



ALL-PARTY PARLIAMENTARY BEER GROUP

BEER TAX FRAUD INQUIRY



July 2012

ABOUT THE APPBG

The **All-Party Parliamentary Beer Group** is a formally registered parliamentary group. It was first established in 1993, and exists:

“To promote the wholesomeness and enjoyment of beer and the unique role of the pub in UK society; to increase understanding of the social, cultural and historic role of brewing and pubs in the UK, and their value to tourism; to broaden recognition of the contribution of brewing and pubs to employment and to the UK’s economy; to promote understanding of the social responsibility exercised by the brewing and pub industries; to support the UK’s brewing industry worldwide, and to promote a positive future for beer and the pub”, achieved through a programme of meetings, briefings, visits and other activity.

It has approaching 350 members drawn from both Houses of Parliament.

The present Chairman is Andrew Griffiths MP (Con),who is supported by Vice-Chairmen Nigel Adams MP, Karen Bradley MP, Sir Tony Cunningham MP, Dr Therese Coffey MP, Thomas Docherty MP, Clive Efford MP, Charlotte Leslie MP, Dan Rogerson MP and the Lord Kennedy of Southwark, and a 22-strong Executive Committee representing all parties.

The Group receives graduated annual subscription funding, currently from 70 companies in the sector, ranging from the largest to some of the smallest, which is reported to the Commissioner for Standards according to the rules laid down by Parliament. This income funds the services of a part-time secretary and the other office services to run the Group, with small amounts being spent on hospitality from time to time.

It was necessary to accept some additional support in order to cover the unbudgeted costs of this inquiry, including clerical fees, printing, postage and other exceptional secretarial expenses. The Panel is grateful to the companies and other bodies listed below for contributing to cover these exceptional costs. The contributions will be declared to the Commissioner for Standards in the normal way and so detailed on the APPBG’s entry in the official Register of All-Party groups:

ABInBev The Campaign for Real Ale (CAMRA) Carlsberg UK Diageo plc Greene King plc	Heineken UK The Independent Family Brewers of Britain Miller Brands UK Molson Coors The Society of Independent Brewers (SIBA)
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The Beer Tax Fraud Inquiry Panel was jointly chaired by:
Andrew Griffiths MP (Con) and **The Rt Hon John Healey MP** (Lab).

Other members were:
Rt Hon the Lord Dholakia, OBE, DL
Thomas Docherty MP
Stephen Hepburn MP
Marcus Jones MP
The Lord Kennedy of Southwark
Brandon Lewis MP
Nigel Mills MP

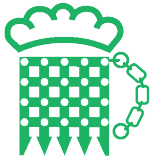
Clerk to the Inquiry Panel: Meriel Thorne
Honorary Secretary to the Group: Robert Humphreys

previous Inquiries undertaken by the Group
Beer Tax Inquiry, HMSO, 1995
Licensing Law Reform Panel Report, October 1999
Community Pub Inquiry, October 2008

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INTRODUCTION

This Group has been promoting, and celebrating, the importance of the British brewing and pub industry for almost twenty years. As a cross-party group of MPs and Peers we value highly the contribution the industry makes to our British economy and culture. Given the many challenges faced by the brewing industry we have a particular interest in ensuring that any potential regulation affecting British brewers is supported by rigorous evidence of its proportionality, its efficacy and its impact.

Her Majesty's Revenue and Customs (HMRC) is proposing new regulatory burdens on brewers to help counter beer tax fraud. It estimates that this fraud is costing the Treasury around £500 million in lost duty every year, and that smuggled beer has now permeated the UK market to the point that one in ten cans and bottles in the off trade is illicit. Beer tax fraud, much like any tax evasion, is highly complex criminal territory in which nothing is simple or guaranteed to work. As a Panel, we therefore approached HMRC's proposals with an open mind, determined that our assessment should be both objective and robust.

Our inquiry has covered considerable ground in just two months, so as to ensure the Treasury can consider our findings alongside the formal consultation process.

We are grateful to our Parliamentary colleagues for their commitment of time and interest to this Inquiry, and grateful also to Robert Humphreys and Meriel Thorne for all the work they have done to support us.

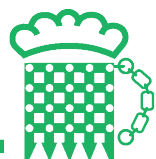
We would like to thank all our witnesses for taking the time and effort to brief us within this tight timescale. In particular, we owe considerable thanks to Andy Leggett and his team at HMRC for helping us throughout our inquiry. We would also like to pay tribute to the front line enforcement team we met at Dover, for their candour in explaining the nature and scale of the problem, and for their dedication in fighting on against the fraudsters.

It is clear to us that this is a serious problem; beer tax fraud continuing unchecked has a corrosive social impact and repercussions reaching far beyond the brewing industry. It has also become evident that no single measure is likely to have a marked effect on its own. However, we consider a series of measures targeted at specific aspects of the problem may work to disrupt the business models of the organised criminal gangs behind the fraud, without imposing disproportionate burdens on the legitimate producers, suppliers, retailers and consumers of beer.

Andrew Griffiths MP

Rt Hon John Healey MP

Co-Chairs of the Inquiry



EXECUTIVE SUMMARY

Alcohol smuggling is not a new problem. Duty differentials between the UK and the near continent mean that for as long as the rewards of smuggling outweigh the risks of detection and penalty, an incentive will be there for fraudsters minded to exploit it. However, the nature of the fraud has changed. The problem is no longer confined to the white van trade smuggling relatively small amounts of beer, but has become the lucrative business of organised criminal gangs importing truckloads of beer through Dover every day, or more usually night, and depriving the Revenue of more than £18,000 worth of duty each time.

HMRC estimate that beer smuggling may be currently costing the Treasury around £500 million pa in lost revenue, with additional costs to legitimate businesses undercut by the illicit beer. They believe that at least one in ten, and possibly one in five, of all cans and bottles of beer on sale in the UK is duty unpaid, and this is not just through back-street dealing. Once fraudsters have smuggled their beer back to the UK it enters the legitimate supply chain, reappearing undetected alongside duty paid beer in supermarket aisles and off-licence shelves.

This is a serious problem which enforcement has failed to keep in check, with serious implications on a number of different levels. We have no doubt that beer smuggling needs to be tackled, and that new measures are required to do so.

The critical test for any new measures will be that they are effective, targeted and – as the Government has stressed – proportionate. In order to assess proportionality, the priority has to be to agree a robust measure of the size of the fraud. We urge all legitimate operators in the trade and HMRC to co-operate in developing agreed methodology, essential both to a proper assessment of the proportionality of any intervention, and to judging its impact. (see recommendations 3,4,5,6,8)

We think enforcement is central to the discussion of options for change. Effective enforcement of existing, and any new, measures requires effective collaboration between all branches of UK enforcement, with other EU tax authorities and with all parts of the production and supply chain. A cultural step-change is needed, and not just by HMRC, to achieve this. We have made a number of specific recommendations. (see recommendations 7,8,9,10)

Some anti-fraud measures already exist, but are not being used to maximum advantage. We have made recommendations for improving the use of the pan-EU computerised system for tracking duty-unpaid goods (EMCS) and for a voluntary code for hauliers to display ARC numbers, making it easier to detect suspect loads. We have made further suggestions for disrupting the fraudsters' passage through Dover. (recommendations 13, 14)

It is our view that voluntary measures, to be developed and promoted by trade bodies and their members in collaboration with HMRC and other agencies, also have an important role to play in getting to grips with this issue. The example that has been set through the Responsibility Deal between the alcohol industry and the Government can be applied to eliminating duty fraud too, and we urge the industry to embrace and develop this idea.

We agree with HMRC and all our witnesses that it is critical that the alcohol supply chain is controlled end to end, and that all wholesalers of alcohol should be registered. Closing this loophole will help tackle wine and cider fraud, alongside beer. To tighten the supply chain further, brewers should produce a template good practice guide on due diligence beyond their first customers and HMRC should collaborate with them more closely in tracing seizures of illicit beer. However, we consider it highly improbable that the concept of and investment in new track and trace technology could pass the tests of being effective, targeted and proportionate. (recommendations 17, 18,19).

We consider proposals for fiscal marks for beer premature. There are significant issues around exclusions and consequent costs, efficacy and impact, and until a clearer and more robust method of establishing the scale of these issues and the tax gap has been agreed we do not see how proportionality can be properly assessed. Our strong recommendation is that HMRC first embrace the other options outlined in this report, that EMCS is given time to become established and develop, and that a clear benchmark is set for assessing the success of these measures against an agreed estimate of the tax gap. (recommendations 15, 16)

1 BACKGROUND

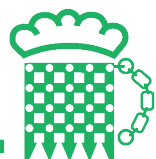
1.1 Overview of UK beer tax fraud

- 1 Alcohol smuggling is not a new problem. All witnesses to our inquiry accepted that duty fraud exists, and as one pointed out, that it probably has since time immemorial on all types of alcohol. Indeed, in a previous Parliament this Group examined the question observing "...the 'van trade' in smuggled excisable goods, and especially in tobacco and beer, has been developing, in the process becoming more sophisticated and established" [Beer Tax Inquiry, 1995]. Duty differentials with the near continent mean that for as long as the rewards of smuggling outweigh the combined risks of detection and penalty, an incentive will be there for those minded to exploit it.
- 2 It is currently a highly profitable business. The duty differential on one lorry load of beer smuggled back to UK is £18,000, although the UK loses more - the whole of the potential UK yield - whereas the French Treasury usually collects its Excise take on this beer. This illicit trade is highly organised. As HMRC, Border Force and Trading Standards made clear, this is not the territory of white vans and small time operators that partially occupied it in the 1990s, but the complex business of organised criminal gangs.
- 3 It is a fraud with widespread impact on legitimate businesses: retailers, distributors, wholesalers, newsagents and the pub trade provided evidence on how it affects their members and costs them business. HMRC's midpoint estimates for all alcohol losses is equivalent to lost legitimate sales in the UK of over £1 billion, with beer estimated at around half that total.
- 4 It is also a fraud that has permeated legitimate supply chains, with far reaching consequences for retailers who may find themselves unwittingly selling illicit product and placing their business, home and freedom to work at their trade at risk, as well as for society more widely.
- 5 However, the size of the fraud, and how best to tackle it, are more controversial.

1.2 Inquiry objectives, activity and terms of reference

- 6 The APPBG first approached the issue in 2011. UK brewers had expressed concerns that HMRC was contemplating legislation to address duty fraud which could place disproportionate burdens on the industry without having reliable data on the scale of the problem. A meeting was held with HMRC in November 2011, and the matter was debated in Westminster Hall on the 27th March 2012, following which the Group's Chairman received clarification on some details from the Treasury Minister, Chloe Smith MP. HMRC subsequently announced substantially revised estimates of the size of beer excise fraud, including a new 'lower bound' estimate.
- 7 Following the March 25th 2012 publication of "Alcohol Fraud", HMRC's consultation document on possible legislative changes, the Chairman invited Parliamentary members of the APPBG to join an inquiry panel, simultaneously writing to Chloe Smith MP, Economic Secretary to the Treasury, explaining the plan. She welcomed the initiative and committed her officials to be of assistance. The Panel would like to reiterate their thanks to all officials at HMRC and Border Force who have helped the inquiry. The Panel determined at the outset to be objective in its assessment of the issues and evidence presented, and the HMRC team has been exceptionally helpful in answering a running string of queries raised in hearings.

- 8 At its inaugural meeting on 10th May 2012 the Panel agreed the following terms of reference:
"To investigate the nature, scale and impact of beer duty fraud in the UK and the evidential basis of HMRC's estimates, to assess the strengths and weaknesses of HMRC's proposals to counter this fraud and to consider reasons for failure of the present system and alternative recommendations."
- 9 Six open meetings were held at Westminster in May and June, hearing evidence from representatives of retailers in the on and off trade, distributors, large and small brewers, importers, HMRC, warehouse-keepers, the wine and spirits trade and experts from trading standards and the law. A full list of witnesses and hearings is at Appendix A, and notes of all hearings are available on the inquiry's website: www.beertaxinquiry.co.uk. In addition, the Panel visited Dover to see at first hand the challenges facing the front line enforcers and to understand the workings of a bonded warehouse.



2 THE NATURE AND SCALE OF THE PROBLEM

2.1 The nature of the fraud

10 HMRC's consultation document explains that "Alcohol fraud in the UK is driven by strong demand for popular brands of alcohol sold at illicit prices. Reducing fraudsters' access to those brands to feed their illicit supply chains is essential if we are to reduce alcohol fraud in the UK."

11 The document says that the UK illicit market requires the following five elements:

- a reliable supply of popular brands;
- ability to position goods for fraud in neighbouring states (duty unpaid);
- low comparative duty rates in neighbouring states where goods can be sourced; (the Panel notes that the word "comparative" is the key here)
- complicity of some businesses involved in the alcohol trade; and
- wholesale and retail outlets for the sale of illicit goods.

And to these the Panel would add:

- inadequate enforcement

How diversion fraud works

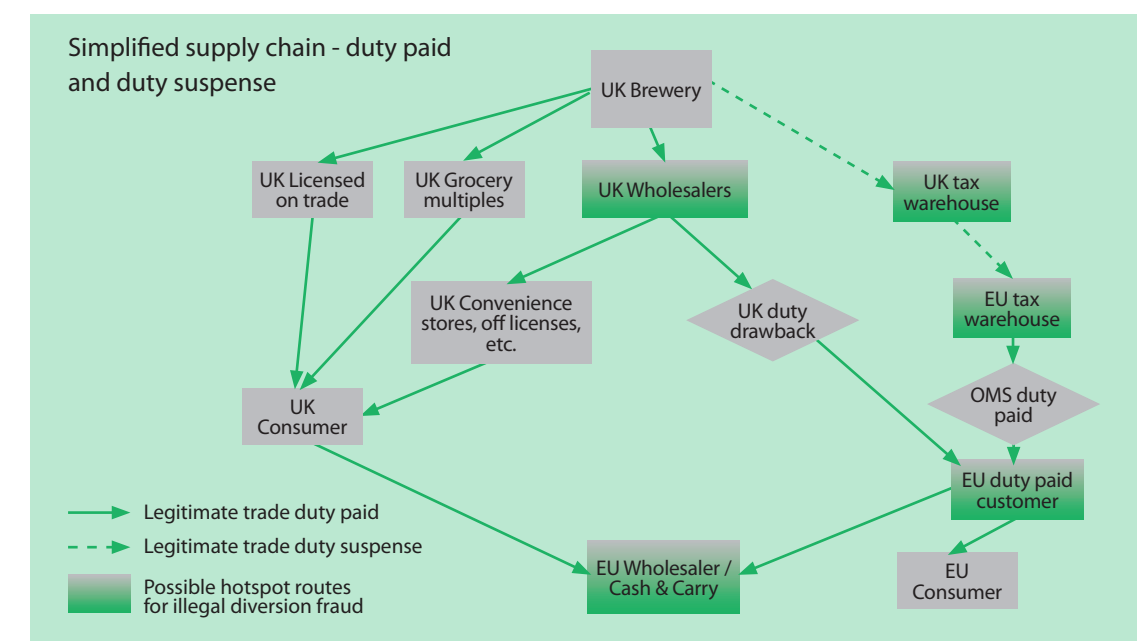
12 HMRC made clear that beer tax fraud is a diversion fraud, limited to cans, and to a lesser extent bottles, of popular brands. It is not a problem of counterfeiting, as with spirits or tobacco, nor is it seen to impinge on supplies of draught beer. As explained by Andy Leggett:

"EU law requires that alcohol can be moved duty unpaid between registered warehouses. Organised criminals exploit that system to divert goods, (UK) duty unpaid, into the UK market, by penetrating the legitimate wholesale and retail supply chains. This is driven by demand for popular brands – the top four brands seized are Stella, Fosters, Carling, Carlsberg – which are sold to retail outlets and corner shops by wholesalers, and can also be found in some of the larger chains. This is very large volumes, and organised criminals operating an end-to-end supply chain."



