

Tobacco Manufacturers' Association

Response to HMRC Consultation on *Sanction to Tackle Illicit Tobacco: A Discussion Document*

31 August 2015

Introduction

The Tobacco Manufacturers' Association (TMA) represents the views of its member companies when communicating with the UK Government, regional and local authorities and other stakeholders on tobacco-related issues, such as the illicit trade in tobacco products, youth access prevention and taxation. The TMA's members are British American Tobacco UK Ltd, Imperial Tobacco Ltd and Gallaher Ltd (a member of the Japan Tobacco Group of companies).

Background

The TMA and its member companies have long been committed to reducing the size of the illicit tobacco market in the UK. The TMA works closely with Government stakeholders, particularly HMRC, and other partners, such as the Scottish Anti-Illicit Trade Group, in order to tackle the illegal tobacco trade. The TMA offers its stakeholders in Government access to up-to-date intelligence; it provides partners with on the ground industry resources; and it runs anti-illicit trade campaigns – to raise public awareness in airports during the summer holiday season, for example.

The TMA welcomes this consultation on sanctions and believes that it is essential for the Government to introduce appropriate deterrents to prevent the growth and encourage the decline of the illicit tobacco market. The scale of the non-UK duty paid (NUKDP) tobacco market remains sizeable. In 2012/13, 54% of the total amount of tax lost on excisable goods as a result of NUKDP consumption was due to tobacco.¹ HMRC estimates that the illicit tobacco trade cost the Exchequer £2.1 billion in 2013/14.² TMA estimates demonstrate NUKDP consumption cost the retail sector as a whole more than £5 billion in lost sales in 2014.³

Earlier this year, the TMA conducted a survey of more than 12,000 UK smokers.⁴ This survey received input from HMRC and other stakeholders. Respondents were asked a number of questions about non-UK duty paid product. The findings from this survey are outlined below.

- 29% of adult smokers that admit to buying non-shop tobacco products do so from non-shop sources, including 'abroad', 'friends and family', 'in the street' and in 'pubs'.
- 19% of adult smokers are aware of illicit tobacco being sold in their area.
- 69% of smokers do not believe that existing legal deterrents are sufficient to dissuade or prevent people from selling illicit tobacco products.

¹ Measuring Tax Gaps - 2014 Edition

² Measuring Tax Gaps - 2014 Edition

³ TMA Regional Non-UK Duty Paid Loss Estimates

⁴ TMA Smoker Survey 2015

Sanctions and Enforcement Issues

HMRC has an extensive array of sanctions at its disposal that can be used to penalise those involved in the illegal tobacco trade at every level. The TMA believes that these sanctions are, by and large, sufficient and appropriate – though they could be strengthened in a number of areas, which we set out below. However, sanctions can be effective only if they are enforced consistently. The TMA believes that this is not the case at the moment for three principal reasons: enforcement agencies are not properly resourced; there is little central co-ordination of national efforts to combat illicit trade; and local tobacco control agendas have overtaken pragmatic considerations, which has politicised enforcement of the law in regard to illegal tobacco.

- **Needless politicisation:** Gradually, efforts to tackle the illegal tobacco market in the UK have been taken over by anti-tobacco activists and lobby groups, who are seeking to prevent the tobacco industry from helping local authorities' attempts to reduce illicit consumption. The most striking example of this is the Local Government Declaration on Tobacco Control (LGDTC), which is a voluntary statement of intent made by councils not to engage with the tobacco industry.

The TMA took legal advice on the LGDTC, which determined that it was not, as stated by its advocates, legally binding and did not prevent co-operation on issues such as illicit trade, which the TMA sent to all local authorities in the UK. In late 2014, the Communities and Local Government Minister stated that "there may be legitimate operational reasons for local authorities to deal with the tobacco industry, such as action by trading standards to tackle the illicit tobacco trade."⁵ Despite this guidance, around 80 signatory local authorities are unwilling to work with the tobacco industry. This attitude will hinder attempts to reduce the size of the illegal market in the UK.

- **Poor co-ordination:** Trading Standards agencies have an important role in tackling illegal tobacco in the UK. However, they are not subject to any form of centralised control or co-ordination. The inconsistent level of effectiveness that exists between Trading Standards agencies in different parts of the country is partly the result of the lack of a holistic strategy for tackling illicit tobacco.

The TMA believes that the formation of a Cross-Ministerial Anti-Illicit Trade Group, as highlighted in the latest HMRC/Border Force tobacco smuggling strategy document⁶ should be expedited and must be given, as part of its remit, the power to co-ordinate the activities of Trading Standards agencies. This will improve the Government's ability to pursue, find and punish illicit traders.

- **Managing resources:** Trading Standards resources have come under considerable pressure in recent years with a reported 40% cut in staff over the period 2010-2016. Therefore, we question Trading Standards ability to commit to tackle illegal tobacco effectively in light of diminishing resources. The TMA welcomes the Chancellor's announcement in the Summer Budget 2015 that the Government will make additional resources available "for HMRC to tackle the organised crime gangs behind the illicit tobacco and alcohol markets."⁷ However, these extra resources

⁵ <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2014-11-11/214200/>

⁶ Tackling illicit tobacco: From leaf to light.

