loss of revenue of Rs. 16.03 crore. [Para 3.2.7.2]
- Allowing sale of stock of previous year in ensuing year without recovery of differential rate of duty resulted in loss of excise duty amounting to Rs. 6.10 crore. [Para 3.2.10]

#### 3.2.1 Recommendations

Government may consider to:

- monitor the production of distilleries as per the installed capacity,
- alcohol yield should commensurate with the norms prescribed,

- PD-2<sup>1</sup> licences may be renewed before the commencement of excise year and
- strengthen the internal control mechanism.

### **3.2.2 Introduction**

Excise duty on liquor for human consumption, fees in case of other intoxicants such as *charas*, *bhang*, and *ganja* etc. and confiscation imposed or ordered is levied under the UP Excise Act, 1910 (UPE Act) and rules made thereunder. These rules are made to have a proper check over leakages of revenue in the department by enforcing control over illicit production, import and export of alcohol, illegal purchase and sale of liquor and other intoxicants in effective manner for which internal control mechanism has been developed.

Alcohol is produced in distilleries mainly from molasses obtained as a byproduct during manufacturing of sugar. Various kinds of liquor, such as country liquor (CL), Indian made foreign liquor (IMFL) like whisky, brandy, rum and gin are manufactured from alcohol. Excise duty on production of alcohol and liquor in distilleries forms major part of the excise revenue. Liquor for human consumption is issued from distilleries either under bond without excise duty or on pre payment thereof at the prescribed rates. Apart from export duty, licence fee also forms part of excise revenue. The District Collector (DC) with the assistance of the district excise officer (DEO) is responsible for settlement of liquor shops in the district.

### **3.2.3 Organisational set up**

The collection of duty, fee and other taxes is administered and monitored by the Commissioner, Excise who is assisted by two Additional Excise Commissioners, three Joint Excise Commissioners (JECs), 10 Dy. Excise Commissioners (DECs) and six Assistant Excise Commissioners (AECs) at headquarters. For the purpose of effective administration, the State is divided into four<sup>2</sup> zones and 17<sup>3</sup> circles. At district level DEOs/AECs are posted to assess, levy and collect revenue. At distillery, AEC/officer incharge (inspector) is posted for levy and collection of excise duty.

### **3.2.4 Audit objectives**

A review on levy, assessment and collection of tax in State Excise Department was conducted during the period from June 2005 to March 2006. Records for the period 2000-01 to 2004-05 were test checked to ascertain whether:

- duties, fees and penalties were realised as per the provisions of Act/Rules and executive instructions issued by the department,
- settlement of shops was done as per provisions of New Excise Policy and
- effective internal control mechanism was in existence.

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<sup>1</sup> PD-2 licence: Licence granted to work a distillery in a premises owned by any person other than Government.

<sup>2</sup> Agra, Lucknow, Meerut and Varanasi.

<sup>3</sup> Allahabad, Azamgarh, Agra, Bareilly, Basti, Chitrakoot, Devipatan, Faizabad, Gorakhpur, Jhansi, Kanpur, Lucknow, Meerut, Mirzapur, Moradabad, Saharanpur and Varanasi.

### 3.2.5 Scope of audit

In order to achieve the objectives, 17 out of 44 distilleries of the State and 13 out of 70 district excise offices were test checked in 17<sup>1</sup> districts. Maximum revenue earning distilleries/district excise offices were selected for review.

### 3.2.6 Trend of revenue

(Rupees in crore)

Years	Budget estimates	Actuals	Shortfall	Percentage
2001-02	2,300.00	1,963.89	(-) 336.11	(-) 14.62
2002-03	2,696.33	2,556.79	(-) 139.54	(-) 05.20
2003-04	2,850.00	2,473.16	(-) 376.84	(-) 13.20
2004-05	3,000.00	2,686.83	(-) 313.17	(-) 10.40

It would be seen that percentage of shortfall in actual receipts as compared with budget estimates ranged between 5.2 per cent to 14.62 per cent during the years 2001-02 to 2004-05.

New Excise Policy 2001 was introduced during 2001-02 and shortfall in revenue in that year was expected. The department attributed the increase in actuals during 2002-03 as compared to 2001-02 to revision in the rate of excise duty on CL, IMFL, beer, and increase in administrative fee on molasses and in licence fees. During the year 2003-04, there was decrease in the amount of settlement of shops and reduction in the rate of excise duty of CL. Amount of Rs. 182.76 crore on account of settlement of shops for the year 2004-05 was deposited in the year 2003-04 (March 2004), yet there was an increase of Rs. 213.67 crore in revenue in the year 2004-05 in comparison to 2003-04.