¹ Andy Leggett Q39

13 HMRC provided the illustration below of how diversion fraud works:



Supply

A reliable supply of popular brands

- 14 Looking at the first of the elements, the Panel heard some suggestion at the outset of the inquiry that brewers might in some way be complicit in oversupplying popular brands to European markets. "Brewers are supplying it to wholesalers who they know are going to export to the continent for levels of demand they know don't exist" (James Bielby)². This point was refuted strongly by the brewers (see paragraphs 183-185 below) and HMRC agreed there was no suggestion of complicity by the brewing industry.
- 15 Andy Leggett explained: "What the brewers say, and I agree, is that they supply customers who are either legitimate, or ostensibly legitimate so far as they can see, in either the UK or EU. In doing so, 450m litres of beer goes out of the UK, duty unpaid, to a market where the maximum demand is 150 -180m litres. It's the middle men who are exploiting the gap to oversupply the EU".³
- 16 While these statistics are not as clear cut as they first appear – HMRC volunteered that there is no empirical way of assessing legitimate EU demand – the brewers agreed that there is "no denial that there's not an issue"⁴. However there are clear problems in getting the scale of that issue right, which are discussed below. (see paragraphs 42-56 and 183 below)

Duty suspense & duty drawback

The ability to position goods for fraud in neighbouring states (duty unpaid)

- 17 EU law requires that alcohol can be moved duty unpaid between registered warehouses. This system is used entirely legitimately by brewers exporting to customers abroad, by brand importers to the UK, by large retailers and by wholesale distributors, and as was shown to us at Dover, by the likes of P&O for their on-board sales.
- 18 Within the UK (usually, although occasionally to and from the near Continent as well), duty suspense is also routinely used by most of the UK's smaller brewers, who number over 800 in all, who contract with others to carry out their packaging into bottles and sometimes cans with the packs then returned to the brewery or depot. This freedom to move goods with a minimum

² James Bielby Q24

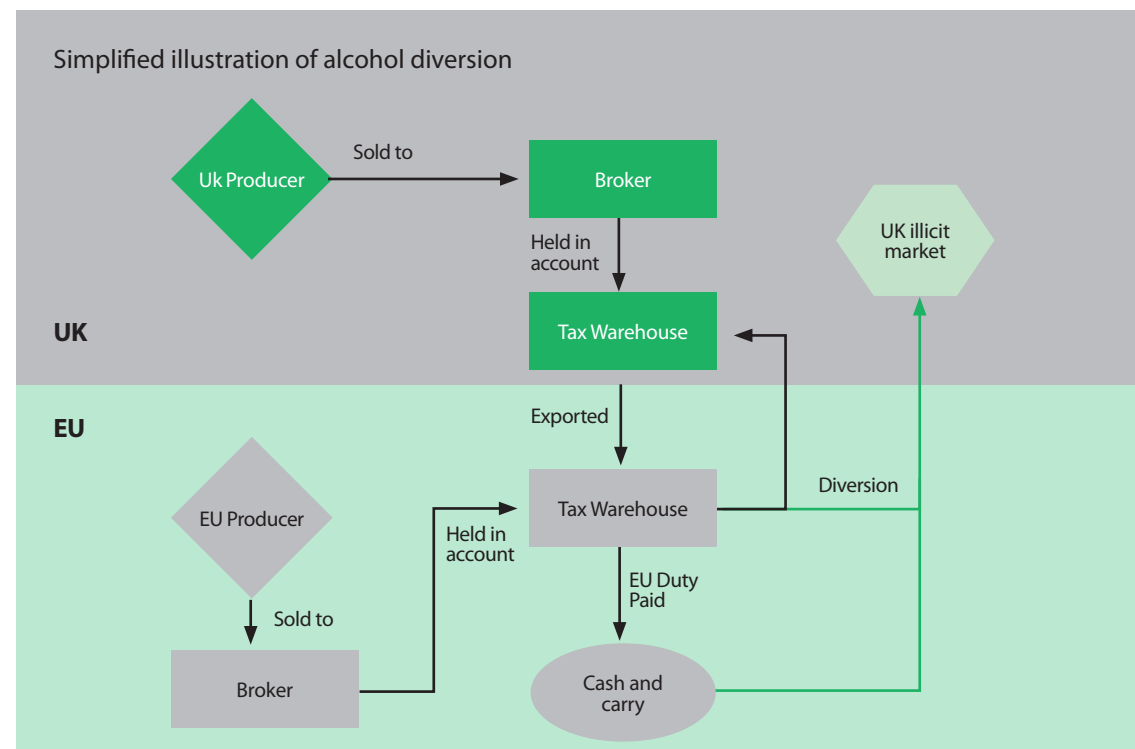
³ Andy Leggett Q194

⁴ Andy Tighe Q214

of formality and without prior payment of duty is vital to the dynamics and the economics of the UK beer market, which presently offers drinkers a greater choice of brands than any other country in the world, for the population size.

19 It is also of course a fundamental principle of the Single Market, so important to delivering downward pressure on price and countervailing upward pressure on consumer choice.

20 HMRC provided the chart below to illustrate where fraudsters can exploit this:



21 When beer is travelling under duty suspense, duty becomes payable at the point it “enters the market”, or in other words is sold to a non-bonded customer – be it in the UK, on EU mainland, or in P&O’s case, on board their ships. A pan-European system of controls monitors the movement of goods being moved in duty suspense – see paragraphs 96 – 115 below for a full discussion of the Electronic Movement Control System (EMCS) – and in the UK, HMRC registers and monitors all bonded warehouses.

22 However, as HMRC makes clear in its consultation, and as we heard in evidence at Dover, organised criminal gangs are able to exploit the duty suspense system. It was explained to us that having exported loads of beer to France duty unpaid, they ship identical French-duty-paid consignments back to the UK “under cover” of one legitimate recorded return movement.

23 The other route for evading duty is via duty drawback. UK supplies of beer, to be exported, can apply for repayment of UK duty already paid – a system used by some of the large retailers, for example, entirely legitimately. As Heineken explained to us “Grocers might buy from us duty paid in the UK then export and apply to HMRC to recover the duty they’ve paid. A large amount of beer goes through duty drawback – effectively it’s HMRC saying they know there’s a market overseas for this product so we’re going to allow you to draw back the duty”.⁵ There were some views at the outset that this could be a major loophole. However Andy Leggett, HMRC, explained “I genuinely believe drawback is a bit of a red herring. The amount of fraud in drawback is very small, probably 2 to 5 % of the total fraud. Drawback is a means to an end rather than an end in itself. It’s

used to position goods on the continent. If we ended drawback tomorrow the fraudsters would use duty suspense instead.”⁶

24 HMRC supported this with the following statistics: of the 450 million litres of beer exported to the EU in 2009/10, approximately 60% was from excise warehouses, 30% direct from UK brewers and 10% drawback.

25 **The amount of duty fraud in drawback may be relatively small in percentage terms, but if HMRC’s estimates of the tax gap are correct it could amount to £40m pa. All loopholes need to be tightened to disrupt fraudsters’ business. It is important that HMRC does not dismiss the scope that duty drawback provides to smugglers, or overlook the need to tighten checks in the system.**

Duty differentials

Low comparative duty rates in neighbouring states where goods can be sourced

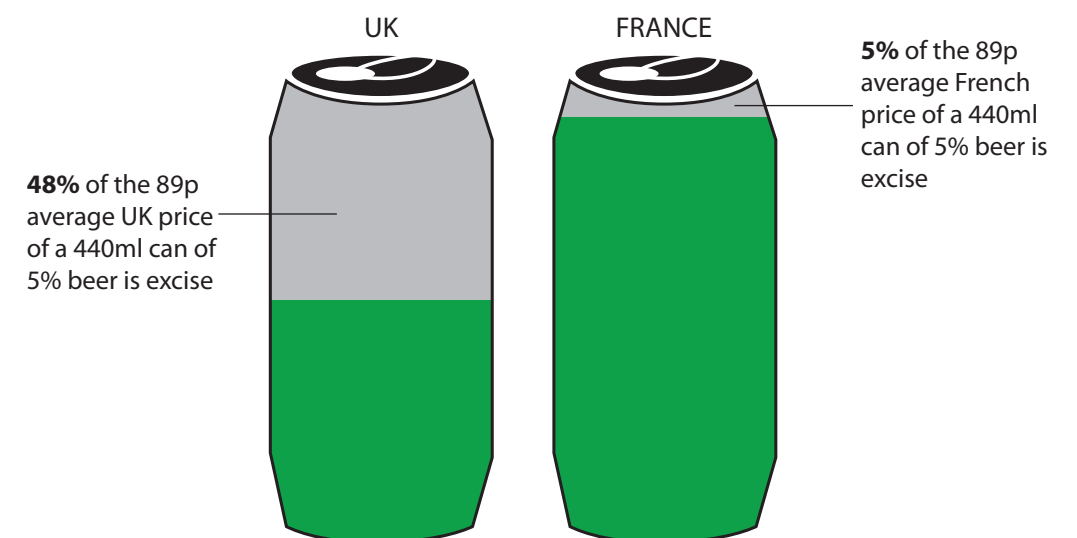
26 Witnesses from the brewing sector were unanimous that duty differentials are the nub of the problem. As Shepherd Neame put it, “France is 30 miles from our door but we pay 7-8 times more duty and 11 times more than the Germans, who are 150 miles away.” And as the British Beer & Pub Association (BBPA) explained, “fraud is being driven by a 50% increase in UK beer duty since 2004”.⁷

27 HMRC pointed out that “the price differential between legitimate and illicit beer is what creates the incentive. Duty is part of it, but there’s also a number of other factors; it’s not to say it’s a natural corollary that every time duty goes up, fraud increases.”⁸

28 We observe that elementary economics indicates that there must be a correlation between the duty differentials between the UK and neighbouring countries and the volume of fraud; and that given the level of uncertainty about the size of the UK beer smuggling market, HMRC cannot in any event dismiss this with any confidence.

29 It was not the central remit of this inquiry to investigate beer duty differentials. But HMRC itself acknowledges that “the illicit market in the UKrequires low comparative rates in neighbouring states....”⁹ It could scarcely do otherwise.

As our predecessor Inquiry in 1995 observed, “The cross-border search for low priced beers is evidently largely a consequence of the Single Market, given present tax rates. It may be almost entirely due to the difference in tax rates within the Single Market, as this Committee is inclined to accept, given that currently a pint of 5% beer bears 5.2p in duty and VAT thereon in France, but 36.1p in the UK”. If only those were still the figures.



⁵ Graeme Colquhoun Q121

⁶ Andy Leggett Q209

⁷ Tom Falcon Q113

⁸ BBPA background briefing “Working together to tackle duty fraud”

⁹ Andy Leggett Q142

¹⁰ HMRC consultation document

- 30 **The view of this Panel is that if duty levels in the UK were closer aligned to those in neighbouring states, the fraudsters’ financial incentives and illegal profits would be significantly reduced. We ask the Treasury to make public its modelling of the effect of relative duty levels on fraud, and the costs of that fraud, so that assessments can be made of how tax changes can impact on levels of fraud and how close UK beer duty rates are to the tipping point where extra revenue raised is off-set by increased fraud.**

Complicit business and available outlets

Complicity of some businesses involved in the alcohol trade, and Wholesale and retail outlets for sale of illicit goods.

- 31 The inquiry witnessed a fair amount of finger pointing, but received no hard evidence of where business may be knowingly complicit. This is the territory of HMRC’s specialist investigations team.
- 32 The nub of the matter is that the supply chain for beer can be long and complex, with wholesalers selling on to wholesalers perfectly legitimately several times over. However the complexity means that once it has been permeated, it is difficult to unravel and prosecute – as Andy Leggett told us *“more so than tobacco because of the supply chains – and there’s a challenge around our disclosure obligations because it touches legitimate businesses. It’s resource intensive and very difficult. Our aim is to target the gangs behind the fraud – it’s not about totting the numbers up”*¹¹
- 33 The National Audit Office (NAO) inquiry into HMRC’s renewed alcohol strategy reported *“In each of the four years to 2009-10, there were convictions in just six cases or fewer for suspected alcohol duties fraud. The Department considers civil sanctions more effective in some cases. During 2010-11, the quantity of alcohol seizures increased to almost 10 million litres – an increase of 61 per cent.”* When questioned on the low level of prosecutions, Andy Leggett told us: *“In January we successfully prosecuted a bonded warehouse owner & 5 others – 35 year sentences, £50m pa fraud – stopped it stone dead, which took more than 5 years to get to sentencing.”*¹²
- 34 **We appreciate that HMRC cannot intervene everywhere and we understand their declared strategy is to target the organised criminal gangs behind beer duty fraud which is complex and lengthy work. Our criticism is not that the strategy is wrong, but that the evidence of its effectiveness is weak. We discuss further on the merits of a better joined up enforcement policy between HMRC, Trading Standards and Border Force on the one hand, and on the other, improved collaboration between HMRC and all parts of the industry and supply chain. Effective enforcement requires effective co-operation, and potentially more resources dedicated to the task.**
- 35 **We also recommend that HMRC is more transparent in publishing its interventions and explaining its outputs and outcomes, as current perception is that this is a relatively risk free fraud for complicit businesses.**
- 36 One of the contributing factors is that neither HMRC, nor any other authority, has direct control over wholesalers and distributors, other than the bonded warehouses. Currently retailers have to be licensed, producers have to be licensed, but the middleman does not. And as was explained to us by several witnesses, the ‘middleman’ may in reality be an elaborate and complex supply chain, designed specifically to obfuscate.
- 37 The Federation of Wholesale Distributors (FWD) believes that extending the licensing regime, or developing a form of registration for wholesalers, would help to close a clear loophole, protecting individual citizens and tackling illegitimate traders who are involved in the fraudulent sale of alcohol. This is discussed further below (see paragraphs 194 – 205). Certainly it would also help retailers who may at present be unwittingly complicit.



