



## **TOBACCO ILLICIT TRADE PROTOCOL – LICENSING OF EQUIPMENT AND THE SUPPLY CHAIN**

### **HM REVENUE AND CUSTOMS CONSULTATION**

**20<sup>th</sup> MAY 2016**

#### **1. INTRODUCTION**

The Tobacco Manufacturers' Association (TMA) is the trade association for the UK tobacco industry. The 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. 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).

#### **2. SCOPE OF RESPONSE**

The measures under consideration in the present consultation relate to the implementation of controls on tobacco manufacturing equipment and the possible introduction of a licensing scheme for one or more of the economic actors involved in the tobacco supply chain. This response will focus on the rationale for and impact of a licensing model for the tobacco supply chain, particularly its impact on retailers.

#### **3. BACKGROUND**

The tobacco sector is one of the most regulated in the UK. It was the subject of a significant amount of tobacco control legislation throughout the Coalition Government (2010-2015). This included both the implementation of regulations that had been passed under the previous Labour Government, such as the tobacco display ban, and new legislation, such as the Tobacco Products Directive (TPD) and standardised 'plain' packaging.

The tobacco duty escalator was re-introduced in March 2010 and continued throughout the Coalition Government. This increased taxation on cigarette products by more than 40 per cent over the course of the last Parliament.<sup>1</sup> Hand rolling tobacco (HRT) products were subject to an increase of almost 50 per cent over the same period.<sup>2</sup> No other consumer product appears to have experienced such significant increases in total taxation.

The TPD and plain packaging will introduce significant changes into the tobacco market in 2016. For example, independent analysis conducted by Oxford Economics suggests that the retail sector will lose approximately £1.5 billion in revenue from lost tobacco and incidental

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<sup>1</sup> *Fact Book* (TMA, 2016)

<sup>2</sup> *Fact Book* (TMA, 2016)

sales. This could result in as many as 11,190 job losses. Furthermore, Oxford Economics also forecasts that £2.1 billion in tobacco tax revenue will be lost as a result of the introduction of the TPD. Of this, £1.2 billion will be lost as a result of increased personal (legal) tobacco imports and a further £850 million will be lost due to increased illicit (illegal) activity.<sup>3</sup>

The most up-to-date figures show that between 2010 and 2015, the overall tobacco tax gap, which includes purchases of both illicit and non-UK duty paid products, increased by more than 18 per cent.<sup>4</sup> However, the value of illicit purchases alone increased by almost one quarter between 2010 and 2015.<sup>5</sup> By the end of the Coalition Government's mandate, the annual tobacco tax gap stood at £2.6 billion, of which £2.1 billion was the result of illicit purchases.<sup>6</sup>

#### **4. RATIONALE FOR A LICENSING APPROACH**

The consultation document makes it clear that "HMRC's focus in undertaking the consultation is on identifying options to tackle tobacco duty evasion."<sup>7</sup> This is in line with the WHO's rationale for a licensing model. Article 6 of the World Health Organisation's (WHO) Protocol to Eliminate Illicit Trade in Tobacco Products, which builds upon Article 15 of the WHO's Framework Convention of Tobacco Control (FCTC), states that:

*The objective of this Protocol is to eliminate all forms of illicit trade in tobacco products, in accordance with the terms of Article 15 of the WHO Framework Convention on Tobacco Control.*<sup>8</sup>

In order to achieve this, the Protocol stipulates that Parties shall "adopt and implement effective measures to control or regulate the supply chain of goods covered by this Protocol in order to prevent, deter, detect, investigate and prosecute illicit trade in such goods".<sup>9</sup> Licensing is perceived by the authors of the FCTC to be integral to realising these objectives. According to the WHO, the suggested licencing approach could include tobacco manufactures and importers/exporters as well as the production, transportation, distribution and retailing of tobacco and tobacco products.

The consultation document also states that the results of the exercise will be considered with the Department of Health "in the context of the Government's wider tobacco control agenda and development and implementation of the Department of Health's (England)

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<sup>3</sup> *The Impact of Minimum Tobacco Pack Sizes on Incidental Spend and Tax Receipts* (Oxford Economics, 2016)

<sup>4</sup> *Tobacco Tax Gap Estimates 2014-2015*

<sup>5</sup> *Tobacco Tax Gap Estimates 2014-2015*

<sup>6</sup> *Tobacco Tax Gap Estimates 2014-2015*

<sup>7</sup> *Tobacco Illicit Trade Protocol – Licensing of Equipment and the Supply Chain Consultation Document* (HMRC, 2016)

<sup>8</sup> *Protocol to Eliminate Illicit Trade in Tobacco Products* (WHO, 2013)

<sup>9</sup> *Protocol to Eliminate Illicit Trade in Tobacco Products* (WHO, 2013)

Tobacco Control Strategy”.<sup>10</sup> This suggests that other priorities not related to the stated goal of reducing duty evasion, such as reducing the number of tobacco retail outlets in a given area, could be considered following the closure of the consultation.