### 3.2.7 Non imposition of penalty

#### 3.2.7.1 Manufacture of alcohol in excess of installed capacity

As per UPE Act a distillery may manufacture spirit under the licence granted by the competent authority. Government issued instructions on 23 July 1998 that officer of Excise Department posted at distillery should ensure that no distillery produces spirit/alcohol in excess of its installed capacity fixed for production. Under the UPE Act, unlawful manufacturing and removal of intoxicant by any distillery will be punishable with imprisonment for two years and with fine of Rs. 500 or not less than 10 times of the duty due, whichever is higher.

Test check of records of a distillery in Simbhoul in Ghaziabad district revealed that Commissioner Excise doubled the installed capacity of the distillery on 26 April 2003 from 13,636 kls<sup>2</sup> to 27,272 kls. As per the condition imposed, increased capacity of 13,636 kls was made available only for manufacture of industrial alcohol.

<sup>1</sup> Balrampur, Bulandshahar, Fatehpur, Ghaziabad, Gonda, Gautam Budh Nagar (Noida), Gorakhpur, Jaunpur, Kanpur nagar, Lucknow, Lakhimpur Kheri, Moradadad, Meerut, Rampur, Saharanpur, Shahjahanpur and Unnao.

<sup>2</sup> kilo litre

It was noticed that during 2004-05 the distillery produced 1,94,93,591<sup>1</sup> BL of alcohol which included 27,78,728.4 BL alcohol for industrial use. The balance 1,67,14,862.6 BL alcohol was produced for human consumption against the installed capacity of 1,36,36,000 BL. Thus, the distillery produced 30,78,862.6 BL alcohol in excess of installed capacity for human consumption for which fine of Rs. 381.78 crore was leviable which was not levied by the department.

After this was pointed out, the department/Government replied in July 2006/August 2006 that the installed capacity of distillery was 27,272 kls and no excess alcohol was produced. The reply is not tenable as the commissioner had increased installed capacity with condition that 13,636 kls alcohol was for industrial use. After deducting production of alcohol for industrial use, production of alcohol for human consumption exceeded the installed capacity; hence, penalty was leviable.

### **3.2.7.2 Low yield of alcohol from molasses**

Under the UP Excise Working of Distilleries (Amendment) Rules, 1978, for every quintal of fermentable sugar content present in the molasses the distillery shall yield alcohol of 52.5 alcoholic litre (AL). For this purpose, composite samples of molasses are required to be drawn by the officer incharge of the distillery and sent for examination to the alcohol technologist. Failure to maintain the minimum yield of alcohol from molasses entails cancellation of licence and forfeiture of security deposit besides other penalties.

Test check of records of 15 distilleries<sup>2</sup>, revealed that 2,140 composite samples of molasses were sent to the alcohol technologist during the year 2002-03 to 2004-05. Based on the reports of alcohol technologist, out of 21.43 lakh quintal of fermentable sugar content present in molasses, 11.24 crore AL of alcohol should have been produced against which actual production was 10.91 crore AL. This resulted in shortfall of 33.39 lakh AL of alcohol and loss of excise revenue of Rs. 16.03 crore. Besides, neither the licence of the distilleries was cancelled nor the security deposit of Rs. 26.87 crore forfeited for low production of alcohol.

It was also observed that while compounding low production of alcohol in 2001-02, Commissioner Excise had warned the distillers between February 2002 to July 2002 to improve the recovery of alcohol within six months failing which their licences would be cancelled and securities deposited by them be forfeited. In spite of this, the distillers did not improve the recovery of alcohol and Commissioner continued to compound the cases with the same warning in a routine matter which had no deterrent effect on the distillers.

After this was pointed out, the department/Government replied in July 2006/August 2006 that strict instructions have been issued in May 2006 by the Commissioner Excise for controlling the disorder of plant and machinery and to check the reasons for low recovery explained by the distillers. It was further added that proposal for enhancement of amount of compounding fee from Rs. 5,000 to Rs. 50,000 has been sent to Government.

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<sup>1</sup> As intimated by the department to the Commissioner

<sup>2</sup> Balrampur (1), Ghaziabad (3), Gorakhpur (1), Gonda (1), Lakhimpur Kheri (1), Lucknow (1), Meerut (2), Rampur (1), Shahjahanpur (1), Saharanpur (2) and Unnao (1).

### **3.2.8 Short realisation of licence fees**

Under UP Bottling of Foreign Liquor Rules, 1969, as amended from time to time, licence fees shall be deposited in advance for obtaining and renewal of licence of FL-3 on or before 28 February each year. The rate of licence fee for obtaining FL-3 licence was Rs. 1 lakh upto 31 March 2003 and Rs. 2 lakh thereafter.