¹¹ Andy Leggett Q50
¹² ibid

Enforcement and penalties

- 38 We were told by HMRC that *“Three factors motivate organised crime – can they do it, is there money involved, and how difficult is it to operate?”*¹³
- 39 Andy Leggett explained that enforcement is not covered in the consultation because it is “business as usual”. He said, *“In enforcement terms it’s our responsibility to do what we can in the legal framework. We’ve increased our effectiveness, but if you don’t change the legal framework the scale of the problem won’t change”*¹⁴
- 40 For the purposes of this inquiry, we have considered enforcement in its broadest terms relevant to the discussion, both because present levels are inadequate, and also because any new measures would also require enforcement in order to be effective.
- 41 **The effectiveness of enforcement, that is the probability of being caught and the penalty if caught, has a direct impact on incentives to smuggle. Enforcement was a recurrent theme of the inquiry and this Panel considers it central to discussion of the options for change. As witnesses repeatedly told us, there is little point introducing new measures without guarantee of proactive enforcement; and without this assurance, businesses may end up bearing possibly significant additional cost to no avail. Enforcement is also critical to establishing clear evidence of the lower and higher risk supply chains, and to targeting those accordingly.**

2.2 The scale of fraud

Anecdote vs evidence

- 42 Whilst we heard anecdotal evidence of the impact of fraud (see below paragraphs 57-81), it rapidly became apparent to this inquiry that there is still a considerable way to go in establishing agreed measures of its scale.
- 43 To take one example, FWD told us that that its members sales loss was “in line with the £500m estimate” from HMRC. However, we were unclear from their evidence how much of this loss can be positively identified as an impact of fraud, how much is attributable to the overall fall in the beer market, and how much could be attributed to their members’ loss of market share as off sales move from the independent sector to the supermarkets.¹⁵ (see paragraph 64 below).
- 44 Opinion differs on the importance of establishing a clear picture of the scale of fraud. FWD said *“We know there’s a problem. There’s no point in being diverted into numbers rather than looking at practical solutions”*¹⁶ On the other hand, as the BBPA maintain, the numbers are important as any *“response needs to be proportionate and HMRC needs to be able to measure the impact”*. HMRC also made it clear that any improvement in the reliability of fraud estimates would be most welcome.
- 45 BBPA told us: *“The only tangible estimate we’ve got is the level of seizures – £6 million worth of beer in terms of lost revenue was seized last year compared to £12m of spirits, which have had tax stamps for 6 years, and compared to £220m of tobacco.”*¹⁷
- 46 We heard evidence from the spirits trade about their unsuccessful efforts to reach an agreed measure of the size of the equivalent problem prior to implementing tax stamps. This failure to agree a starting point for the size of the tax gap at least partially accounts for the lack of clear evidence about their impact – there is no clear ‘before’ and ‘after’ (see paragraph 130 – 132 below). We appreciate that a number of factors were in play affecting the estimated size of the spirits tax gap, and that as Andy Leggett explained, there is no empirical way to measure the impact of tax stamps in isolation: *“There’s no straight line trajectory. So it’s difficult to measure*

¹³ Andy Leggett Q46

¹⁴ Andy Leggett Q50

¹⁵ James Bielby Q30

¹⁶ James Bielby Q38

¹⁷ Andy Tighe Q4

the impact of one specific measure – alongside introduction of duty stamps a whole lot of other economic factors would have come into play.”¹⁸

47 **Whilst we agree that no one is questioning that there is a problem, and that there is a need to look at practical solutions, we are also convinced that a robust measure of the scale of fraud is required as the basis for any decision on new, and therefore unpredictable, market interventions. We consider this measure essential both to a proper assessment of the proportionality of any intervention, and to judging its impact.**

Establishing reliable estimates of the beer tax gap

Lower bound & upper bound methodology & critiques

48 HMRC’s first published estimate was its upper bound estimate that £800 million, or 14 %, of the beer market was being lost. Following discussions with the brewing industry, it subsequently produced a lower bound estimate in February 2012 of £250 million or 5% of the market. This generates the current HMRC “mid-point” estimate of £500m lost, but the margins are of course very far apart.

49 Andy Leggett explained to us: “The upper bound is the estimate it can’t be any higher than, the lower bound the estimate it can’t be any lower than. The upper bound is a top down estimate – taken from the total beer consumption in the UK using Office of National Statistics (ONS) consumption data, then we know how much duty is paid in the UK, so the gap between is deemed to be illicit. It’s not precise, it’s based on assumptions and it is an estimate.

“The lower bound is bottom up methodology. It looks at diversion fraud, which we think is the main fraud in the UK. It looks at how much beer is moved out from the UK to the EU, duty unpaid, how much of that is for legitimate consumption, and assumes the rest is coming back illegally”. It is a salutary reminder of the economics of this trade that no-one would consider exporting UK duty paid beer to France fraudulently, so no allowance needs to be made for that traffic.

50 He continued: “The methodology around the lower bound assessment of diversion fraud isn’t very different to industry’s assessment of diversion fraud, and increasingly that will become the figure by which we’ll assess the options, as the options are to tackle diversion fraud.”¹⁹

51 The industry estimates referred to were explained by Andy Tighe, BBPA: “We have produced our own initial fraud estimate based primarily on how much beer is sold duty in suspense by the major UK brewers to wholesalers in the UK and EU. From that we get to 6% - so if everything the brewers sold in duty suspense went onto an illicit market, it would be 6%. If you take a midpoint of 50% of this, it would give you 3%, then add an element of imported beer, which would take it up to 4%.”²⁰

52 Prior to our inquiry, BBPA commissioned KPMG to review HMRC’s beer tax gap methodology, and they shared this report with us. KPMG’s headline conclusion was that the methodology for the upper bound estimate was reasonable, but needed to take into account margins for error which could mean the tax gap was anything between 26% and 2%, and was just as likely to be one as the other. They concluded the lower bound estimate was less robust, and based on several unsubstantiated assumptions. KPMG’s overall conclusion was that “We do not consider that the estimates of illicit trade are currently sufficiently robust to be used for policy making purposes.”

53 Andy Tighe for BBPA and Andy Leggett for HMRC both gave considerable time to explaining their differences. We asked them to draw up a joint note of where their methodologies differed, and for HMRC to share with us and BBPA their analysts’ concerns with KPMG’s critique. At the time of publishing this report, agreement had yet to be reached between BBPA and HMRC on their methodological differences. The text below summarises HMRC’s view of the differences:

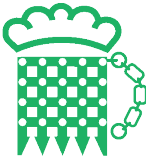
1. HMRC’s tax gap upper estimate covers all types of illicit beer in the UK market. HMRC’s lower estimate does not cover certain types of beer fraud, for example, counterfeit beer and diversion of beer produced abroad. This is one of the reasons it is a lower estimate.

- 2. BBPA’s tax gap upper estimate does not cover certain types of beer fraud, for example, drawback beer, counterfeit beer, and beer moved within a company that is later diverted back to the UK illicit market. The BBPA believe that these elements are small and are offset by over-estimating other elements of the illicit market, thus making it an upper bound. However, we have seen no evidence to support this. Therefore we do not believe their estimate is upper bounding.
- 3. BBPA’s tax gap lower estimate is based on the amount of illicit product we seize. We believe that this gives an unrealistically low lower estimate and consequently also creates an unrealistically low midpoint estimate.
- 4. HMRC’s upper estimate is 14% in 2009-10, the lower estimate is 5% and the implied midpoint estimate is 10%. The BBPA’s upper estimate is 8%, their lower estimate is 0.3% and their midpoint is estimated at 3-4%.

Comparison between HMRC and BBPA methodology

BBPA’s upper estimate uses similar data to the HMRC lower estimate. Both are based on dispatches of beer, however, they have different assumptions about which dispatches are likely to feed the illicit market. HMRC provided the following table setting out their interpretation of the key similarities and differences between the two methodologies – some of which in turn is challenged by BBPA.

HMRC methodology	BBPA methodology
Is a lower estimate	Is an upper estimate
Assumes that beer moved in duty-suspense to high risk EU countries, over and above estimated legitimate demand in those countries, is bound for illicit consumption in the UK.	Assumes that beer moved in duty-suspense to UK and EU wholesalers is bound for illicit consumption in the UK.
Believe it is a lower estimate because certain types of illicit beer have been excluded from the calculation. We also purposely under-estimate the frauds that are included, to ensure it is a lower estimate. The key under-estimates are to only include beer destined for the highest risk countries and to make a generous allowance of legitimate demand abroad, which is subtracted from the estimated beer at risk.	Believe it is an upper estimate because they believe much of this beer moved to wholesalers will be supplying the legitimate market. Therefore it over-estimates the amount of illicit beer moved to wholesalers. However, it does not take account of the possibility of illicit beer diverted from other destinations e.g. beer moved within a company or supplied to NAAFI that is later diverted back to the UK illicit market.
Does not cover any illicit beer produced abroad and then brought into the UK for illicit consumption. This contributes towards it being a lower estimate.	Includes an estimate of illicit beer produced abroad and then brought into the UK for illicit consumption. This contributes towards it being an upper estimate.
Includes an estimate of illicit beer sent abroad using the drawback system then subsequently diverted back to the UK illicit market.	Does not cover any illicit beer sent abroad using the drawback system then subsequently diverted back to the UK illicit market. Therefore it may not be an overall upper estimate.
Does not cover any counterfeit beer in the UK illicit market. This contributes towards it being a lower estimate.	Does not cover any counterfeit beer in the UK illicit market. Therefore it may not be an overall upper estimate.



¹⁸ Andy Leggett Q46
¹⁹ Andy Leggett Q39
²⁰ Andy Tighe Q2

- 54 Whilst we are encouraged by the progress that is apparently being made, and by the fact there is some consensus about the scale of fraud around the lower bound estimates, we think it essential that vigorous efforts are now made to agree methodology and a far more precise assessment of the size of this traffic, in order to equip all those involved with a proper, reliable measure of their performance in reducing it, as well as in appraising the proportionality of any contemplated change. For example, the use as a starting point in the assessment of legitimate beer consumption in the UK of the relatively small ONS household survey sample, which is then subjected to various uplift assumptions, appears to this Panel completely inadequate as the basis for rigorous measurement of the effectiveness of policy measures, let alone to the proper assessment of policy change. The Panel was also concerned to have heard no convincing evidence that HMRC's assumptions about the size of legitimate foreign markets are reliable, where the industry with its pan-European reach could be of significant assistance. We look to all parties with a useful contribution to make to the pooling of resources and intelligence to accept that more needs to be done to agree a common basis.
- 55 There are numerous parties with a direct interest in resolving the challenges around methodology, including the UK brewing industry, legitimate wholesalers and the retail trade, as well as enforcement officers from other branches of the Government, such as trading standards officers and the Border Force. Their resources and information need to be fully harnessed.
- 56 **We hope this inquiry will spur the step change in collaboration necessary to establish an agreed methodology for measuring the beer tax gap, and to establishing the flow of data and information to size it. We suggest that an independent and technically authoritative body, such as the National Audit Office, with the involvement and advice of the Office of National Statistics (ONS) lead work in this area.**

2.3 The impact of fraud

On Treasury and enforcement

- 57 HMRC estimate the scale of the beer tax gap at between £250 and £800 million, the industry nearer £150m. Even the lower figure, if accurate, is obviously a large revenue loss. As we learnt at Dover, it is also of significant frustration to the front line enforcement teams who know that on night ferries in particular, dozens of lorry loads of illicit beer are going past unchecked.
- 58 The fraud is also damaging HMRC's reputation. As one witness said: *"it's puzzling that Customs seem unable to target and eliminate a finite number of known criminal gangs, when they've got a highly specialised covert wing, on a highly visible bulky product with the same route in and out of the country. After so many years it seems impossible for Customs not to have a handle on it."*²¹
- 59 We heard from Brandon Cook, Trading Standards Institute (TSI), that the fraud also has an effect for local trading standards officers who come across illicit product in the course of their work. The practice and priorities of trading standards officers (tso) vary from authority to authority, but currently it is clearly not common practice for them to be authorised to seize illicit beer even when they observe suspect goods during the course of a normal visit to premises. This wastes resource, limits effectiveness and causes frustration. This is discussed further below (see paragraphs 116 - 119)

On Warehouses

- 60 We were given an overview of the impact on warehouses and holdings and movements operations by Alan Powell, advisor to the United Kingdom Warehousing Association (UKWA).



²¹ Alan Powell Q102

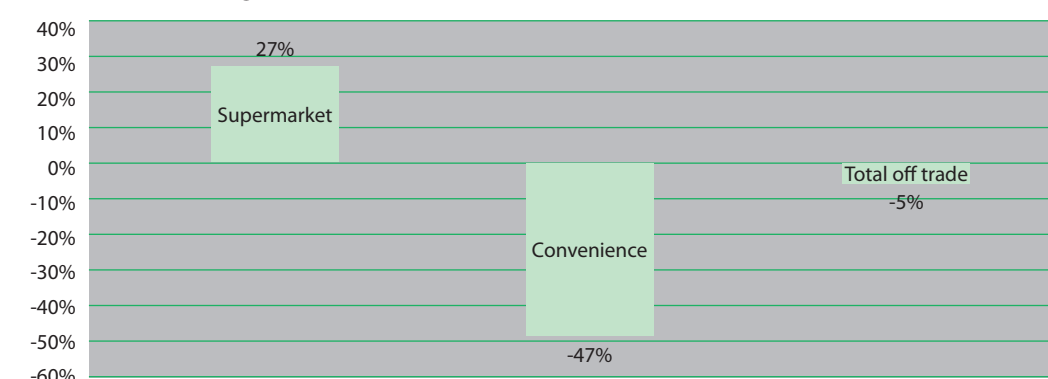
Duty suspended warehouses are registered by HRMC and some wholesalers are also registered as bonded warehouses, or licensed for the retail sale of alcohol, as we heard from Kate Nicholls (ALMR). Wholesalers generally, however, are not presently registered.

- 61 It was explained that bonded warehouse-keepers' responsibilities are to despatch product as required, and that using the Excise Movement Control System (EMCS) should be sufficient to ensure the movement is legitimate. However, warehouse-keepers have no visibility beyond the despatch, particularly if it is subcontracted to a haulier. Recent amendments to the law state that if a person has knowledge or reasonable grounds of knowledge of a fraud anywhere in the supply chain they may be liable for the duty. UKWA accordingly advises its members to consider the commercial rationale of all movements of duty suspended goods as part of their due diligence – asking themselves, for example, is this "sending coals to Newcastle?"
- 62 Warehouse-keepers, in common with all other parts of the supply chain, are being undercut by competitors selling well below realistic market prices. There was some clear frustration with current enforcement – we heard of one UKWA member being unable to get hold of officers to report suspect dealings, and *"a common complaint from the wholesale sector is that information is passed on but nothing seems to be done"*.²²

On Wholesalers

- 63 James Bielby, of FWD, explained the impact on wholesalers: *"Alcohol fraud is a big problem for our members, stunting job creation, and we believe enforcement alone isn't enough. This is about organised criminal gangs selling beer ex-duty on the open market. We think it's better to stop the product getting onto the market in the first place. From 2007-2011, we've seen a 10% decline in £ sterling on beer, a 3% decline on wine, spirits has increased 9% and the wholesale sector as a whole has gone up 17.5%. The National Audit Office (NAO) report found substantial weaknesses in enforcement strategy"*. However, he added: *"Where enforcement has been rigorously applied, in certain parts of the UK we've seen our members' sales go up."*²³
- 64 It was pointed out to us by BBPA that the FWD's 10% drop in beer sales should be seen in context of declining beer volumes overall (13%) in the same period, and a shift in beer sales from the independent sector to the major supermarkets. See table below.
- 65 **It is clear that those needing to understand and interpret market trends, including HMRC and the trade associations, would benefit from a better sharing of data. The Wine and Spirit Trade Association has done some work in this area as one of their measures to combat spirits fraud and we urge the trade associations to investigate what might be transferable, and helpful, to combatting beer fraud.**

Beer sales through the off-trade 2004-2010, source: BBPA



²² Alan Powell Q108

²³ James Bielby Q19

Millions of Litres*	Supermarket	Convenience (independent off-trade)	Total off trade
2004	1,313	1,031	2,344
2010	1,670	546	2,216
Difference	+357	-486	-128