The TMA urges the Government not to consider other priorities, such as using a licensing scheme to reduce the number of tobacco retail outlets, on the basis that: it is not the stated purpose of the consultation; the tobacco industry and its supply chain will not have had a chance to comment on such a proposal; and the evidence is still emerging on this issue and, as yet, supports no definitive conclusions.

## **6. PROBLEMS WITH A LICENSING APPROACH TO TACKLING ILLICIT TRADE**

The TMA does not believe that a licensing approach would be an effective means of reducing the scale of duty evasion related to the illicit tobacco trade.

### **a) The detection of illegal tobacco retailers.**

The supply of illegal tobacco products operates through channels that are distinct from the conventional supply chain. These channels do not necessarily comprise established tobacco wholesalers or retailers. The Royal United Services Institute (RUSI) highlighted this in its 2015 report on the illicit trade in tobacco, alcohol and pharmaceuticals.

RUSI found that, far from entering the normal supply chain, the final destination of illicit tobacco products “was typically warehouses or storage facilities in large towns and cities such as Birmingham, Leicester, Upminster, Gloucester and Wolverhampton.”<sup>11</sup> The RUSI report also concluded that there were a number of different types of criminal involved in the illicit tobacco trade, many of which would not be subject to a licensing procedure were one to be adopted. The authors highlighted organised criminal gangs, white collar criminals and ‘mules’ as examples of the sorts of people involved in purchasing, transporting and selling illegal tobacco products.<sup>12</sup>

The findings of the RUSI report suggest that a licensing model would do little or nothing to prevent or reduce the trade in illegal tobacco products. It would do little to deter the criminal traffickers and traders who cannot be prevented from selling tobacco products through the withdrawal of a licence.

### **b) The enforcement of a licensing scheme.**

The degree to which any statutory measure can be effective is determined by the extent to which it can be enforced by the Government. Across the country, Trading Standards services are responsible for enforcing “laws that govern the way we buy, sell, rent and hire

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<sup>10</sup> *Tobacco Illicit Trade Protocol – Licensing of Equipment and the Supply Chain Consultation Document* (HMRC, 2016)

<sup>11</sup> *On Tap: Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK* (RUSI, 2015)

<sup>12</sup> *On Tap: Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK* (RUSI, 2015)

goods and services.”<sup>13</sup> Included within Trading Standards’ remit is a requirement to ensure consumer safety and tackle the trade in counterfeit goods.<sup>14</sup> As a result, Trading Standards services in the UK are responsible for enforcing the law in regard to illicit tobacco.

If the proposed licensing approach is adopted and administered in a similar fashion to alcohol licensing, it will fall to Trading Standards services to enforce it. This would be a logical step given their existing remit in regard to illicit tobacco. However, Trading Standards’ ability to enforce a new and extensive licensing system effectively is questionable. This is because Trading Standards’ resources have been significantly reduced since 2010.

According to the Local Government Association (LGA), figures suggest that between 2010 and 2015 “the average cut to Trading Standards’ budgets in England was 40 per cent, mirroring the overall cut.”<sup>15</sup> Research conducted by the Department for Business, Innovation and Skills (BIS) found that Trading Standards services’ capabilities have been severely degraded as a result of budget cuts.