⁷ [Summer Budget 2015](#)

must be managed responsibly and effectively. This can only be done in the context of a nationally co-ordinated anti-illicit trade strategy that makes the fullest use of public/private partnerships.

Consultation Questions: TMA Response

1. Do you think that the current financial penalties reflect a proportionate response to individuals and businesses smuggling tobacco into the UK for their commercial benefit?

No, as the financial penalties issued in many cases are at the lower end of the available scale. Consumption of illicit product imposes significant costs on taxpayers and retailers. The TMA believes that the financial penalties for illicit traders should reflect the scale of the costs illegal consumption imposes on the taxpayer and retailers.

2. Do you consider penalties are currently set at appropriate levels? If not, do you think that we should legislate to: increase penalties; introduce a sliding scale depending on the volumes of product involved; apply increased penalty levels for those who repeat the offence?

The TMA believes that the penalties levied should be the maximum level allowed. The TMA also believes that sanctions could be more effective in targeting recidivists. Financial penalties should certainly be applied to reflect the serious consequences of illicit trade. Non-financial penalties should be extended as set out below.

HMRC has the power to prohibit retailers convicted of selling illicit tobacco products from selling any form of tobacco product for six months, but TMA does not know how on how many occasions this has occurred. This should be applied to those organised criminals convicted of trafficking illicit goods. For each of these categories, the penalties should be extended and enforced as set out below. These sanctions would form part of a new *zero tolerance* approach to tobacco fraud.

- For the most serious offenders, an immediate and absolute prohibition from selling tobacco products should be applied.
- For less serious offenders a sliding scale of prohibition periods should be applied, depending on the amount of illegal product recovered. However, the minimum ban for any offender should be set at one year.

3. Should we consider removing the need for HMRC to be able to demonstrate culpability, e.g. a full penalty applies for being in possession of illicit product regardless of whether this was deliberate evasion?

Yes. Although, this should not be implemented alone; it should be accompanied by an education strategy that informs wholesalers, retailers and hauliers about illicit product, on the one hand, and the law surrounding illicit product, on the other. HMRC may also wish to consider reviewing the burden of proof, whereby an individual in possession of the product is required to demonstrate that their possession is legal.

4. How do you think we can better deter repeat offenders?

The TMA believes that the best way to deter recidivists is to institute a *zero tolerance* policy for organised criminals that traffic and retail illicit tobacco products. Repeat offenders should be prohibited from selling tobacco products of any kind for an indefinite period of time and subject to increasingly stringent financial and custodial penalties. This approach is in line with academic research on the effectiveness of sanctions on recidivists. For example, Winand Emons, Professor of Economic Theory at the University of Bern, found the following.

“When the benefit from the offense is high, sanctions that increase with offense history are optimal; when the benefit is low, decreasing sanctions minimize enforcement costs. When the benefit from the act is high in relation to the agents’ wealth, a high probability of apprehension is necessary to deter. With a high probability of apprehension, raising the sanction for the second offense at the expense of sanction for the first offense makes being honest very attractive.”⁸

It is also important that financial and non-financial penalties are able to be employed consistently across the UK. This means that a coherent national approach to tackling the illegal tobacco market must be embraced, which includes all of the relevant stakeholders. Finally, information about the impact of the illegal tobacco trade should be provided to both repeat offenders and the public at large. This campaign should emphasise that it is not a victimless crime.

5. Do you think that there is a case to lower the current threshold (£25,000) for the provision to publish details of those evading duty in civil cases involving tobacco fraud?

Yes.

6. Are there other activities concerned with the illegal possession or sale of tobacco that you think should attract civil penalties?

No further comment.

7. With reference to the examples of sanctions in section 3 above, do you wish to suggest other financial penalties or types of sanction, i.e. non-financial penalties that you think we should introduce for tobacco evasion?

No further comment.

8. What are your views on ‘on the spot’ fines – potential benefits and drawbacks?

The TMA is not opposed to the introduction of any new forms of penalty that will help to reduce the illicit trade in tobacco products. However, the TMA firmly believes that new sanctions should be grounded on evidence. Evidence about the effectiveness of ‘on the spot’ fines is mixed. In 2011, Keep Britain Tidy conducted research into the effectiveness of fixed penalty notices as a deterrent to littering. This research concluded that although fixed penalty notices altered litterers’ behaviour in the short-term, they did little to foster positive long-term behaviour change.⁹ As part of the current review process, HMRC should consider which of the available sanctions has been

⁸ http://www.usc.edu/schools/business/FBE/seminars/papers/AE_4-30-04_EMONS-paper1.pdf

⁹ The Effectiveness of Enforcement on Behaviour Change: Fixed Penalty Notices.

effective in the past and which has not before introducing new types of penalty. Consideration should also be given to whether an 'on the spot' fine would be appropriate as each case is likely to involve a different scale of fraud.