*Nielsen splits of total GB off-trade sub-sectors scaled-up to BBPA UK off-trade market measure. Eg. Total size of Independent convenience sector in 2010 was 546million litres

On the on-trade

- 66 The Association of Licensed Multiple Retailers (ALMR) told us that whilst retailers remain very concerned about the potential for duty fraud they had no evidence that illicit alcohol is penetrating the on-trade. The on-trade supply chain is relatively short, robust and secure, as pubs primarily buy beer direct from a brewer or from national wholesalers.
- 67 BBPA were insistent that duty fraud was not contributing to the drop in their members' pub sales, as had been suggested in HMRC's consultation document. Brigid Simmonds said from 2004-2010 "supermarkets have increased their sales by about 27%; for convenience stores it's gone down by 47% - compared with 35% for pubs, for whom there are also a lot of other reasons why beer sales have gone down. It's clear that it's the supermarkets who are gaining from the convenience stores; the wholesalers are being squeezed because they're not getting the sales to the convenience stores they used to have because the supermarkets are setting up in competition to them. Pubs have seen a 42% increase in beer taxation since 2008, they have nowhere to go but to pass on the tax to the customer, they've had the smoking ban and a whole lot of other regulation, so I'd say that duty fraud hasn't been causing problems in pub sales".²⁴

On the off-trade

- 68 The Association of Convenience Stores (ACS), representing 33,500 local shops, told us that alcohol accounts for 20% of their sales on average. They said their members suffered from alcohol fraud in two ways – the loss of sales through competing illegitimate trade, whether through real shops nearby or by other routes, and through the risk of unwittingly stocking product which is non-duty paid.
- 69 A similar picture was presented by the National Federation of Retail Newsagents (NFRN), representing primarily local, family owned micro-business shops, who pointed to the significant sanction, the loss of a licence, which their members face if convicted of stocking fraudsters' products.
- 70 Brandon Cook explained this from the Trading Standard's perspective: "At the moment we can't get at the next level of the supply chain without a big surveillance exercise, so the buck stops with the retailer, who gets prosecuted or a licence review."²⁵
- 71 David Dadds, a solicitor advocate specialising in licensing reviews told us, "since the VAT rate increased, my work has increased relating to non-duty paid alcohol being present on licensed premises – it was previously about 10% of the reviews, whereas now it's probably over 50% - but it could be due to the duty increasing, or the enforcement increasing."

"There are two categories of problems. One where people have knowledge – committing a fraud and knowing they're committing a fraud – a retailer knowing they're purchasing in this way but

they're driven by competition into buying non-duty paid goods or turning a blind eye and not checking as they should. Then there's the retailer with no knowledge."²⁶

- 72 HMRC painted a vivid picture of the degree to which illicit product has now permeated the off-trade supply chain. Their published estimate is that 1 in 10 cans and bottles are illicit (this is based on the lower bound estimate that 5% of the total beer market is illicit, and multiplying by the approximately 48% of beer that is sold in the off-trade in can and bottle). If their midpoint estimate is used, this increases to 1 in 5.
- 73 BBPA contended that a fraud of this size would be larger than the size of the whole independent off-trade; it would mean that every can and bottle sold through independent off-licences would be illicit - unless the major supermarkets' chains had also become contaminated with illicit product.
- 74 HMRC confirmed that this is indeed the case. Our inquiry heard how illicit beer can be detected intermingling with duty-paid beer on major supermarket shelves, as well as in corner shops. Andy Leggett provided us with two illustrative examples from the week prior to our final hearing, where HMRC's specialist intelligence teams had come across cases relating to two of the big four supermarkets sourcing from the grey market to cover short term shortages, and in fact ending up with illicit product.

As he explained: "This isn't to say it's a huge problem in the large supermarkets. But the idea that this is only in the impulse sector is wrong. I'm not saying the large supermarkets are culpable – they're buying from a legitimate grey market and they're carrying out due diligence, but because of the penetration of the supply chain they're unwittingly buying illicit product. So it does occur in the larger supermarkets as well."²⁷

- 75 In explanatory notes HMRC later told us:

"HMRC sees the illicit market in packaged beer manifesting across all sectors in the off-trade to varying degrees i.e. not just SME retailers, and estimates that total off-trade sales of beer - legitimate and illicit - are closer to 2497 million litres. HMRC's lower estimate indicates an illicit market of approx 250 million litres (10% off-trade sales), and a mid-estimate equivalent to 500 million litres (20% off-trade sales)."

They added, "We have tried to estimate the level of penetration of illicit product in the off-trade based on the estimated level of total consumption from the ONS survey data, which would necessarily include any off-record sales. Using this as the starting point you arrive at a very different level of penetration in the impulse off-trade, even if you cautiously allow that all illicit trade is within the impulse sector. Below is an illustration of that.

- Overall consumption of beer in the UK = circa 5200m litres (ONS survey data)
- BBPA report split between on / off sales is 52:48. estimated off-sales therefore 48% of 5200m litres = 2500m litre
- BBPA report that 36% of off-sales is in the impulse sector, 36% of 2500m litres = 900m litres
 - HMRC lower-bound estimate of illicit beer = 250m litres. That is equivalent to 27% of total off-trade impulse sales
 - HMRC mid-point estimate of illicit beer = 500m litres. That is equivalent to 55% of total off-trade sales.

"Therefore, our lower-bound estimates of beer fraud suggest a level of penetration of illicit of around 1 in 4 bottles sold in the impulse sector (possibly less if we factor in illicit product in the larger multiples and on-trade)."



²⁴ Brigid Simmonds Q155

²⁵ Brandon Cook Q92

²⁶ David Dadds Q93

²⁷ Andy Leggett Q206

- 76 HMRC's estimates suggest that more than one in four, and possibly one in two, of all cans and bottles sold in the independent off trade may be illicit. Every fraudulent sale diverts money and tax revenues from the legitimate supply chain; allowing it to go unchecked sends a clear message to consumers that buying outside of normal channels is neither a crime nor has a real victim. Duty fraud seriously damages the activity of all legitimate operators.
- 77 ACS expanded on this corrosive effect. Drawing on experience of tobacco fraud they explained *"In more deprived communities people aren't going near retailers to buy their product any more, there's such an informal network. And experience is that once a network does one thing, it does another as well."*²⁸
- 78 **This is a relatively low risk fraud for the organised criminal gangs behind it. But the widespread trading in black market goods which has gone unchecked by those responsible for local law enforcement, increasingly the norm according to the evidence, undermines lawful society and sets an ominous precedent. The present implicit message to society is that defrauding the state is acceptable and is even becoming the normal standard of behaviour. We believe that this trade must be arrested urgently, but we have not been persuaded that its implications are yet recognised, as to either resource or political commitment.**
- 79 Once again we see the urgent necessity for much greater certainty about the present extent of fraud, and not merely for beer, but for all alcoholic drinks.

On brewers and their brands

- 80 The larger part of our time with brewers was focused on the impact of HMRC's proposals for reducing fraud, rather than on the fraud itself. However their cumulative evidence was that the brands they spend millions of pounds in developing and promoting suffer from illicit trade.
- 81 Graeme Colquhoun, Heineken, explained: *"We're a brands led business with billion pound brands and it's not good for them if they're traded in illegitimate routes to market. We trade hard in legitimate markets but absolutely don't turn a blind eye to fraud – we do everything we can to stop illegitimate traders getting hold of the product, and if they do, take steps to find out who they are and fulfil our obligations to the law."*²⁹
- "We don't want our brands involved in criminal activity. It's bad for our relationships with legitimate customers – FWD are very exercised about this. It takes up a lot of time. And it's hard to take on new customers and give them the benefit of duty suspense because of perceived risks to us."*³⁰



²⁸ Shane Brennan Q171
²⁹ Graeme Colquhoun Q117
³⁰ Graeme Colquhoun Q119

3 CURRENT ENFORCEMENT MEASURES & ISSUES

- 82 HMRC's current alcohol strategy was launched in 2010, an evolution from previous strategy to counter spirits fraud. It focuses on the whole supply chain, for all alcohol, and as Andy Leggett explained, it is more than just a seizure strategy. He said: *"In the first year of operation we increased our output on fraudulent activity by more than 50%. Our outputs increased by 50% in the first year of the new strategy, largely due to specialist investigations teams targeting criminal gangs, finance etc looking at any sanctions. We get £18 returned for every pound invested and an extra £17 million for tackling alcohol fraud from the SR10 spending round. Enforcement is only part of the story."*³¹
- 83 The National Audit Office recently reviewed HMRC's renewed alcohol strategy, and the House of Commons Public Accounts Committee is due to report its findings on the subject shortly. This Inquiry had no wish to go over this same ground, and focused on the following issues arising from witnesses' concerns about enforcement.

3.1 Penalties

- 84 Punitive powers now exist against someone holding duty unpaid goods through the penalty regime for excise "wrongdoing". Alan Powell, UKWA: *"If you're found holding duty unpaid goods, you're liable for a penalty of 100% of that duty, and customs can go back through your books, though it can be mitigated down to 30% or 20%. This is an absolute liability. So from 2010 the landscape changed – with a lot of implicit threat that you could be held responsible for the duty if you knew there was fraud in the chain. With the new powers, Customs became very pugnacious but little seems to have developed on that front."*³²
- 85 Andy Leggett told us that there were 41 excise wrongdoing penalties specific to alcohol in 2011/12, with combined value of £284, 282. The total of all types of civil penalty in relation to alcohol excise duty was 86, with a value of £472,117. When asked why there were so few penalties, he told us: *"I agree it's a woefully inadequate number. To put in context, the new penalty regime was implemented financial year 2011/12. Last year was the first year of operation and we've had difficulties. The process is established and we are getting a large number of referrals from Border Force to HMRC for penalties to be issued, where people are liable to a penalty. We have had over 500-600 in the first few months of operation. However, we have had difficulty in HMRC in recruiting the teams to process those referrals into the issuing of penalties."*³³
- 86 **We repeat the recommendation made throughout this report that it is critical that HMRC and all responsible for enforcement officers at a national and local level are adequately resourced to discharge their responsibilities under the current legal framework, and that any new powers are accompanied by additional resource. Without this commitment, we can quite understand industry's perception that they will be made to pay for failures in enforcement way outside their control.**
- 87 **From evidence received during our visit to Dover, we concluded that Border Force teams, and the investigation colleagues behind them, require more resources. We propose that a proportion of proceeds seized, be it impounded trucks or duty reclaimed, be earmarked for reinforcing HMRC's enforcement operations. The precedent is established for the Police with the Proceeds of Crime Act and this approach should now be extended for proceeds from illicit seizures by enforcement officers – at Dover and other ports, by local Trading Standards Officers, and by HMRC's specialist intelligence teams.**

³¹ Andy Leggett Q39
³² Alan Powell Q99
³³ Andy Leggett Q198

3.2 Resource and seizures at Dover

- 88 Andy Leggett told us: *"At Dover we currently seize c 1.2% of illicit beer, based on the lower bound estimate of 250 million litres. If we increased seizure rates fourfold we'd only have a very small impact on the tax gap."*³⁴
- 89 At our final session he expanded on this. *"We seize 6 million litres of illicit beer at Dover every year...if we were to increase our performance in terms of seizures and detections by 400%, based on the midpoint estimates, the level of fraud would go down from 500 million litres to 475 million litres. Once it's at the border, whilst we can improve, it's almost too late. We can get smarter, we can get better, but if you want to reduce that 500m litres of illicit beer going into the system each year, you're not going to do it by doubling resources at the border"*.³⁵
- 90 **We take the view that this analysis, a straight arithmetical calculation, is far too simplistic. The urgent need is for a significant change in culture, in resource and in practice, which in combination would have a potentially much more significant impact, not least through raised deterrence.**
- 91 We could not report without paying tribute to the team we met at Dover. They explained the breadth of their responsibilities to us, that alcohol may often be a relatively low priority against competing pressures, and that they were limited by time, by space and by legal restrictions as to what they could do.
- 92 In the fiscal year to 2012, some 226 HGVs had been seized. Of these 54 were restored free of charge, 47 offered restoration for a fee (the value of the duty seized and a penalty) and 101 had been held. In most cases the driver walks away. Given that if even the lower bound estimate is correct, that there are tens of thousands of illicit movements per year, this percentage seems frustratingly low.
- 93 Hauliers are unregistered, and we were told it is anyway common practice for fraudsters to lease their vehicles. Andy Leggett told us *"I've challenged my team to think as laterally as possible. I followed up after the visit to Dover with the team there to ask what more we can do to free them up. I don't know the answer at present, but we're looking at it all afresh.... We've done a lot of work with the haulage industry, trying to exert leverage, and some of the hauliers who were involved have pulled out completely, voluntarily"*.³⁶
- 94 According to the evidence almost all the traffic feeding the UK's fraudulent alcohol market passes through this port, yet at present it is apparent that it is virtually unchecked. It is therefore essential that immediate and forensic attention is paid to the opportunities and obstacles this concentration of criminal activity presents.
- 95 **It appears to us that there is much creative work to be done at and in the vicinity of Dover in disrupting fraudsters' business. We are much encouraged by HMRC's willingness to set aside past assumptions, which we strongly encourage, and we are also persuaded that the beginnings of a new way of more collaborative working is now in train. We intend to review progress in due course.**

3.3 EMCS and ARC numbers

- 96 EMCS is an EU-wide anti fraud system, some 10 years in gestation, but only now in its first full year or so of use. Established by a 2003 decision of the European Parliament and the Council [1152/2003/EC], its specific purpose was to reduce duty fraud across the EU. The Commission is understood to have spent some €35m on its establishment over the following six years, while all European Member States (MS) also spent additional sums in setting up their own systems to function within the overall framework. It is believed that across the 27 MS of the EU these investment sums varied from the smallest at €5m to the largest, the UK, at €80m.