During scrutiny of records of a distillery at Rampur it was noticed that licence fee for renewal of FL-3 licence of Rs. 6.98 lakh was either not deposited or deposited short by the distiller during year 2000-01 to 2004-05. No action was taken by the department to realise the same.

After this was pointed out, the department/Government stated in July 2006/August 2006 that FL-3 licence for the year 2000-01 to 2004-05 was being renewed by the District Collector. Further action was awaited (August 2006).

### **3.2.9 Loss of excise duty due to short lifting of minimum guaranteed quota of country liquor**

Under the provisions of the Uttar Pradesh Excise (Settlement of licenses for retail sale of Country Liquor) Rules 2001, a licensee is liable to lift the entire minimum guaranteed monthly quota (MGQ) fixed for each licensee during the year. In case of failure, the licensing authority shall adjust the amount of duty from the security deposit of the licensee and ask the licensee to replenish security or cancel the licence of the shop.

During scrutiny of records of four DEOs<sup>1</sup> it was noticed that 102 licensees lifted 12,68,903.735 BL against MGQ of 13,37,595 BL of CL during the period from 2002-03 to 2004-05. This resulted in short lifting of 68,691.265 BL MGQ involving excise duty of Rs. 54.50 lakh as shown in Appendix-C.

After this was pointed out, the department/Government intimated between June 2006 and August 2006 that demand of Rs. 54.50 lakh had been raised against the licensees out of which recovery of Rs. 3.19 lakh had been made/adjusted from the security deposited by the licensees and for the balance amount recovery certificates had been issued.

### **3.2.10 Loss of excise duty due to non recovery of difference rate**

Under the Uttar Pradesh Excise (Settlement of licenses for retail sale of country liquor) Rule 2002, entire quantity of CL lifted by the licensee during the year shall have to be sold during the validity of his licence and on expiry of licence unsold stock is to be returned to Government. The rate of excise duty of CL was Rs. 79 per BL for the year 2003-04 whereas it was Rs. 69 per BL in 2002-03.

Test check of records of the office of Commissioner Excise revealed that in 29 districts the balance stock of 61 lakh BL of CL for the year 2002-03 was not returned by the licensees to the distillery after the expiry of their licences. As such they were liable to pay difference of excise duty for the year 2003-04

<sup>1</sup> Gorakhpur, Jhansi, Kushinagar and Saharanpur.

at the rate of Rs. 10 per BL. Although the Commissioner Excise allowed on 26 March 2003 to sell the balance stock of the year 2002-03 in the month of April 2003 but there was no mention regarding recovery of differential rate of excise duty. This omission resulted in loss of excise duty amounting to Rs. 6.10 crore.

After this was pointed out, the department/Government replied in July 2006/August 2006 that permission was given for the sale of balance CL of 2002-03 in the year 2003-04 to save probable loss of revenue for 2003-04 and loss occurred during 2002-03. It was presumed by the department that no additional duty was leviable, so no duty was realised. Reply is not tenable because the presumption was not based on facts and recovery of excise duty at differential rates was to be made.

### **3.2.11 Non fixation of norms for food grain based distilleries**

UPE Act provides for maintaining minimum fermentation and distillation efficiency to achieve minimum recovery of alcohol from molasses consumed in a distillery. However, in the case of foodgrain based distilleries the department has prescribed no norms for production of alcohol.

A distiller had been requesting the Commissioner Excise for fixation of norms for yield of alcohol from foodgrains since 1997 but no norms were fixed so far (May 2006). Thus, due to non fixing of norms for yield of alcohol, Government suffered loss of excise duty.

After this was pointed out, the department replied in July 2006 that draft rules for providing norms for production of alcohol from foodgrain had been sent to Government for their approval in April 2006. The approval of Government is awaited.

### **3.2.12 Irregular adjustment of security**

The Commissioner Excise declares its policy every year for settlement of retail shops and each year it is clarified that 10 *per cent* security on basic licence fee would be deposited into treasury. At the end of the year after adjusting dues, if any, the balance security will be refunded. As per Financial Hand Book Volume V Part I all deposits or balances unclaimed for more than three complete accounts years will, at the close of March in each year, be lapsed to Government and credited to the appropriate head of revenue through transfer entries in the office of the Accountant General.

During scrutiny of records of eight DEOs<sup>1</sup>, it was noticed that securities of the shops owners amounting to Rs. 1.88 crore deposited in the year 2002-03 were adjusted against their security due for the year 2005-06 which was irregular. As the amount of security deposit was more than three years old it should have lapsed to Government. This was irregular adjustment of security of Rs. 1.88 crore.