9. How do you think 'on the spot' fines should work in practice?

No comment.

10. If introduced, what further action would you think we should take if people refuse to pay such fines when levied in the UK or at the border?

If such fines are not paid immediately, they should be increased by half and then doubled if they are not paid within 21 days, as is currently the case with littering. Subsequent avoidance should be pursued through the court system.

11. What are the benefits of and obstacles/drawbacks to 'on the spot' fines?

Clearly the benefit is the immediacy of the punishment administered. However, the potential obstacles/drawbacks are twofold. As stated above, research suggests that 'on the spot' fines do little to foster positive long-term behaviour change in offenders. This could make such sanctions largely ineffective. Moreover, the Royal United Services Institute (RUSI) drew attention to the scale of the profits made by illegal tobacco traders in a recent report.¹⁰ Therefore, if an 'on the spot' fine is not levied at a sufficiently high rate, it will not act as a deterrent to illicit traders, who often make significant profits from their activities.

12. What are your views on the criminal sanctions described above?

The TMA is satisfied that the custodial powers available to the courts are appropriate. As stated above, the TMA believes that the financial sanctions for those involved in the illegal tobacco market need to be increased and other, new non-financial penalties should be explored.

13. Do you believe that they are proportionate to the nature of the criminality behind the fraud?

The TMA considers the custodial features of the current system to be proportionate to the nature of the criminality behind tobacco fraud in most instances, though sentences could be increased to reflect the participation of serious and organized crime gangs in the illegal tobacco trade. However, the financial and non-financial sanctions (addressed immediately above) require reform if they are to reflect the scale of the impact of tobacco fraud.

14. Can you suggest additional activities specifically related to tobacco fraud which should attract a criminal sanction?

No comment.

15. Can you suggest how we could increase the deterrent effect of sanctions on particular types of offender?

¹⁰ On Tap: Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK.

Of the 12,000 smokers surveyed in the TMA's 2015 poll, 69% think that existing legal deterrents are not sufficient to dissuade or prevent people from selling illicit tobacco products; 74% do not consider the economic deterrents to be conducive to this end; and 77% believe that the social deterrents are insufficient for this purpose.¹¹ Clearly, HMRC needs to consider what it can do to increase the effect of these types of sanctions.

16. Are there any specific conditions that you think we should attach to Serious Crime Prevention Orders?

No comment.

17. Do you have any views on the potential use of criminal cautions to deal with tobacco offences?

No comment.

18. Do you have any suggestions for how HMRC and Border Force in partnership with other enforcement agencies can strengthen its attack on the criminality behind the fraud and deter participation in it?

The Government should attempt to depoliticise efforts to tackle the illicit trade in tobacco products as a matter of urgency. This needless politicisation is harming attempts to reduce the size of the illicit market, by preventing the appropriate stakeholders from working together in order to enforce the law. The Government must do more to emphasise to local authorities that public/private partnerships between councils and companies are the best way to counter the spread of illegal tobacco products. The Government should issue clear guidance to councils, which indicates what best practice looks like in this area. HMRC and other departments have the opportunity to lead by example, by including tobacco manufacturers in the newly established Cross Ministerial Anti-Illicit Trade Group.

The TMA would like to emphasise once more that the Government needs to improve co-ordination between the central departments responsible for enforcing illicit trade legislation. Relationships between central and local government also need to be better developed in order to ensure that a comprehensive nationwide strategy for reducing the scale of the illicit market is put in place and is workable. This last point will require HMRC or the Cross Ministerial Anti-Illicit Trade Group to allocate sufficient resources to enforcement agencies, such as Trading Standards, so that they are properly equipped to carry out their job. For example, where an offence is related to illicit tobacco, funds recovered through the Proceeds of Crime Act (2002) could be hypothecated into tobacco enforcement activities and allocated to the geographical areas most in need of supplementary resources.

Finally, there is a clear relationship between tax and illicit trade. In the last Parliament, the total tax burden on a pack of twenty cigarettes increased by more than forty per cent. This created significant price differentials between UK product and product in other EU countries. RUSI concluded in a recent report that the "policy of high taxation has the unintended yet inevitable consequence of generating an illicit market that generates substantial profits for sellers."¹² Indeed, in recent years, the size of the illicit tobacco market has started to grow once again after a long

¹¹ TMA Smoker Poll 2015.

¹² On Tap: Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK.

period of decline in the 2000s, which corresponded with an inflation-only tax policy. An obvious and long-overdue means of tackling the illegal tobacco trade, therefore, would be to remove the duty escalator.

Conclusion

The TMA believes that the only workable solution to the illegal tobacco trade is one that will combine a fully-integrated national strategy with effective public/private partnership working and a proportionate approach to the Government's tobacco policies. Although this consultation on sanctions is welcome and, as set out above, the TMA believes that there are clear areas in which the Government can maximize the penalties illicit traders will be subject to when caught, new sanctions will not be enough to reduce the illegal market if they are not combined with a new approach.