- 97 EMCS is a real-time electronic registration and tracking system for all duty suspended movements of excisable goods. Registered warehouse-keepers are required to register every planned movement, up to seven days in advance of the start of the movement, with their national customs authorities. The details of the load, the locations from which and to which the goods are to be moved, and the length of the journey must all be specified. The authority then grants approval for the movement in the form of a number known as an Administrative Reference Code (ARC), and this number must accompany the movement of goods.
- 98 Upon the goods' arrival at their destination the receiving warehouse-keeper must advise his or her tax authority, at which point the movement is "closed" and the ARC expires. However, the consignee has five days grace during which the receipt of the goods must be reported.
- 99 The lead time appears not to be of concern since no movement may start, hence no cover for illegal movement would be afforded, until the start date specified by the consignor. The five days' grace on completion of the movement could, on the face of it, be used by an enterprising smuggler to cover additional movements if the original ARC number had not already been surrendered on challenge, but again this would be a riskier fraud than movements within the start and finish dates, since it would not be "covered" by the ARC, the delivery date having passed. Besides, any reduction to either period of grace would require the agreement of all 27 EU MS to amend the legislation, since they're specified, and it being a fiscal measure, that means unanimity would be needed.
- 100 The permitted journey times, however, are another matter. These are subject to national discretion, provided the provisions are reasonable and non-discriminatory, hence differing rules have been introduced country by country across the EU. The timings of journeys between different MS need to be agreed between them. We heard a clear concern expressed during our Dover visit that the present UK rules offer the enterprising smuggler far too much leeway. Many logged journey times greatly exceed what may be thought realistically necessary, creating an easily avoidable window for abuse.
- 101 **We recommend that the UK should urgently initiate discussions with the Douane on tightening up the permitted length of journeys starting in France, and possibly with the Belgian and Dutch customs authorities too, and that we should amend our rules also, as necessary, so as substantially to reduce this loophole.**
- 102 We note in passing that when Andy Leggett met the APPBG in November 2011 he assured us that HMRC has the full co-operation of neighbouring customs authorities, but the Home Office Minister Damian Green MP, in a Parliamentary Answer to Andrew Griffiths MP dated 26th March 2012, said *"Home Office officials in UK Border Agency or Border Force do not work with officials in other EU Member States in alcohol duty fraud"*. Given the estimated scale of the problem this is surprising and may be yet another area where better and closer collaboration is called for at the front line, however good it may be at a strategic level.
- 103 Another concern relates to consignees; HMRC confirms that the consignee must be routinely notified of a movement before authorisation can be granted. Where it subsequently emerges that an authorised movement was in fact a "cover" for illegal shipments, the possible complicity of the consignee must attract close scrutiny.
- 104 **We suggest that consideration should be given to this question, if necessary including discussions with the Commission, with a view to proposing change if feasible.**
- 105 A third issue with the present operation of the system is the full exploitation of its "real time" benefits and speed of response. With other countries' rules in mind, the system operates at considerable speed, and full access to EMCS data can be gained in respect of a load in just a few minutes via a hand-held terminal. Other countries have equipped their front-line officers with such terminals, but we learned that our own Border Force teams are not so equipped, in spite



³⁴ Andy Leggett Q39

³⁵ Andy Leggett Q196

³⁶ Andy Leggett Q201

of the UK's set-up costs having exceeded those of any other MS, and notes of suspect vehicle movements are passed to a separate office for logging and subsequent investigation. It was not clear to us whether this is to save cost or centralise control, but it clearly implies a missed opportunity to improve the effectiveness of front-line officers.

106 We recommend that immediate steps are taken to equip and train all front-line staff working at and near our ports of entry with hand-held terminals capable of interrogating the EMCS database within minutes.

107 As has been explained, the proof of a legitimate EMCS movement is the unique ARC number. This must accompany the goods at all stages of transit, and when it is logged at the destination the movement is closed and the ARC number expires. If a load of duty-suspended beer is found in transit without a valid ARC number it is sufficient grounds for instant seizure.

108 As we heard at Dover, ARC numbers are readily misused and abused. Unless each and every vehicle carrying excisable goods has its ARC number checked and recorded, fraudsters can run a number of lorries through "under cover of" a single number until challenged. Current targets for UKBA are to intercept 2000 lorries a year, some 7% of the HMRC estimate of illicit movements, meaning roughly one in 13 lorries will be stopped. Thus on average, 12 lorries may enter the country with illicit loads for every one recorded EMCS movement.

109 It was explained that fraudsters' practice is to generate an ARC number by notifying one legitimate EMCS movement, which then acts as "cover" for as many as possible 'mirror loads' of beer, bought French duty paid from a cash and carry. Once one lorry is stopped and the ARC number divulged to the officer, fraudsters will start using the next ARC number legitimately generated.

110 In doing so, criminals are taking advantage of the prohibition on border controls enshrined in the Single Market rules, but of course by entering the country carrying French duty paid beer with the intention to re-sell it without paying UK duty, they have then committed a criminal act. The real challenge for the authorities is to stop the criminal activity without disrupting legitimate movements.

One load per code

111 We heard a number of suggestions from witnesses, including the team at Dover, as to how the abuse of ARC numbers could be tightened. It is of course the proper duty of customs officers to protect the revenue and prevent crime, and we are minded that creative thought must be applied to ways in which this can be better done. One idea which emerged during our discussions was **for hauliers of excisable goods in duty suspense to display their ARC in a machine-readable form in the windscreen of their vehicle. We would like to see this made mandatory, although we understand there are legal questions about creating 'border controls' within the Single Market. If display of ARC numbers cannot be made a requirement, it should become a voluntary code for hauliers.**

112 Machine-reading of displayed ARCs could perhaps be done at Coquelles when passport checks are being conducted. Since the EMCS system also holds the registration number of the first vehicle to be used in any movement, these could also be easily checked with hand-held devices. Assuming that all legitimate hauliers would happily participate in such a voluntary scheme, some suspicion would naturally fall on any vehicle conveying excisable goods which was not displaying an ARC number, and patrolling the area around Dover could become much more focussed.

113 **HMRC told us of some of the successes they have achieved through leverage, rather than legislation, and voluntary display of ARC numbers appears ripe for the same treatment. We urge HMRC to explore a code of practice with bonded warehousekeepers and any**

retailers receiving duty suspended goods, for display of ARC numbers to become a part of their normal supply chain due diligence.

114 Finally, we learn that it was a clear ambition of the scheme as devised that the collected data should be used for the purpose of risk analysis, although the precise means by which this should best be done has yet to be settled. We understand that the Polish government is proposing a workshop on administrative cooperation during 2013. **We urge the Government to commit to participation in this.**

115 **EMCS is in place in outline but there is considerable scope to improve and develop it further to counter duty fraud. We urge the Government to be bold in testing its boundaries with the Commission. Prevention of crime and revenue protection call for determined measures.**

3.4 Trading standards powers

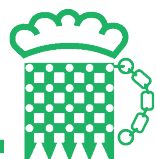
116 Trading Standards have a role to play in counterfeit, bootlegged and non-duty paid alcohol. They also have a role from a public health angle – with counterfeit spirits that may have 19 or 20 times the legal limit of methanol, for example – and the criminality behind it.

117 We were given an insight into their operations by Brandon Cook, speaking as a lead officer in this area on behalf of the Trading Standards Institute and as a Staffordshire TSO. He explained that the activity of trading standards officers at the retail level complements HMRC's national overview. It is clearly not a perfect relationship however. As he explained: *"we have some issues with exchange of information with HMRC – it tends to go in and not come out. We find that at the top level they're very willing; at the bottom level with personal contacts they're very willing; but in the middle we tend to get a lot of quotes about there being no gateway for exchange, it being illegal; despite protocols being there, it is a stumbling block on a daily basis."*³⁷

*"There's a protocol between HMRC and trading standards that authorises intelligence exchange. It should be happening but it tends not to – whether through lack of understanding about what they can and cannot do, or lack of resources, and we don't have shared databases."*³⁸

118 Trading Standards powers vary from local authority to local authority in relation to priorities, guided by financial and political pressures. Each officer carries his authorities in a document, which lists all those pieces of legislation under which his employer empowers him to act, and these can vary considerably: TSOs do not have the powers to prosecute or seize per se. Brandon Cook explained the practical impact *"if we find some counterfeit product alongside duty free product, there may not be an offence for us to seize the duty free product, so we just have to walk away knowing that it's there. By the time HMRC get there it's going to be gone. There are a lot of burdens on enforcement which could be made easier."*³⁹

119 **We want to see clear and explicit trading standards powers to seize and pursue action on non-duty paid alcohol in cooperation with and on behalf of HMRC. We pursued this point with David Dadds, who provided us with a subsequent note explaining that a useful amendment could be made to clarify powers under Section 139 (1) of the Customs & Excise Management Act 1979, and/or guidance made clearer about Trading Standards powers.**



³⁷ Brandon Cook Q85

³⁸ Brandon Cook Q86

³⁹ Brandon Cook Q86



⁴⁰ Keith Bott Q147

3.5 Co-operative enforcement

- 120 **It is clear to us that the best use of existing resources is not being made, through full collaboration and through the sharing of information and of strategic objectives. We urge the relevant bodies, including HMRC, LGA, TSI, Association of Chief Trading Standards Officers (ACTSO), together to identify and to resolve the present weaknesses.**
- 121 Concerns were expressed at various points throughout our inquiry that HMRC expect much of others in feeding in information, but little by way of co-operation is extended in return. The point was made by brewers, for example, that better provision of information on seizures could be mutually beneficial, and that high level discussions were often positive, but what happened afterwards often less fruitful.
- 122 We were given the following perspective from Keith Bott, The Society of Independent Brewers (SIBA): *“In my 25 years in the industry, the level of communication between brewers and HMRC has diminished to the point where it’s now nearly negligible. We’ll receive a visit every 2-3 years if we’re lucky, whereas we used to have an excise officer on site for every brew. I realise that’s not possible now, but there was a regular dialogue and interaction with them if we felt anyone was pushing the rules or trading illegally. That route to capture the information has now gone entirely. Working with the industry with limited resources, they’re reliant on their own intelligence rather than any passed from within industry. Increasing levels of communication would improve things enormously. We’re committed to educating people about it but we’re getting no information from HMRC in doing so.”*⁴⁰ This latter point was echoed by our retail witnesses.
- 123 **We repeat our observation that effective enforcement requires effective co-operation. Everyone in the supply chain, from brewers through to consumers buying at suspiciously low prices, has a role to play in enforcement through feeding information in to HMRC. In return, they need to know what information is useful, what is acted on and with what result. HMRC needs to do a better job of feeding back, as recommended in Paragraph 35 above, and working with the trade associations on improved communication to their members.**

4 HMRC’S PROPOSALS

4.1 Fiscal marks

- 124 HMRC is considering the introduction of fiscal marks on beer. They explained the aim is to reduce the amount of beer held and moved in duty suspense. Beer intended for export would not be marked and could continue to move in duty suspense, but any beer for UK consumption, whether produced in the UK or imported, would be need to be marked. Marked beer would not be permitted to move in duty suspense, at least once it had changed ownership, and fiscal marks would have to be obliterated or removed before it could be exported. For the purposes of the consultation, HMRC is working on a proposed fiscal mark similar to the black and white stamp on cigarette packets, rather than the holographic mark used on spirits.
- 125 Andy Leggett told us the intended effect would be that smugglers would only be able to access unmarked beer, which would make it easier to detect, and more difficult to penetrate legitimate supply chains through the UK wholesalers and retailers. As he said, *“Whether knowingly or unknowingly, wholesalers & retailers may be involved if one can of beer looks very much like another”*.⁴¹
- HMRC explained the intention is to target the beers that feature in the illicit market: cans and to a lesser extent bottles of 10 to 20 popular brands, sold in ‘small pack’ sizes. They confirmed that the acid test of any proposal will be its proportionality. They do not want to burden all beers with disproportionate costs and they know *“a lot of practicalities need thinking through. This is around mainstream brands... not to capture the small niche brands and those that aren’t part of the illicit market. We need to understand how imports would work, and exports.”*⁴² Their initial suggestion for limiting and targeting the impact is by exempting all beer at 2.8% or less (which enjoys a 50% discount on the prevailing duty rate) and that from brewers producing under 200,000 hectolitres pa.
- 126 Andy Leggett explained that HMRC *“know there are issues with costs – costs are not known or quantified - and that we need to work with industry to understand costs. At the Public Accounts Committee (PAC) hearing, the BBPA suggested they could be £50m – at that figure it works out c 0.9p per unit, and units net of duty are sold c 35 – 40p per unit.”*⁴³
- 127 These uncertainties, while consistent with a genuine desire to promote debate and creative thinking around the present difficulties, have presented those responding to the consultation with difficulties, for example in putting realistic costs on a range of options. We have some sympathy with both sides in this debate.

Spirits stamps precedents

- 128 No other EU country has duty stamps on beer. Turkey, Brazil and California all have them, but we heard they were introduced to answer other problems – not to tackle issues akin to the UK’s diversion fraud - and their systems and markets are also very different to HMRC’s proposals for the UK.
- 129 We were thus interested to learn of the UK’s experience of spirits stamps in countering fraud – in the case of spirits, a mix of diversion fraud and counterfeit production. It was explained to us clearly that the scale of production, the volumes and the business models were very different in spirits and beer. For example, Miller Brands UK alone, with a fairly small UK market share, still sells some 210 million bottles and cans – over half the amount of the entire spirits market. Miller Brands later produced a video graphically illustrating the impact these differences would make to the application and removal of fiscal marks. They showed canning lines moving at six times the speed of spirits bottling lines, highlighted the difference in volumes – fiscal marks are applied to 400 million spirit bottles annually, which is just 7% of the 5.5billion cans & bottles

⁴¹ Andy Leggett Q39
⁴² ibid
⁴³ ibid

of beer that might be covered – and explained that the cost ratio of applying a stamp as a percentage of the value of the product is significantly higher for beer than for spirits.

Impact on diversion fraud:

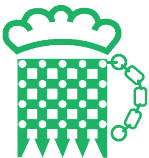
- 130 We received no clear picture of the impact of spirits tax stamps on diversion fraud. Spirits stamps were introduced in 2006 and their impact, as measured by the tax gap estimates, is not clear cut. As mentioned earlier, there was dispute between HMRC and industry at the outset about the size of, and methodology behind, the spirits tax gap. Estimated in 2002 to be circa £600 million, it was revised down to £450 million in 2004.
- 131 Andy Leggett told us *“The upper bound [estimate] has stayed the same. The lower bound has moved and with it the implied mid-point. It’s difficult to directly attribute how much spirits stamps have contributed. Our analysts estimate what the impact could have been, but it’s not a precise science.”*⁴⁴
- 132 The view from the spirits trade was given by Graham Bateman, of the Wine and Spirits Trade Association (WSTA) : *“According to Customs and Excise (C&E) fraud is running at about £250m pa. How the tax stamp affects that is very difficult to estimate. We know certain illicit and counterfeit product has a counterfeit stamp, but we’re hoping that trading standards and C&E will remove them from the market place. Industry helps by reporting them when we see them, and we expect C&E to take appropriate action.”*⁴⁵

Impact on counterfeit trade:

- 133 We received a similarly mixed picture in terms of the impact on counterfeit spirits. We heard *“illegal alcohol is coming in, in bulk... it tends to be bottles, alcohol and closures all coming in separately. A lot of it is produced in Eastern Europe and put together in the UK. You do get the finished product smuggled in too, but haven’t heard so much of that in recent years – it tends to be the large scale bottling plant.”*
- 134 Brandon Cook told us that from trading standards perspective, *“Counterfeit labels are often almost identical. Holographic duty marks are extremely useful – we’re in the process of distributing UV lights to help retailers identify what is and isn’t genuine product. Reading the consultation [on beer stamps], the intention is to use the tobacco type of stamp, which would be far too easy to counterfeit & wouldn’t have the benefits of a UV hologram, so I would urge the government to introduce a holographic stamp even if it’s more expensive.”*
- 135 David Dadds gave us this perspective of their efficacy, *“With spirits stamps, you can see a stamp counterfeited and put over a bottle, and see them very well embedded in a label. With individual tracing, we have contacted companies and found the product has been destined for markets outside the UK – it comes back stamps obliterated or new stamps over the top.”*

Impact on retailers:

- 136 One of the key benefits of spirits stamps was explained in terms of the visibility spirits stamps bring. It is immediately evident if a bottle is stamped, and so licit. Exemptions are limited to bottles 35 cl or under, or less than 30% alcohol, so there is little scope for retailers, wholesalers or distributors to be confused by what should or shouldn’t bear a mark. We did, however, learn of one case of a trading standards officer seizing unmarked spirits, albeit they were clearly labelled ‘millennium’ – ie six years prior to introduction of the stamps.