After this was pointed out, Government accepted the audit contention and instructed the Commissioner Excise on 9 May 2006 that the security for which three complete accounts years have lapsed, should not be, adjusted against the security of current year. The amount of previous years' security may be arranged to be refunded to licensees from the treasury. In future, provisions of

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<sup>1</sup> Fatehpur, Gonda, Gorakhpur, Jaunpur, Kanpur city, Meerut, Shahjahanpur and Saharanpur.

Excise Rules and Financial Hand Book may be followed and security may not be carried forward for the next financial year.

### **3.2.13 Inordinate delay in renewal of PD-2 licence**

As per UPE Act, an application for renewal of licence for the excise year shall be made to the Commissioner Excise on or before 28 February each year. A licence fee as prescribed from time to time shall be payable in advance for such a renewal for a year or part thereof. In case renewal of licence is not submitted in time or the renewal is delayed, the distillery would be liable for penalty as provided by law. In the event of licence being refused for a distillery which had been previously licenced, permission may be granted to continue operation temporarily, for a reasonable time pending appeal.

During scrutiny of records of 12 distilleries for the year 2000-01 to 2004-05 it was observed that their licences (PD-2) were not renewed before the commencement of the excise year though their applications for renewal of licences were submitted in time to the Commissioner Excise. No permission was also granted to continue operation temporarily. The Commissioner Excise has taken three to 37 months to issue the licences as shown in Appendix-D.

After this was pointed out, the department/Government stated in July 2006/August 2006 that the applications for renewal are mostly submitted late by the Collectors. It was also stated that delay was due to irregularities found during inspection, which were rectified and licences renewed. Obviously, this process is time taking. Further, this offence which is covered under Section 64 of the Act is punishable under Section 74 (1).

The reply is not tenable as there are no provisions in the Act and Rule to run a distillery without licence. Commissioner had also issued orders from time to time stressing for renewal of licence till 31 March of every preceding excise year. If the licence is not renewed in time, production and sale of alcohol of such distilleries would not be carried out after 31 March. Even then such distilleries continued production and sale of alcohol which was unlawful and attracts penalty under the Act. But no penalty was imposed.

### **3.2.14 Internal control**

#### **3.2.14.1 Non conducting of periodical inspection of distillery**

In order to have an effective control over working of the distilleries, the Commissioner Excise vide order dated 18 August 1990 prescribed the norms for periodical inspection of distilleries by excise staff as under:

Sl. No.	Designation	Periodicity
1.	Officer incharge	To inspect every section of the distillery once a month
2.	District excise officer	To do detailed inspection of the distillery quarterly
3.	Dy. Excise Commissioner	To do detailed inspection of the distillery half yearly

Test check of records of 11 distilleries<sup>1</sup>, revealed that required inspections were not conducted during the period from 2000-01 to 2004-05 as under:

<sup>1</sup> Balrampur, Bulandshahar (Sikandarabad), Ghaziabad (Simbhauli & Modinagar), Gonda, Gorakhpur, Lakhimpur kheri, Lucknow, Rampur, Shahjahanpur and Saharanpur (Tapri)

Sl. No.	Category of Officer	No. of Inspections due	No. of inspections carried out	Shortfall	Percentage of shortfall
1.	Officer incharge	660	415	245	37.12
2.	District Excise Officer	220	25	195	88.64
3.	Dy. Excise Commissioner	110	90	20	18.18
4.	<b>Total</b>	<b>990</b>	<b>530</b>	<b>460</b>	<b>46.46</b>

It would be seen that shortfall in inspections, ranged between 18.18 *per cent* to 88.64 *per cent* at different levels during these years. This indicated that the department had failed to exercise proper control over the distilleries. Had periodical inspection been conducted as per prescribed norms, excess production and low yield of alcohol would have been avoided.

After this was pointed out, the department/Government stated between July 2006/August 2006 that reasons for shortcomings in periodical inspections were rush of work, non posting of any officer incharge in some distilleries, inspection of liquor shops by the DEOs and appointment of officers in local elections. Strict instructions have been issued to all the inspecting officers to adhere to the norms of inspections in the industrial units.

### **3.2.14.2 Improper supply of excise locks**

Under UPE Act, excise locks are supplied by the department for locking all warehouses, spirit pipes and vessels etc. to prevent any misuse, or leakage of spirit in the distillery.