*There has been much loss of expertise and experience through voluntary redundancy programmes, departments have lost much of their resilience, and there is less emphasis on specialisation...*<sup>16</sup>

As a result of the decline in staffing levels, BIS concluded that among Trading Standards services a shift has taken place, “from proactivity and prevention to a more reactive and responsive approach.”<sup>17</sup> Routine inspections and sampling work to check compliance levels among businesses have been replaced by a work pattern that is driven by complaints from consumers and other intelligence.<sup>18</sup> Many Trading Standards officers pointed out to the authors of the BIS research that non-compliance has risen as a result of the uneven level of enforcement activity.<sup>19</sup>

Research conducted by UNISON, a trade union, into the effect of cuts on Trading Standards reflects the above conclusions. One Trading Standards officer cited in UNISON’s report stated that:

*Payday loans, fee-paying debt collectors, cheap illicit tobacco, wines and spirits all become more attractive to consumers when money is short. We no longer have the resources to carry out regular or routine unannounced spot inspections...therefore we don’t discover these goods on the shelves.*<sup>20</sup>

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<sup>13</sup> <http://www.tradingstandards.uk/jobs/jandc-careerints.cfm>

<sup>14</sup> <http://www.tradingstandards.uk/jobs/jandc-careerints.cfm>

<sup>15</sup> Local Government Association Trading Standards Review (LGA, 2016)

<sup>16</sup> *The Impact of Local Authority Trading Standards in Challenging Times* (BIS, 2015)

<sup>17</sup> *The Impact of Local Authority Trading Standards in Challenging Times* (BIS, 2015)

<sup>18</sup> *The Impact of Local Authority Trading Standards in Challenging Times* (BIS, 2015)

<sup>19</sup> *The Impact of Local Authority Trading Standards in Challenging Times* (BIS, 2015)

<sup>20</sup> *Trading standards – how cuts are putting individuals and communities at risk and damaging local businesses and economies* (UNISON, 2013)

The inability of Trading Standards services to carry out existing enforcement activities effectively, as a result of reduced resources, places the efficacy of a new licensing approach as a means of tackling the illicit tobacco trade in serious doubt. A requirement for Trading Standards services to enforce a licensing scheme would add to their existing responsibilities at a time when resources are at their most scarce. This could harm existing enforcement efforts and, as a result, *increase* the prevalence of illicit tobacco.

Efforts to tackle the illegal tobacco trade have been further undermined by the Local Government Declaration on Tobacco Control (LGDTTC), which has led to a situation where the TMA and its member companies now find engagement with some trading standards departments increasingly difficult.

The LGDTTC, along with references to Article 5.3 of the Framework Convention on Tobacco Control (FCTC) guidelines and/or being in receipt of Local Authority public health funding, have been given as reasons for not engaging with the tobacco industry on enforcement activities to tackle illicit tobacco. The LGDTTC is an entirely voluntary agreement and has no legal basis in English or Scottish law. Its operation hinders local authorities' ability to tackle illicit counterfeit tobacco. We feel that the LGDTTC not only affects the industry's anti-illicit trade activities negatively, but also the success of HMRC's work to tackle tobacco smuggling. Clearly, it is impossible to have an effective, joined-up approach to tackling illicit tobacco, when a key partner refuses to engage with other stakeholders.

The TMA's member companies work closely with a number of trading standards departments on a variety of operational issues through, for example, the work of brand enforcement officers in authenticating seized goods and providing intelligence and data for prosecutions. However, we are increasingly seeing that these relationships are being put at risk through a number of local authorities' and others' desire to politicise tobacco. Reviewing the LGDTTC and its impact on effective enforcement should be considered as a matter of priority.

### **c) The impact of a licensing scheme on retailers**

Aside from the fact that a licensing model would do little to help enforcement agencies detect illicit product and that it would be difficult for Trading Standards services to enforce, given their reduced resources, such an approach would have a negative impact on businesses in the retail sector in particular.

Licensing schemes that have been introduced to regulate the sale of other products or services, such as alcohol and certain types of gambling, carry a significant fee for vendors (see below for examples). The retail sector has been forced to adapt to a host of tobacco and other regulation in recent years; the addition of yet another burden would have a detrimental impact on this important sector of the UK economy.

Type of Licence	Cost	Cost over 10 years to Retail Industry of a Tobacco Equivalent (minimum/maximum) <sup>21</sup>
Licence to sell alcohol	£100 - £1,950 (one-off charge) £70 - £1,050 (annual charge)	£232,252,000/£3,614,421,750
Licence to provide general betting services	£1,531 (annual charge)	£4,444,722,650

Furthermore, a licensing model would disproportionately affect small and independent retailers, who are least able to bear the burden of new regulation. This is even more onerous following the recent introduction of the Tobacco Products Display Ban and the forthcoming implementation of Standardised 'plain' Packaging and the Tobacco Products Directive. At present, there are around 50,000 small and independent retailers in the UK.<sup>22</sup>

A licence applied at the minimum rate for the sale of alcohol would add an additional burden of £40 million to the small and independent retail sector over 10 years. Were a licence to be applied to retailers at the rate of that applicable to betting outlets, it would add an additional £765,500,000 to the small and independent retail sector over 10 years.

