Tobacco taxation in the UK

The Government's tobacco duty policy – increasing taxes above the rate of inflation each year – has resulted in falling revenues and a well established illegal tobacco market. It is time for the Government to see sense and scrap the tobacco duty escalator.

tma
tobacco manufacturers' association

Overview

- The Government has followed a policy of high and increasing tobacco tax, raising tobacco duty by 2% above the rate of inflation each year, to discourage consumption while raising revenue[1].
- As a consequence, these tax increases have shifted consumption from the legal to the illegal tobacco market, reducing potential tax revenues.

2% THE DUTY ESCALATOR'S ANNUAL RISE ABOVE INFLATION

£3bn LOST TAX REVENUES TO THE ILLICIT MARKET AND CROSS BORDER SHOPPING IN 2015-16[2]

Tobacco taxation

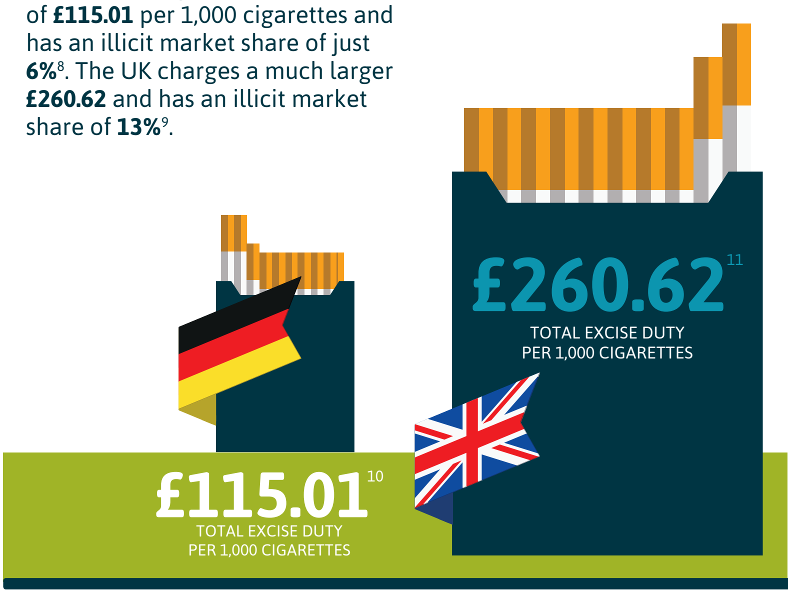
- Tax on cigarettes is made up of specific duty of £196.42 per 1,000 cigarettes and an ad valorem rate of 16.5% of the Recommended Retail Price[3]. VAT is charged in addition.
- A pack of 20 cigarettes with an RRP of £8 will be over **80% tax**, while on some of the lowest price cigarettes tax can account for **90%**[4].
- Between 2010 and 2016 the average duty burden on cigarettes increased by **50%**, while in the case of handrolling tobacco it has increased by **60%**[5].
- Excise revenues over the same period were more than **£2bn** less than forecast[6].

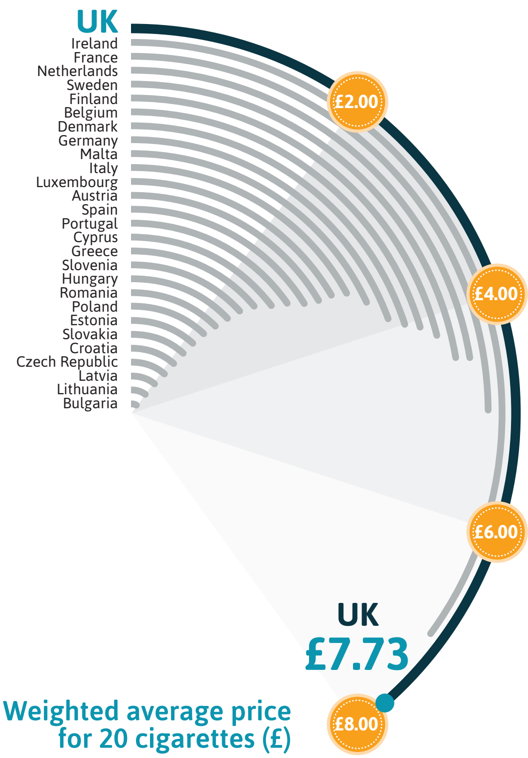
£12 BILLION

£12 billion in tax revenue – **£9.5** billion in excise duty plus **£2.5 billion** of VAT – was raised from the sale of tobacco products in 2016.