During the test check of records of 14 distilleries<sup>1</sup>, it was noticed that the required number of excise locks were not provided by the department for the period from 2000-01 to 2004-05 as detailed below:

Year	Locks required	Locks provided by the department	Shortage
2000-01	134	88	46
2001-02	102	65	37
2002-03	100	50	50
2003-04	114	54	60
2004-05	121	65	56
<b>Total</b>	<b>571</b>	<b>322</b>	<b>249</b>

Due to shortage of excise locks, misuse and leakage of spirit could not be ruled out. Out of requirement of 571 locks, only 322 locks were provided leaving a gap of 249 locks.

It was further noticed that in four<sup>2</sup> distilleries against the demand of 72 excise locks the department had supplied 129 locks, which were in excess.

After this was pointed out, the department/Government stated in July 2006/ August 2006 that the report of excess or short supply of locks has been called for from all distilleries. Factual position will be intimated as and when reports are received from distilleries and locks would be supplied to every distillery against demand.

<sup>1</sup> Balrampur, Bulandshahar (Sikandarabad), Ghaziabad (Mohan Meikins, Mohan Nagar, Modinagar and Simbhauli), Gorakhpur (Sarriya), Gonda (Nawabganj), Lakhimpur Kheri, Lucknow (Mohan Meikins), Rampur, Saharanpur (Tapari and Pilkhani), Shahjahanpur and Unnao.

<sup>2</sup> Bulandshahar, Gonda, Lucknow and Unnao.

**3.2.14.3 Internal audit**

An internal audit wing functions under the control of Finance Controller and Chief Accounts Officer. The wing consists of one Sr. Finance and Accounts Officer and one Assistant Accounts Officer. The audit wing is responsible for conducting the audit of distilleries, offices of the DEOs and other excise units of the State.

During test check of records of internal audit wing, it was noticed that percentage of units audited was very low as detailed below:

Year	Units due for audit	No. of units audited	Short fall	Percentage
2000-01	108	14	94	87.03
2001-02	108	21	87	80.55
2002-03	108	2	106	98.14
2003-04	112	30	82	73.21
2004-05	112	25	87	77.67

As the percentage of test check by the internal audit wing was very low, the purpose of internal audit was defeated.

After this was pointed out, the department/Government stated in July 2006/August 2006 that there was deployment of 26 *per cent* staff against the sanctioned strength hence, performance of internal audit was affected. The reply is not tenable, as State Government had already issued instructions dated 15 January 2003 to reorganise and strengthen internal audit, which was not done by the department.

**3.2.15 Conclusion**

Failure of the department to check excess production of alcohol, non fixing of norms for production of alcohol by the department for foodgrain based distilleries, short realisation of licence fees, unlawful adjustment of security and other irregularities resulted in loss of revenue amounting to Rs. 406.40 crore.

**3.2.16 Acknowledgment**

Audit findings as a result of review on "Levy, assessment and collection of taxes in State Excise Department" was reported to the State Government in June 2006 with a specific request for attending the meeting of Audit Review Committee for State Receipts (ARC-SR) so that viewpoint of Government/department was taken into account before finalising the review. The meeting of ARC (SR) was held on 8 August 2006 with Special Secretary (Finance/State Excise) and the representatives of State Excise Department. The views expressed by the members had been taken into consideration during finalisation of the review.

**3.3 Loss of revenue due to non settlement of shops**

According to the New Excise Policy, Government ordered<sup>1</sup> for settlement of shops for the year 2004-05. MGQ fixed for the district is to be settled through renewal of quota of the existing licenced shops as per existing provisions. Remaining MGQ is to be settled by creation of new shops for which lottery

<sup>1</sup> No. 518 -2/13 2004-07 dated 26.2.2004

system is to be adopted as prescribed. The rate of basic licence fee and excise duty was Rs. 10 and Rs. 79 per BL respectively for the year 2004-05.

During audit of records of district excise office, Ghazipur, it was noticed in April 2005 that 27,70,000 BL of MGQ was fixed for Ghazipur district in 2004-05. Only 167 shops were settled at 25,73,431 BL against fixed MGQ of 27,70,000 BL. Department failed to carry out the orders of Government as existing shops were settled by reducing their annual MGQ. Thus due to non-creation of new shops, 1,96,569 bulk litre (MGQ) remained unsettled and Government was deprived of revenue in the shape of basic licence fee and excise duty of Rs. 1.75 crore.

After this was pointed out, Government/department replied in June 2006 that the new shops could not be settled due to deployment of staff in Lok Sabha elections of May 2004 and in view of code of conduct imposed by Election Commission and opposition by the existing licensees. The reply is not tenable as the department failed to create new shops, run the shops departmentally or to settle the shops even after Lok Sabha elections were over.