## 7. ALTERNATIVES TO A LICENSING MODEL

For the avoidance of doubt, it is the opinion of the TMA that the introduction of a licensing scheme for tobacco wholesalers and retailers would be an ineffective response to the threats posed by the illicit trade in tobacco products.

Equally, there is little evidence to support the idea that a licensing regime would improve compliance with existing tobacco control legislation and limited and inconclusive evidence that there is a link between concentrations of tobacco retail outlets and individual smoking.

In order to achieve the objective outlined in the consultation – tackling duty evasion – the Government could do the following:

### a) Legislate for a light-touch retailer registration scheme

A free registration scheme, similar to the one present in Scotland, but administered by HMRC would enable the Government to record all legitimate tobacco retailers in England.

Although this would not aid in the detection of the sale of illicit tobacco products, it would enable HMRC to monitor the sorts of vendors allowed to sell tobacco products.

### b) Provide enforcement agencies with sufficient resources and powers

Trading Standards services in local authorities across the country have been adversely affected by the speed and scale of budget cuts.

<sup>21</sup> Based on 290,315 UK retail outlets cited by <http://www.retailconomics.co.uk/library-retail-stats-and-facts.asp>

<sup>22</sup> *The Local Shop Report* (ACS, 2015)

The scale of the budget cuts has affected Trading Standards' ability to maintain effective anti-illicit trade procedures. In order to reduce the illicit tobacco trade in the long-term, Trading Standards services must be properly funded. Increasing funding for such services would enable Trading Standards officers to:

- restore random, unannounced checks and sampling activities;
- increase the number and frequency of retail outlet checks;
- build sustainable working relationships with retailers;
- rebuild specialised anti-illicit trade skills and necessary expertise; and
- respond to customer complaints and other intelligence promptly and efficiently.

Additional resources should be supplemented by new powers for Trading Standards services. All powers available to HMRC in this area at present should be delegated to Trading Standards services.

**c) Introduce more stringent penalties for offenders, particularly repeat offenders**

Sanctions for those individuals and organisations involved in the illegal tobacco trade need to be reviewed.

The TMA welcomes the Government's commitment to do so. Repeat offenders must be subject to new and far-reaching penalties that remove the incentive to engage in the illicit tobacco trade by:

- tackling the high financial rewards repeat offenders often obtain;
- publicising all proceedings against repeat offenders; and
- ensuring that custodial sentences are a mandatory part of the punishment of repeat offenders.

The Government should also ensure that existing financial and other legal sanctions are used to the full by the judiciary in proceedings against all offenders, repeat or otherwise.

**d) Prioritise the formation of the Cross-Ministerial Anti-Illicit Trade Group**

The Cross-Ministerial Anti-Illicit Trade Group was announced as part of Budget (March) 2015.

The Government stated its intention to establish "a cross-government ministerial group to oversee future evolution of the anti-illicit tobacco strategy".<sup>23</sup> The TMA and its members supported and continue to support this approach. The illicit tobacco trade affects multiple government departments and all layers of government. As a result, a joined-up strategy that incorporates stakeholders from all relevant government departments and private industry is essential if sustained reductions in the illicit tobacco market are to be achieved.