EU comparisons

- The average price of 20 cigarettes in the UK is **£7.73**, against **£3.27** in Spain and just **£2.31** in Poland[7].
- Germany charges total excise duty of **£115.01** per 1,000 cigarettes and has an illicit market share of just **6%**[8]. The UK charges a much larger **£260.62** and has an illicit market share of **13%**[9].
- Given this, it seems likely that high excise duty rates are **fuelling the illicit market** and the UK is **beyond the point of revenue maximisation**.





Weighted average price for 20 cigarettes (£)

Sources: 1: https://www.gov.uk/tax-on-shopping/alcohol-tobacco; 2,9: HMRC, 2016, Measuring Tax Gaps, Tobacco tax gap estimates for 2015-16; 3: https://www.gov.uk/government/publications/rates-and-allowances-excise-duty-tobacco-duty/excise-duty-tobacco-duty-rates; 4,5,6: TMA calculation; 7,10,11: EUROPEAN COMMISSION: EXCISE DUTY TABLES Part III – Manufactured Tobacco, July 2016; 8: KPMG, 2016, Project Sun: A study of the Illicit Cigarette Market.

Illicit market and the tax gap

- High UK tobacco taxes contribute to high levels of illicit trade and cross-border shopping with lost duty revenues totalling £3 billion in 2015-16[1].
- A 2016 survey found that **71%** of smokers had purchased non-UK duty paid products and **20%** are aware of illicit tobacco being sold in their area[2].
- **33%** of cigarette smokers have been offered non-UK brands[3].
- **25%** of smokers spend more than **£10** a week on non-UK duty paid tobacco products[4] .

The Royal United Services Institute (RUSI) have said that: **'This policy of high taxation has the unintended yet inevitable consequence of generating an illicit market that generates substantial profits for sellers.'**[5]

Lost revenue, HMRC central estimates[6]

	2012-2013	2013-2014	2014-2015	2015-2016
Total	£2.8 BILLION	£3.0 BILLION	£2.3 BILLION	£3.0 BILLION
Illicit cigarettes	£1.3BN	£1.4BN	£900M	£1.6BN
Illicit HRT	£900M	£1.1BN	£900M	£800M
Cross-border cigarettes	£400M	£400M	£400M	£500M
Cross-border HRT	£200M	£100M	£100M	£100M

New risks to tobacco revenues

- From May 2017 the sale of packs of cigarettes of fewer than 20 and packs of HRT less than 30g will be banned.
- Products to be banned are bought by 24% and 71% of consumers respectively[7].

Research from Oxford Economics found that minimum pack sizes will reduce incidental spend at retailers and increase the size of the illicit market. This will cause:[8]

£1.5bn
LOST REVENUE FOR RETAILERS

£2.1bn
INCREASE IN LOST TAX REVENUE

11,190
LOST RETAIL EMPLOYMENT

A more effective tax is policy is required

- The UK's high level of tobacco taxation acts as the main driver of the illicit market.
- In order to protect future tax revenues and effectively tackle the illicit market, the Government must review its tobacco tax policy.
- It should begin by removing the tobacco escalator.

Sources: 1,6: HMRC, 2016, Measuring Tax Gaps, Tobacco Tax Gap Estimates for 2015-16; 2,3: TMA Anti-Illicit Trade Survey, 2016; 4: Ibid; 5: RUSI, 2014, On Tap; Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK; 7: Oxford Economics, 2016, The Impact of Minimum Tobacco Pack Sizes on Incidental Retail Spend; 8: Ibid.