⁴⁴ Andy Leggett Q46
⁴⁵ Graham Bateman Q78

Precedent:

- 137 We heard one line of thinking that the exemption for smaller bottles of spirits might set a precedent for beer stamps on the basis of proportional cost – that the cost of adding a fiscal mark was disproportionate to the value of the bottle. As one witness pointed out: *“if there’s 37.5% it’s probably worth £6, which may be ok, but 15p to put a stamp on a bottle at £1 is not.”*⁴⁶
- 138 Andy Leggett told us that he didn’t *“see it as setting a legal precedent. Any scheme we design will be subject to a proportionality test. I don’t think the 35cl exemption for spirits affects that. [Fiscal marks for beer] will stand on its own merits of whether it’s proportionate or not... is the cost proportionate to the outcome we’re trying to achieve? Whilst that’s the outcome of the process for spirits stamps, we don’t see it as constraining us or freeing us one way or another.”*⁴⁷
- 139 Our conclusion is that there is no clear evidence of the direct impact of tax stamps on spirits diversion fraud, but they have clearly not delivered a knock-out blow in the fight against counterfeit product. This latter point is a consideration, as whilst we understand counterfeiting is not a major problem in the illicit beer market at present, we are aware how quickly one form of fraud can displace to another. And as Andy Leggett said *“anything can be counterfeit – bank notes, duty stamps”*.⁴⁸
- 140 **Our key finding from the case of spirits stamps is the importance of establishing an agreed understanding of the nature and scale of the issue before intervening, to ensure the measure is targeted and proportionate, and to enable the impact to be realistically assessed after. We also note that the relative cost of stamps to product value is of a very different order in the case of spirits to that of beer, and that the exemptions in spirits are extremely marginal, thus weakening the relevance of the spirits stamp experience to the case under consideration.**

The proposed 200,000 hl exemption

- 141 HMRC explained to us that the 200,000 hl exemption for beer fiscal marking had been proposed *“as a possible way of exempting products not susceptible to fraud, as a trigger for discussion – if we’re trying to exempt, how might we do it?”*⁴⁹
- 142 We were pleased to hear this, as the logic of an exemption set by brewery output was questioned, convincingly, by several witnesses. For example, Tom Falcon of Shepherd Neame was vehement that: *“the exemptions and carve outs aren’t logical – the consultation is pointing at the larger packaged brands whilst coming up with a 200,000hl brewery output and the two don’t follow the same logic. So you could have a 200,000 hl brewery putting out one single Stock Keeping Unit (SKU), or you could be like us, a 300,000 hl brewery producing 25 different products, the largest of which in package would be 50,000 barrel, or 60-70,000 hl. The logic can’t be justified.”*⁵⁰
- 143 The question is, if not 200,000 hl, what basis if any should be used for exemptions? It became clear from our inquiry that any carve out needs to include certain protections:

⁴⁶ Graeme Colquhoun Q136 ⁵⁰ Tom Falcon Q113
⁴⁷ Andy Leggett Q178
⁴⁸ Andy Leggett Q61
⁴⁹ Andy Leggett Q178

For small brewers:

- 144 SIBA, representing brewers under 200,000 hl, explained how critical it was that their membership was excluded from fiscal marking: *“it would be incredibly detrimental to the only growth sector of the industry”*.⁵¹
- 145 Keith Bott pointed out that for most SIBA members, exports are a *“tiny percentage of product but it’s a useful and growing area of business for small brewers”*, and *“if fiscal marks were introduced with no exclusions it would effectively close the export market for our members, because we’d need separate SKUs for each line. Whereas currently I can send someone in Denmark exactly the same labelled product as I have in the UK.”*⁵²
- 146 SIBA also expressed concern *“whether retail outlets will understand what they should be looking for and expecting from their suppliers. How this is dealt with is important as it could mean retailers only choose to buy products with fiscal marks so guaranteeing they were within the law – this would obviously affect our members”*.⁵³
- 147 This was echoed by retailers – as summarised by Kate Nicholls of ALMR: *“there will be harm to smaller suppliers, producers and wholesalers as uncertainty and complexity will mean retailers won’t be prepared to take the risk. Larger retailers will send the message down the chain to say don’t accept product that’s not marked if you can’t be certain, and face the risk of a criminal prosecution.”*⁵⁷ This consideration is addressed further below.

For importers & consumer choice:

- 148 As proposals stand, imports from any foreign brewer producing more than 200,000 hl would need to have fiscal stamps applied before entering the UK market. SAB Miller explained the complex logistics behind their imports of brands such as Peroni, and the fact that they need to build as much flexibility and simplicity as they can into their business to keep it competitive.
- 149 They told us that UK beer stamps would either necessitate separate production runs, or uneconomic labour-intensive manual application of tax stamps prior to UK import. The costs involved were still being quantified, but they had a sufficiently clear a picture of the added costs for Gary Haigh of Miller Brands to tell us: *“if introduced as proposed, fiscal stamps would result in the following brands being removed [from the UK market]: St Stephanus, Peroni Grand Reserva, Peroni Red, we’d have a close look at Pilsner Urquell, we’d stop supplying bottles to the Channel Islands and we’d stop supplying Peroni Nastro Azurro and Pilsner Urquell into the Republic of Ireland, simply because of the cost of running very short runs and the complexity of separate SKUs for two markets very close together.*
- 150 *“I think it would be the same for other importers. There are 2,200 imported brands in the UK and a lot of those – upwards of 2000 – would come under the same sort of pressure as our smaller brands described.”*⁵⁵
- 151 This point was reinforced by Graeme Colquhoun of Heineken: *“Take a brand like Dos Equis, small volume, made in Mexico – how would Heineken even with its resources launch a brand like that in the UK, as you’d have to make a special SKU in Mexico, pay the duty and bring it in. It’s very difficult to see how a small start-up brand could be launched. And for some companies their entire business is these small start-up brands – they’d be out of business.”*
- 152 Their argument was compellingly made and there are some clear implications under EU law relating to barriers to trade and free movement of goods, as well as for consumer choice. As Graeme pointed out: *“If it disproportionately affects imported beers to the point when even a company the size of Heineken can’t make an internal business case to launch a start-up brand from elsewhere in the EU, then it’s having a disproportionate effect. Proportionality is the nub of the law from a legal perspective”*.⁵⁶



⁵¹ Keith Bott Q141

⁵² Keith Bott Q146

⁵³ ibid

⁵⁴ Kate Nicholls Q149

⁵⁵ Gary Haigh Q124

⁵⁶ Graeme Colquhoun Q122

For exports:

- 153 With fiscal marks, any beer destined for export would either have to be produced in a separate run to product for the UK, or have its fiscal mark obliterated or removed. We heard from Graham Bateman, WSTA, that prior to the introduction of tax stamps, their SME members had been concerned about the deterrent this would prove to smaller exporters. Graham could provide us with no conclusive evidence as to whether this had been borne out in practice, but a very similar concern was raised by Shepherd Neame, on behalf of the family brewers:
- 154 *“The issue for us is that if we can find space on the label, yes we could put a physical mark on the back of the bottle but it’s the implications of that change that are huge. IFBB members are all trying to grow exports; we export a host of different types of products; for example a grocer like Lidl might ask us to produce four SKUs to go to France, Spain etc. That will cease to be viable if we have to do short runs with or without fiscal stamps on the back. All IFBB members will export some core SKUs but also a number of different premium bottled ales. [Fiscal marks will impact] these short-run beers, and excess stock from a promotion that may not have gone as well as we’d like, and our ability to take these and transfer to other markets would become unviable.”*⁵⁷
- 155 Tom Falcon quantified it: *“We’d be looking to reduce our export SKUs from 40 to about four. We currently export to 26 countries, and I don’t know how many that would reduce to.”*⁵⁸

For retailers:

- 156 Any exemption needs to be capable of being readily understood by everyone in the supply chain, and by enforcement officers, and by consumers. Simplicity and clarity are obvious aims. When asked, HMRC could not tell us how many different brands of beer are presently sold in the UK in bottle and can, but figures provided subsequently by the BBPA suggest some 1,100 brands out of an estimated total of 5,400 brands would need to be marked. Thus approximately 80% of the canned and bottled beer brands currently on sale in the UK would be exempt.
- 157 Many of these brands are imported, from all over the world, and it is unclear how knowledge of the size of their brewers could be obtained, let alone disseminated. Thirteen of the UK’s approximately 850 breweries would be obliged to add stamps, but of course production can vary from year to year, raising further potential complications both for retailers and brewers.
- 158 Representatives from the on and off trade pointed to the confusion this could cause, to the encyclopaedic knowledge licensees would need of what brands were produced by which brewers so as to ascertain whether they should or should not be marked, and as mentioned above, to the likely consequence for consumer choice if smaller operators were unwilling to risk their licences by stocking products of which they were uncertain.
- 159 Brandon Cook was asked how he thought retailers could be always aware of which beers should carry a mark and which did not need to. After joking that first officers would face a challenge to keep up to date, he added, *“I guess it will clearly have a slightly confusing effect on the retailer knowing what should and what shouldn’t ...they’ll know the headline brands but they won’t know the ones in between”*.⁵⁹
- 160 Keith Bott of SIBA proposed “a relatively simple solution” that on the face of it, appears to answer these concerns for UK beers. He suggested: *“all beer without the [fiscal] mark to carry information on the bottle simply saying it has been produced by a brewery producing less than 200,000 hl”*.⁶⁰ He explained that this would have no impact on their exports as they could sell the same stock at home and abroad. This does not help in the matter of imports, however, which could be placed at an even greater relative disadvantage to domestic products. It also does not help those brewers whose output fluctuates around the 200,000 hl mark, as they would be required to switch from one type of label to the other.

⁵⁷ Tom Falcon Q113

⁵⁸ ibid

⁵⁹ Brandon Cook Q89

⁶⁰ Keith Bott Q146

For enforcement:

- 161 Several witnesses explained their concern that fiscal marks, without adequate enforcement, would prove a costly and burdensome imposition on industry and ultimately consumers whilst not having any real impact on the underlying fraud. Effective enforcement is key to any intervention, and as mentioned above, Brandon Cook gave us the trading standards perspective that the black and white stamps proposed by HMRC “would be far too easy to counterfeit & wouldn’t have the benefits of a UV hologram, so I would urge the government to introduce a holographic stamp even if it’s more expensive.” Andy Leggett assured us, in respect of the wholesalers registration proposals, that HMRC would only propose the measure if they could commit to police it; a similar axiom clearly applies to any other measures, including fiscal marks.⁶¹

For proportionality:

- 162 HMRC are right to state proportionality is central to their assessment of any new measures, including fiscal marks. Andy Leggett told us: “On fiscal marks, it’s understood it’s the big issue for the industry – on costs, on proportionality and some of the practicalities – and we’re going to need to work through them.”⁶² As Miller Brands summed up: “Fiscal stamps are going to hit a business which is 100 times more complicated logistically than the spirits industry for a revenue opportunity which at best is about the same. Second, it’s restrictive against imports. And third, there will be an unintended and serious consequence for consumer choice, particularly for connoisseur beers – those consumed reflectively, responsibly, thoughtfully.”⁶³
- 163 Cost is clearly going to be central to any test of proportionality. Keith Miller, SAB Miller, explained “If a fiscal mark is applied on the packaging line within the label, in theory it’s comparatively cheap in terms of design, but it depends on the details of the fiscal mark. A 3cm by 1cm mark (as outlined in the consultation) is more difficult. [There are] practical problems about where you actually put it on some bottles where you would have to think about redesigning the label or even the bottle, which has massive cost and brand impact.
- 164 “There are also other costs to be factored in. If you import a pallet of Peroni from Italy, how do you know that the bottles are duty marked unless you open each case? Checking all bottles were duty paid would require all bottles to be removed from the case, increasing the risk of breakages. If one bottle breaks the case is a write-off. So that type of manual checking involves potentially massive costs.”⁶⁴
- 165 BBPA has been working on initial industry estimates of costs of the HMRC proposals for black and white stamps. But if HMRC were to switch to holographic stamps, as proposed by our trading standards witness Brandon Cook, BBPA estimates costs would rise to upwards of £500m. For black and white stamps they estimate one-off costs of £6m to £32m (depending on exemptions, costs of label design changes etc) with ongoing costs of £27m - £32m. We think it important that the industry works closer with HMRC in refining these cost ranges, as we took note there was incredulity from some witnesses about the direct continuing costs of labelling for the biggest UK brewers, given that the vast bulk of their product is made in the UK and sold in the UK with UK specific labelling. BBPA told us that until there is much more clarity and detail around how a system would work it is hugely difficult to assess costs.

Conclusion

- 166 The arguments we heard in favour of fiscal marks came from HMRC, from FWD and from the Association of Convenience Stores. Shane Brennan, ACS, told us: “Looking at the market we’re trying to close down, it’s in cheaply available well-known products. Customers are looking to buy the brands they know at bargain prices. If you’re introducing a duty stamp in that market, I don’t think there’s a problem... the product on the shelf will be stamped – a clear indication it’s paid duty. ... I’m not generally in favour of new burdens or bureaucratic process, but there’s a real and growing criminal problem that needs to be tackled, and there are ways to limit the burdens.”⁶⁵
- 167 This is the nub of the problem. Is it possible to limit the burdens? HMRC’s proposed 200,000hl exemption, with SIBA’s amendment, could limit the burdens on the smaller brewers but it would still hit, and hit hard, the export business of other brewers and severely restrict the number of imported brands on offer to UK consumers. According to the evidence it would also severely distort and disrupt the UK market.
- 168 We have considered some other options, but we believe they too would be likely to distort or foreclose the market, depriving domestic and other European producers of existing markets, and likely to face legal challenge under EU law.
- 169 We assume that the simplest option, for example, of requiring tax stamps to be applied to all beers, was rightly dismissed by HMRC when developing the present proposals, as disproportionate as well as politically contentious. At the other extreme, the proscribing of only those brands which presently feature in seizures, even if it survived legal challenge, would certainly lead to a cascade of displacement. HMRC would be playing a constant catch-up game with an ever increasing list of brands, with consequent costs for brewers and importers of beer and insuperable confusion for suppliers and retailers.
- 170 **In summary, we consider HMRC’s superficially simple proposal of extending fiscal marking from spirits to beer is extremely problematic. It would almost certainly cause detrimental change to the production and sale of UK beers and substantially inhibit the free entry of other European producers’ beers to the UK market. Beer drinkers would be deprived of much choice and would face increased prices, and producers would lose markets, including even those exempt. HMRC has told us the proposals hinges on proportionality and we consider the metrics on both sides of the equation are not good enough to make proper assessment – there is not an agreed measure of the fraud, of the fiscal benefits of this specific policy, of the costs of proper enforcement, or the costs to industry.**
- 171 **We consider the proposal to be premature. Our strong recommendation is that HMRC first embrace the other options outlined in this report, that EMCS is given time to prove its capabilities, and that a clear benchmark is set for assessing the success of these measures against an agreed estimate of the tax gap. HMRC should keep the proposal as a fall back for re-examination if the combination of other measures prove to fail, but much more work is needed on the proposal before a credible and confident decision to go ahead could be taken.**