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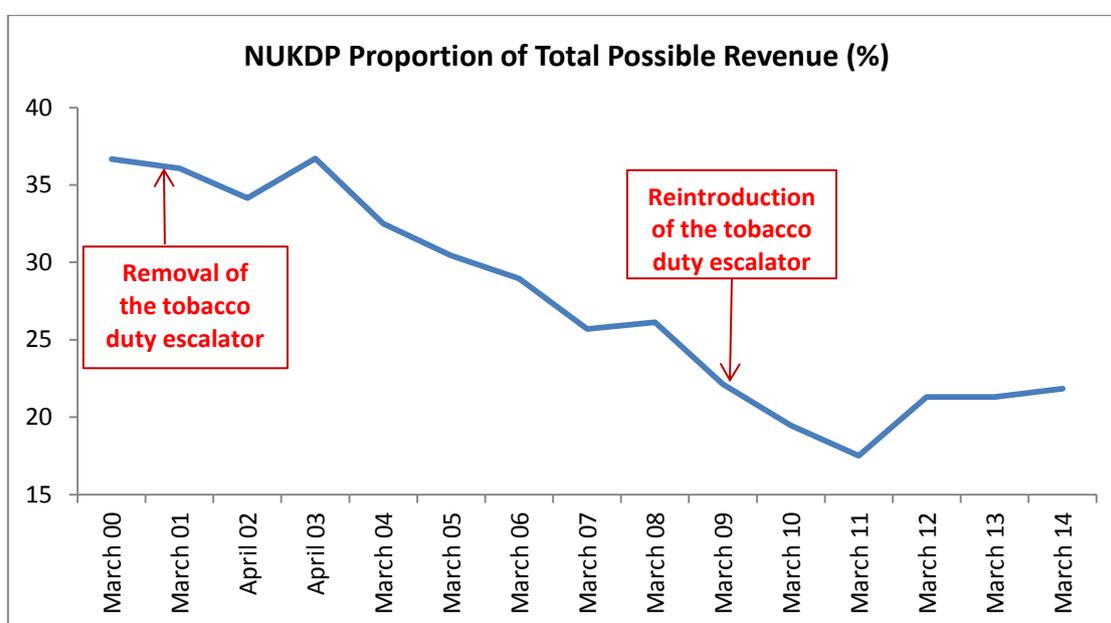
<sup>23</sup> *March Budget (2015)*

### e) Eliminate the tobacco duty escalator

The measures outlined above aim to tackle the supply of illicit and other non-UK duty paid (NUKDP) goods. Eliminating the tobacco duty escalator would help to tackle the demand for illicit goods.

The TMA conducted a survey of 12,000 smokers in 2015. 80 per cent of respondents stated that the high price of tobacco products, which is driven by above inflation duty increases, was the principal reason for purchasing 'non-shop' tobacco products.<sup>24</sup> In other words, the Government's high tobacco tax policy is creating demand for NUKDP tobacco products.

Moreover, although there has been a significant decrease in the size of the NUKDP tobacco market since 2000, HMRC data shows that the most significant declines during this period were achieved in the years in which the tobacco duty escalator did not apply (2001-2009) (see below graph).



### f) Place stricter limits on the amount of tobacco product that can be imported by individuals from high risk, low tax EU markets.

The EU provides a mechanism for restrictions on the importation of tobacco products from Member States whose tobacco taxes do not meet EU wide minimum rates.

An absolute maximum of 300 cigarettes can be applied to travellers in these cases. Other Member States, such as Austria, Croatia, Denmark, Germany, Ireland, Italy, Slovenia and Sweden, apply the lower limit for travellers coming from Bulgaria, Croatia, Hungary, Latvia, Lithuania or Romania.<sup>25</sup> The TMA would like the Government to make use of this mechanism.

<sup>24</sup> *Anti-Illicit Trade Survey* (TMA, 2015)

<sup>25</sup> [http://ec.europa.eu/taxation\\_customs/common/travellers/within\\_eu/index\\_en.htm](http://ec.europa.eu/taxation_customs/common/travellers/within_eu/index_en.htm)

**g) Support the roll out of the Codentify system at the local level**

Codentify is a system of product authentication that provides a means of tracking and tracing tobacco products.

It was developed and has been implemented by all the major tobacco manufacturers in order to tackle the illicit trade in tobacco products. The Codentify system can be used by enforcement distributors, wholesalers, retailers and enforcement agencies in order to verify the legitimacy of any tobacco product. At present, the TMA is exploring the feasibility of providing training to Trading Standards organisation on the use of the system. HMRC support for the roll out of Codentify would expedite this process.

**h) Provide clear guidance to all members of the supply chain and consumers on new tobacco control measures**

This year (2016) is a defining year for the UK tobacco market. The TPD and standardised packaging regulations are due to come in to force in May and these measures will have a significant effect on the UK tobacco market. For example, Oxford Economics estimates that the TPD regulations will cost the Exchequer £2.1 billion in the first year alone. Of this, £850 million will be lost to the illicit trade and £1.2 billion will be lost to personal imports of legal NUKDP tobacco products.<sup>26</sup>

In order to mitigate this loss, the Government should ensure that all members of the supply chain as well as consumers are made as aware as possible of the forthcoming changes so that they are able to identify non-compliant and illicit tobacco products.

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<sup>26</sup> *The Impact of Minimum Tobacco Pack Sizes on Incidental Spend and Tax Receipts* (Oxford Economics, 2016)