⁶¹ Brandon Cook Q85

⁶² Andy Leggett Q176

⁶³ Gary Haigh Q124

⁶⁴ Keith Miller Q63

⁶⁵ Shane Brenna Q165

4.2 Restricting Duty suspense

- 172 Allied to fiscal stamps, HMRC is proposing to restrict movements in duty suspense for all fiscally marked beer.
- 173 Concerns were raised on behalf of the vast majority of UK brewers who contract their canning or their bottling that this would have severe consequences for their cash flow. We were thus reassured to hear from Andy Leggett that HMRC has no intention of restricting such movements while ownership of the product remains with the brewer.
- 174 Alan Powell told us of warehouse-keepers' concerns with the proposal: *"With spirits, you can move marked product in duty suspense – effectively, it's the release for consumption to the retail sector where duty is paid. Of concern to us is that if there were duty stamps for beer, with an associated restriction on duty suspense, it would cause a lot of problems for those businesses that trade legitimately in duty suspense and who benefit from the obvious cash-flow. Cessation of duty suspense for beer would cause major problems for those now operating warehouses. There's no need to restrict the supply chain in that way even if the product is stamped and such a measure may not be legal in EU law."*⁶⁶
- 175 The legality was also questioned by Gary Haigh of Miller Brands: *"You'd need to make sure that it wasn't anti-competitive. There are a variety of reasons why customers might want to use the drawback system or duty suspended. Our four largest customers – and we only have 10 customers out of 210 using duty suspended – take it for cash flow purposes."*⁶⁷

4.3 Supply chain controls

- 176 HMRC's consultation says that supply chain legislation has been effective in the tobacco sector, and *"in principle, similar legislation could also be effective in tightening controls over the supply of other high risk products such as packaged beer"*. It proposes this be introduced by requiring those supplying beer to:

"recognise their responsibility and take all reasonable steps to prevent fraud by:

- carrying out due diligence and reasonable care in relation to their customers by requiring the creation and maintenance of a written supply chain policy;*
- introducing a system to track and trace goods so that customer details and supply chain intelligence can be used to facilitate a joint approach between HMRC and brewers."*

Knowing your market and your customer

- 177 Keith Bott and Tom Falcon, representing the smaller brewers and family brewers respectively, told us that their supply chains are relatively short. They are often supplying direct to the end customer and tend to deal with more established wholesalers and distributors "who we know and trust". As Tom Falcon explained: *"We have to be careful and we're at the scale we can do it. For our ales, we have some unique SKUs for export – we know where the beer is going so if it appeared back on the market we'd know in a flash."*⁶⁸
- 178 For the larger brewers, we were provided (in confidence) by ABInBev with extracts from their supply policies, illustrating the breadth and depth of their due diligence. And we were told by Keith Miller, that *"within SABMiller we have values we live by, including corporate and social responsibility, we seek to comply with SEC rulings, have governance controls, anti-bribery rules, etc. The amount of value you could gain from selling through illicit or being complacent about the requirement to prevent it, would not be worthwhile to our worldwide reputation and the damage it could do. I'd be stunned if the other brewers weren't in the same situation in terms of governance."*⁶⁹
- 179 Keith also outlined some concerns about the wider implications of refusing to supply

customers: *"If a brewer had confirmed the validity of its immediate customer for duty unpaid stock, whilst volumes might seem high, at what point and for which customer does the brewer stop supplying? If a brewer simply turned an order down without reasonable grounds, he could potentially face a legal case. That's a challenge. Individually if they've done the validation checks they should be doing there's a limit to what they can know. For competition purposes they can't know our customer's customer."*⁷⁰

- 180 Gary Haigh explained Miller Brands' policy was to meet customers regularly. He said they met with their four big wholesale customers who receive product in suspense once a month, that they had agreed sales profiles with them, and if there is *"any material deviation from them we meet with them immediately to understand why. Normally due to a strong promotion or change in customer."*⁷¹
- 181 Heineken's process was outlined by Graeme Colquhoun: *"the first steps are to know your customers and make sure you're not supplying wrong routes to market, and second, where you see something you don't like you deal with it. We deal [duty suspended] with a very small number of customers – you can count them on one hand. We used to deliver to them in France but HMRC didn't like that so now we only deliver duty suspended to their HMRC approved bonded warehouses in the UK. When we deliver we tell HMRC what we're delivering – we're very transparent and have signed a concord with them about that."*⁷²
- 182 Graeme explained: *"We're aware of the commercial confidentiality concerns about customers not telling us who their customers are – it's their only protection against us dealing direct – so to try to get round that we ask KPMG to check they have legitimate customers. We've done it for all existing customers, and because of fears in this area we're really reluctant to take on any new duty suspense customers – it's a board level decision."*⁷³

Oversupply

- 183 HMRC's core thesis in relation to the leakage of duty suspended beer is that brewers "oversupply" – which is to say, sell more beer to customers in neighbouring countries than the level of legitimate demand there.
- 184 The brewers object that all they can possibly or legally do is to establish the probity of each customer and then supply or not as the evidence suggests, it being impossible for them to have any view of the overall level of all supplies being made by all brewers and wholesalers to a particular market, let alone a reliable view of whether that totality of supply might match some assessment of the totality of demand.
- 185 We have also seen a letter dated 5.7.2012 and sent by HMRC to a Mr T Thornton, a tax specialist, which says inter alia *"we had no independent estimates of UK beer demand on the continent so we estimated it using the data that was available"*. The letter goes on to explain that those data included a Euromonitor 2009 report and the 25.1.2012 NAO Report "Renewed Alcohol Strategy: A Progress Report". Later the letter adds *"I can therefore only conclude that HMRC has not produced a separate database which informs producers when they are oversupplying to Europe"*.

As we have already recommended, there is a clear and urgent need for an agreed methodology for assessing levels of demand on the continent and so the question of oversupply. We sympathise with the brewers and wholesalers that until there is, they face considerable difficulties in assessing whether any one order constitutes 'oversupply'. However, we also sympathise with all our witnesses who expressed frustration that beer is coming back duty unpaid and competing alongside their product duty paid. We call for fuller and closer co-operation by all players in this field to help develop the necessary metrics, as recommended in paragraph 56 above.



⁶⁶ Alan Powell Q109

⁶⁷ Gary Haigh Q128

⁶⁸ Tom Falcon Q115

⁶⁹ Keith Miller Q65

⁷⁰ ibid

⁷¹ Gary Haigh Q124

⁷² Graeme Colquhoun Q118

⁷³ ibid

Track and Trace

- 186 HMRC's proposals for track and trace have their origins in measures introduced to control counterfeit tobacco. However, they are not neatly translated across to beer. Keith Miller explained: *"Tobacco faces a very different set of circumstances – they suffer from counterfeiting, so up to 49% of worldwide duty loss is down to counterfeit product. It drives a number of things - the industry is looking to prove the authenticity of the product to the consumer – that it's been produced by them in a certain location on a certain day so it's legitimate. So there's an incentive to ensure they have a mechanism for proving authenticity, and investing hugely in new technology. But beer fraud is much further down the supply chain. In order to see whether a bottle has been diverted, you need to mark and record it at the start and record all 5.5 billion bottles in the UK through every level."*⁷⁴
- 187 A key issue is what is technically feasible, and at what cost. Gary Haigh told us that Miller Brands can *"track to first customer and trace back to batch. So if you give me a bottle I can find out where and when it was produced and who the first customer was. But we can't track through the whole process and I'm not aware of anyone who can other than likes of DHL – spirits can't."*⁷⁵
- 188 Tom Falcon explained Shepherd Neame could likewise track and trace at pallet level and at batch level, and that with individual bottles they can identify through deduction to batch, as with any product recall. However, to extend this through to the 6 billion units of beer per year in the market place would be a considerable undertaking. He explained, *"You'd need a unique bar code on each bottle, which would have to be ramped up to a unique encompassing bar code on each case, a unique code encompassing all the bottles in the case, and a unique code on each pallet. Which would all take systems in the warehouses, databanks to capture it, so HMRC could identify a particular bottle."* He estimated the cost for Shepherd Neame for such a system rolled out at case level *"would be about £350,000 and ongoing administration costs of £100,000 pa, which would push us out of the market."*⁷⁶ On probable costs, Keith Miller said: *"we can only say track and trace would be a massive cost, but I suspect the answer to consultation is that we don't know how much, given it would have to be developed from scratch."*⁷⁷

Conclusion

- 189 Beer is clearly leaking out of the legitimate supply chain at some point between breweries and intended customers. It is a long and complicated supply chain that needs to be secured at every step along the way – an issue addressed below in the warehouse registration proposals.
- 190 Whilst smaller brewers may know their customer's customer, larger brewers are hampered by competition issues. These competition issues can be worked around, to a degree, by using third party audit to ensure the same due diligence applies through the supply chain, and the evidence we heard convinced us that this is an issue the major brands take very seriously.
- 191 However, whilst we may have been convinced by the producers' supply chain controls, it is clear that some parties are not, and brewers should do a better job of publicly demonstrating they are not putting their heads in the sand. Everyone in the legitimate industry and enforcement clearly needs to raise their game.
- 192 **We recommend that the brewing industry produce a template good practice guide, and that HMRC work closer with brewers in sharing information about seizures of their product. From the evidence we heard, it is clear the process for feeding intelligence in could be better communicated, and that more feedback from HMRC could be beneficial to brewers looking to track back their supply chains. A significant change in the culture of collaboration by all parties appears overdue.**



⁷⁴ Keith Miller Q60

⁷⁵ Gary Haigh Q130

⁷⁶ Tom Falcon Q130

⁷⁷ Keith Miller Q62

- 193 With a real push to a co-operative approach, we consider the recommendations elsewhere in this report should, if enforced properly, obviate the need for more costly interventions such as track and trace.

4.4 Registration of wholesalers

- 194 HMRC's consultation document explains: *"At present there is no requirement for wholesale dealers, such as brokers, cash and carries, and retailers to be registered with HMRC to trade in alcohol products.... When inward diversion of goods occurs, illicit goods enter supply chains after the point at which excise duty would normally have been paid, and often the first person or business to take ownership of these goods is a wholesale dealer."*
- 195 The alcohol supply chain is licensed or registered end to end with the significant exception of wholesalers. In what James Bielby described as *"a rare example of business asking for more regulation"*⁷⁸, the FWD has proposed that this now be tackled via a registration scheme for dealers in alcohol.
- 196 James Bielby explained to us the proposal meant suppliers *"would be unable to sell in wholesale quantities without some sort of registration from HMRC – a form of licence"*. For the detail, he said FWD were in *"ongoing dialogue with them about it about how it would work in practice. But agreed in principle it's a good idea."*⁷⁹
- 197 Every witness we asked thought likewise – that in principle, it is a good idea. The only caveats entered were from UKWA, who mentioned not all their members may have thought through the implications, and the on and off sales retailers, concerned about the criminal penalties they could face if found guilty of stocking illicit beer; especially as at present, as we heard from both Brandon Cook and David Dadds, officers presently tend to use a review of a retailer's licence as the preferred sanction, since it is cheaper and easier, but the penalties are likely to be draconian.
- 198 The trade associations argued that if HMRC proceed with their proposals for registering wholesalers, and wholesalers are required to ensure their product is legitimate and duty paid, retailers should be expected only to ensure they are buying from a registered or licensed supplier to demonstrate sufficient diligence. As Shane Brennan of ACS explained: *"if you're sourcing from a legitimate wholesaler, we believe it's the wholesaler's duty to ensure they're supplying legitimate product and give customers necessary paperwork to be compliant"*.⁸⁰ This point was reinforced by BBPA and ALMR for proving on-trade due diligence, and summed up by Niki Hayward of NFRN: *"If retailers can prove they have purchased from a registered wholesaler they should be made free from liability under the law"*.⁸¹
- 199 **We agree. We recommend that HMRC's proposed sanctions against retailers found stocking illicit product are amended to ensure that a retailer can prove they have exercised due diligence by purchasing from a licensed wholesaler.**
- 200 The main debate we encountered concerned how best to keep the scheme simple and low cost, whilst also ensuring it is effective – in information provided to HMRC and in enforceability and sanctions – and consistent with other regulation. David Dadds helpfully suggested to us that licensing under the Licensing Act would be simpler than registration. *"Why go for a warehouse registration scheme through customs and excise when you have a licensing regime structure already? It would be relatively simple for a wholesaler to have a premises licence – call it a wholesaler licence – downscale the application and appropriate regulation so it's not bureaucratic; the responsible authorities could be the police, trading standards and customs and excise, and police and Trading standards are already in the mix. And refusal should be only on the basis of special circumstances – ie fairly automatic."*⁸² He explained the cost of such a licence would be around £37 for ten years.

⁷⁸ James Bielby Q28

⁷⁹ James Bielby Q23

⁸⁰ Shane Brennan Q167

⁸¹ Niki Hayward Q167

⁸² David Dadds Q93

- 201 He further suggested that it would be simple to create a new offence for retail licensees, that of buying from an unlicensed person, so that diligence could be shown by the examination of the dealer's personal licence and the recording of the number. This clearly would marginalise the unlicensed black market dealer, although displacement is to be expected.
- 202 When our predecessor Committee reported on its 1995 investigation, it commented *"At the same time the 'van trade' in smuggled excisable goods, and especially tobacco and beer, has been developing, in the process becoming more sophisticated and established. Hence, as distribution of smuggled beer ...is more widespread and better known, some of those who might initially have made their own shopping trips to Calais will choose instead to pay a modest premium to buy the same goods from a local smuggler. ...It was even attested by several witnesses that home delivery and shopping to order are now commonplace throughout Britain. As the network for the smuggling of beer has developed, so too has the level of more experienced criminal involvement..."* (Beer Tax Inquiry, HMSO, 1995 p xv, para 15)
- 203 HMRC must be aware that what can and has shifted over the years from an amateur to a professional distribution system could very well revert to "home delivery" at the end of the distribution chain, if the established route to the licensed shop was effectively choked off.
- 204 Andy Leggett told us the objective was to remove the power that fraudsters currently have to operate in the field and *"if licensing offers a better opportunity than registration, we will consider it."* He further agreed with us the importance of the scheme being backed up by an adequate compliance regime.⁸³
- 205 **From our initial analysis licensing, which would have the effect of sharing enforcement with local authorities (already responsible for enforcement of the Licensing Act) , does appear to have attractions over a registration scheme, whose effectiveness would be dependent on assurance or compliance visits. As we heard from retailers, loss of licence and so ability to trade, is a fierce sanction. We heard that an HMRC registration scheme had been successful in restricting the amount of oils frauds, via the Registered Dealers in Controlled Oils, but that it also comes with a sizeable commitment for staffing to achieve the compliance programme. Andy Leggett assured us HMRC would only propose it "if we could commit to police it", and we recommend these staffing costs are fully accounted and realistically considered when the relative merits of registration and licensing are weighed.**

4.5 Wine and other alcohol fraud

- 206 HMRC says that it believes wine duty fraud is significant in the UK, that the fraud is similar to beer in that it is a diversion fraud, and the fact that they have not got a tax gap estimate is *"not constraining us in looking at options and controls would work."*⁸⁴
- 207 FWD told us that their members had seen a decline in wine sales, for the big brands in particular, and they estimated the loss compared to beer was *"probably about half as much again on wine – ie £750m loss."*⁸⁵
- 208 Alan Powell gave us some anecdotal evidence of *"inquiries about people wanting to get involved with the movement of wine to the near continent, and it's always the same brands – you have to ask why new world wine is being sent to France where there's no market for it. It may very well be approaching the scale of beer in terms of diversion."*⁸⁶ Andy Tighe said that BBPA could *"only go by the level of seizures, which are the same for wine as for beer in duty terms, based on a lot less intelligence around wine which is in theory a growing market, more profitable per litre, less brand loyalty etc. And wine would become even more attractive if these measures were introduced for beer."*⁸⁷

- 209 Several witnesses said that for this reason, beer fraud should not be looked at in isolation. Andy Leggett told us that HMRC were working on new methodology with the Wine and Spirit Trade Association to get to a reliable wine gap estimate, and that if the current consultation responses lead HMRC to believe that fiscal marks would be effective for beer, they would consider something in parallel for wine. *"The first question the Minister would ask is will this work for wine? Also, the licensing for wholesalers option works as well for wine as for beer."* This point was repeated by other witnesses.
- 210 We heard no evidence to counter that view that there is an illicit market in wine, that it is on a higher value product, and so there are potentially significantly greater gains to be made by HMRC in successfully closing the tax gap. Given the predilection of fraudsters to go for easy targets, we consider any attempts to close off beer fraud should be accompanied by measures to stop displacement to wine, cider and, indeed, reversion back to spirits fraud. Moreover, increasing regulatory burdens on beer while ignoring wine seems unfair. Many of the measures we have proposed in this report will close loopholes exploited by fraud for wine as much as beer or any other illicit alcohol, re-emphasising the importance of tackling these issues as a priority, and before revisiting fiscal marking for beer.



⁸³ Andy Leggett Q186

⁸⁴ Andy Leggett Q39

⁸⁵ James Bielby Q32

⁸⁶ Alan Powell Q106

⁸⁷ Andy Tighe Q8

⁷⁸ James Bielby Q28

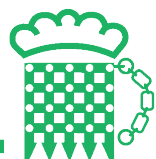
⁷⁹ James Bielby Q23

⁸⁰ Shane Brennan Q167

⁸¹ Niki Hayward Q167

5 CONCLUSION

- 211 We learnt much in the course of our inquiry. HMRC and the brewing industry are closer than at first appeared in agreeing the size of the problem to be tackled, but further impetus is needed to iron out disagreements in methodology. We consider an agreed measure critical to assessing the proportionality of regulatory response.
- 212 Legislative intervention is not the only answer. Everyone can and should play a part in helping to stamp out this corrosive fraud. This partnership requires improved communication and co-operation between HMRC and other EU authorities, Trading Standards and Border Force, and with brewers, retailers and suppliers. Information exchange has to be improved, and to be an exchange not an inconclusive one-way flow.
- 213 Proposals for registering wholesalers have met with wide support; those for new supply chain technology and fiscal marks considerably less so. The onus is now on the Minister to ensure government's response is effective, targeted, and above all proportionate. The brewing industry cannot afford the government going too far, too fast with red tape, and in our view the UK's health cannot afford anything that encourages a switch from lower alcohol products like beer to higher alcohol products.
- 214 At one point in our inquiry, we almost concluded that this is a relatively risk free area of fraud and crime – a suggestion which would have widespread social ramifications. Collectively we need to tackle a core problem. As HMRC told us, *"If there are better options we need to hear them out."*⁸⁹ We trust this inquiry has.



⁸⁹ Andy Leggett Q66

6 INQUIRY FINDINGS AND RECOMMENDATIONS

The scale and nature of beer duty fraud

- 1 **The view of this Panel is that if duty levels in the UK were closer aligned to those in neighbouring states, the fraudsters' financial incentives and illegal profits would be significantly reduced.**
- We also ask the Treasury to make public its modelling of the impact of relative duty levels on fraud, so that assessments can be made of how tax changes can impact on levels of fraud and how close UK beer duty rates are to the tipping point where extra revenue raised is off set by increased fraud. (paragraph 30)
- 2 **The amount of duty fraud in drawback may be relatively small in percentage terms, but if HMRC's estimates of the tax gap are correct it could amount to £40m pa. All loopholes need to be tightened to disrupt fraudsters' business. It is important that HMRC does not dismiss the opportunities duty drawback provides to smugglers, or overlook the need to tighten checks in the system. (paragraph 25)**
- 3 **A robust measure of the scale of fraud is required as the basis for any decision on new market interventions. We consider this essential both to a proper assessment of the proportionality of any intervention, and to judging its impact. (paragraph 47)**
- 4 **A step change in collaboration between HMRC and industry is necessary to establish an agreed methodology for measuring the beer tax gap, and to establishing the flow of data and information to size it. We suggest that an independent and technically authoritative body, such as the National Audit Office, lead work in this area. (paragraph 56)**
- 5 **Those needing to understand and interpret market trends, including HMRC and the trade associations, would benefit from a better sharing of data. The Wine and Spirit Trade Association has done some work in this area as one of their measures to combat spirits fraud and we urge the trade associations to investigate what might be transferable, and helpful, to combatting beer fraud. (paragraph 65)**
- 6 **There is a clear and urgent need for an agreed methodology for assessing levels of demand on the continent and so the question of oversupply. We call for fuller and closer co-operation by all players in this field to help develop the necessary metrics. (paragraph 185)**

Enforcement strategy

- 7 **HMRC's declared strategy is to target the organised criminal gangs behind beer duty fraud. Our criticism is not that the strategy is wrong, but that it is ineffective. Effective enforcement requires effective co-operation and improved partnership is needed between HMRC, Trading Standards and Border Force and improved communication and collaboration between HMRC and all parts of the industry and supply chain. We urge the relevant bodies together to identify and to resolve the present weaknesses. (paragraph 34). We want to see clear and explicit trading standards powers to seize and pursue action on non-duty paid alcohol in cooperation with and on behalf of HMRC (paragraph 119)**
- 8 **Everyone in the supply chain has a role to play in enforcement through feeding information in to HMRC. In return, they need to know what information is useful, what is acted on and with what result. HMRC needs to do a better job of feeding back, and working with the trade associations on improved communication to their members. (paragraph 123)**
- 9 **Enforcement is central to discussion of the options for change. There is little point introducing new measures without guarantee of proactive enforcement, and without this**

assurance, businesses may end up bearing possibly significant additional cost to no avail. Enforcement is also critical to establishing clear evidence of the lower and higher risk supply chains, and to targeting those accordingly. (paragraph 41)

- 10 This is a relatively low risk fraud for the organised criminal gangs behind it. But the widespread trading in black market goods which has gone unchecked undermines lawful society and sets an ominous precedent. The present implicit message to society is that defrauding the state is acceptable and is even becoming the normal standard of behaviour. (paragraph 78)

Enforcement at Dover

- 11 We propose that a proportion of proceeds seized, be it impounded trucks or duty reclaimed, be earmarked for reinforcing HMRC's enforcement operations. The precedent is established for the Police with the Proceeds of Crime Act and this approach should now be extended for proceeds from illicit seizures by enforcement officers – at Dover and other ports, by local Trading Standards Officers, and by HMRC's specialist intelligence teams. (paragraph 87)
- 12 There is much creative work to be done at and in the vicinity of Dover in disrupting fraudsters' business. We are much encouraged by HMRC's willingness to set aside past assumptions, which we strongly encourage, and we are also persuaded that the beginnings of a new way of more collaborative working is now in train. We intend to review progress in due course. (paragraph 95)

EMCS & ARC numbers

- 13 EMCS is in place in outline but there is considerable scope to improve and develop it further to counter duty fraud. We urge the Government to be bold in testing its boundaries with the Commission. (paragraph 101)
- 14 Hauliers of excisable goods in duty suspense should display their ARC in a machine-readable form in the windscreen of their vehicle. We would like to see this made mandatory, although we understand there are legal questions about creating 'border controls' within the Single Market. If display of ARC numbers cannot be made a requirement, it should become a voluntary code for hauliers and HMRC should explore a code of practice with bonded warehousekeepers and any retailers receiving duty suspended goods, for display of ARC numbers to become a part of their normal supply chain due diligence. (paragraph 111)

Fiscal Marks

- 15 We consider HMRC's superficially simple proposal of extending fiscal marking from spirits to beer is extremely problematic. HMRC has told us the proposal hinges on proportionality and we consider the metrics on both sides of the equation are not good enough to make proper assessment – currently there is not an agreed measure of the fraud, of the fiscal benefits of this specific policy, of the costs of proper enforcement, or of the costs to industry. (paragraph 170)
- 16 We consider the case for fiscal marks to be premature. Our strong recommendation is that HMRC first embrace the other options outlined in this report, that EMCS is given time to prove its capabilities, and that a clear benchmark is set for assessing the success of these measures against an agreed estimate of the tax gap. HMRC should keep the proposal as a fall back for re-examination if the combination of other measures prove to fail, but much more work is needed on the proposal before a credible and confident decision to go ahead could be taken (paragraph 171)

Supply Chain controls

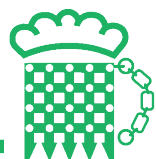
- 17 We recommend that the brewing industry produce a template good practice guide on supply chain due diligence, and that HMRC work closer with brewers in sharing information about seizures of their product. A significant change in the culture of collaboration by all parties appears to overdue. (paragraph 192)
- 18 With a real push to a co-operative approach, we consider the recommendations elsewhere in this report should, if enforced properly, obviate the need for more costly interventions such as track and trace. (paragraph 193)

Registration of wholesalers

- 19 We recommend that HMRC's proposed sanctions against retailers found stocking illicit product are amended to ensure that a retailer can prove they have exercised due diligence by purchasing from a licensed wholesaler. (paragraph 199)
- 20 From our initial analysis licensing appears to have attractions over a registration scheme, whose effectiveness would be dependent on assurance or compliance visits. We recommend staffing costs are fully accounted and realistically considered when the relative merits of registration and licensing are weighed. (paragraph 205)

Wine duty fraud

- 21 There are potentially significant gains to be made by HMRC in successfully closing the wine tax gap. Given the predilection of fraudsters to go for easy targets, we consider any attempts to close off beer fraud should be accompanied by measures to stop displacement to wine, cider or indeed back to spirits fraud. (paragraph 210)



APPENDICES

LIST OF WITNESSES

First Hearing Tuesday 22 May 2012: Questions 1 - 38

- James Bielby, Chief Executive, Federation of Wholesale Distributors
- Andy Tighe, Director of Brewing, British Beer and Pub Association

Second Hearing Thursday 24th May 2012: Questions 39 – 66

- Andy Leggett, Deputy Director, Alcohol, Tobacco and Gambling Taxes, HMRC
- Keith Miller, Group Indirect Tax Manager, SAB Miller

Visit to Dover Wednesday 30th May 2012

- Rob Meredith, Head of Supply Chain, P&O Ferries Logistics
- Rapinder Kaur, Tax Manager, P&O Ferries Group
- Tom Driscoll, Warehouse-keeper, P&O Dover
- Kayti Wellard, Border Force Senior Officer, Revenue Fraud Detection Team, BF South
- Alison Anchor, HO, RFDT
- Angela Morphet, HO, RFDT
- Carole Upshall, Director, BF Detection South
- Paul Booth, Assistant Director, BF Dover

Third Hearing Wednesday 13th June 2012: Questions 77 - 109

- Graham Bateman, Deputy Director, Gin & Vodka Association at the time of introduction of tax stamps for spirits, and now Spirits Director at the Wine & Spirit Trade Association
- Brandon Cook, Trading Standards Institute lead on alcohol tax Evasion, Trading Standards Manager, Community Services, Social Care & Health, Staffordshire County Council
- David Dadds, Solicitor Advocate and Barrister, David Dadds Solicitors
- Alan Powell, Consultant, representing the United Kingdom Warehousing Association

Fourth Hearing Thursday 14th June 2012: Questions 110 - 140

- Keith Miller, Group Indirect Tax Manager, SAB Miller
- Tom Falcon, Production and Distribution Director, Shepherd Neame, but also speaking for the 37 member companies of the Independent Family Brewers of Britain
- Graeme Colquhoun, Company Secretary and Head of UK Legal, Heineken UK
- Gary Haigh, Managing Director, Miller Brands UK

Fifth Hearing Thursday 21st June 2012: Questions 141 - 175

- Keith Bott, Chairman, Society of Independent Brewers
- Kate Nicholls, Strategic Affairs Director, Association of Licensed Multiple Retailers
- Brigid Simmonds, Chief Executive, British Beer & Pub Association
- Shane Brennan, Public Affairs Director, Association of Convenience Stores
- Niki Haywood, Public Affairs Manager, National Federation of Retail Newsagents

Sixth Hearing Tuesday 26th June 2012: Questions 176 – 216

- Andy Leggett, Deputy Director, Alcohol, Tobacco and Gambling Taxes, HMRC
- Andy Tighe, Director of Brewing, British Beer & Pub Association

GLOSSARY

ACS	Association of Convenience Stores. Trade association representing more than 33,500 local shops.
ACTSO	Association of Chief Trading Standards Officers. Represents the views of local authority trading standards services and seeks to influence trading standards policy issues on a national basis.
ALMR	Association of Licensed Multiple Retailers. Trade association representing modern bar and pub restaurant operators. Its 160 member companies operate over 13,000 pub, bar and casual dining outlets, employing 350,000 people
APBPG	All-Party Parliamentary Beer Group – see inside front cover
ARC	Administrative Reference Code. The unique reference number issued by the EMCS system to authorise a duty suspense movement of excisable goods within the EU.
BBPA	British Beer & Pub Association. Trade association representing Britain's brewers and pub companies. Its members account for some 96% of beer brewed in Britain today, and own more than half of the nation's pubs.
Border Force	Home Office agency. Protects the UK border, and is one of the largest law enforcement agencies in the UK with 23,500 staff - including more than 9,000 warranted officers - operating in local communities, at our borders and in about 130 countries worldwide.
CAMRA	The Campaign for Real Ale. An independent, voluntary organisation campaigning for real ale, community pubs and consumer rights. CAMRA has 141,096 members across the world, and has been described as the most successful consumer campaign in Europe.
EMCS	Excise Movement and Control System. An EU-wide electronic system for the control of duty suspense movements of excisable goods.
EU	European Union
FWD	Federation of Wholesale Distributors. Trade association for UK wholesalers operating in the grocery and foodservice markets supplying independent retailers and caterers. Its members manage the distribution of goods around the UK with a total value of about £25 bn.
HMRC	Her Majesty's Revenue and Customs



KPMG	KPMG in the UK is a leading provider of professional services including audit, tax and advisory.
LGA	The Local Government Association. The national voice of local government with a mission to support, promote and improve councils.
MS	EU Member States. The 27 members of the European Union.
NAO	National Audit Office. Scrutinises public spending on behalf of Parliament, with three strategic priorities: informed government, financial management and reporting, and cost effective delivery.
NFRN	National Federation of Retail Newsagents. Trade association representing over 16,500 independent news and convenience retailers in membership throughout the UK and Ireland.
ONS	Office of National Statistics. ONS is the UK's largest independent producer of official statistics and the recognised national statistical institute of the UK.
SIBA	The Society of Independent Brewers. Trade association for the independent UK brewing sector.
SKU	Stock Keeping Unit. A single pack type, so each beer brand might be produced in several SKUs, such as can and bottle, and with labels in different languages or bearing different information for different markets.
TSI	Trading Standards Institute. The professional and standards body for trading standards practitioners.
UKWA	United Kingdom Warehousing Association. The UK's only trade association for warehousing and logistics. Its members are companies that operate a warehousing or distribution facility.
WSTA	Wine & Spirit Trade Association. Trade association for the wine and spirit industry, representing over 340 companies producing, importing and selling wines and spirits, including major retailers, brand owners and wholesalers, fine wine and spirit specialists, and logistics and bottling companies.



