

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.

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 revenue¹.
- As a consequence, these tax increases have shifted consumption from the legal to the illegal tobacco market, reducing potential tax revenues.



THE DUTY ESCALATOR'S ANNUAL RISE ABOVE INFLATION



LOST TAX REVENUES TO THE ILLICIT MARKET AND CROSS BORDER SHOPPING IN 2015-16²

Tobacco taxation

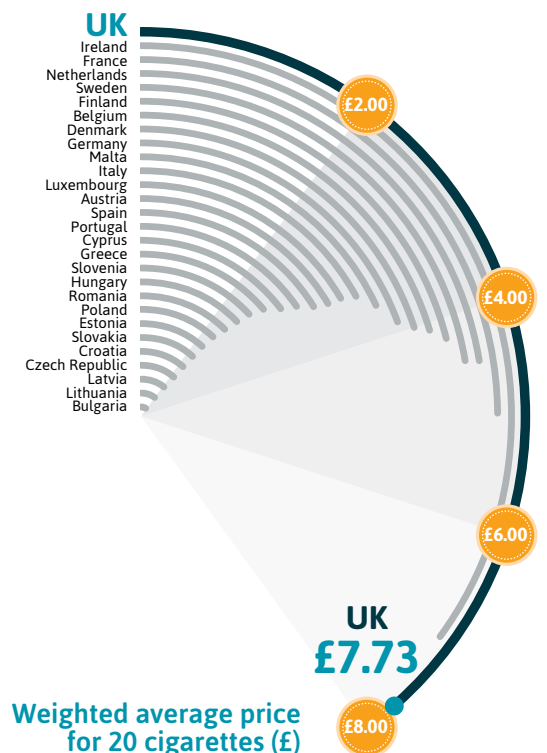
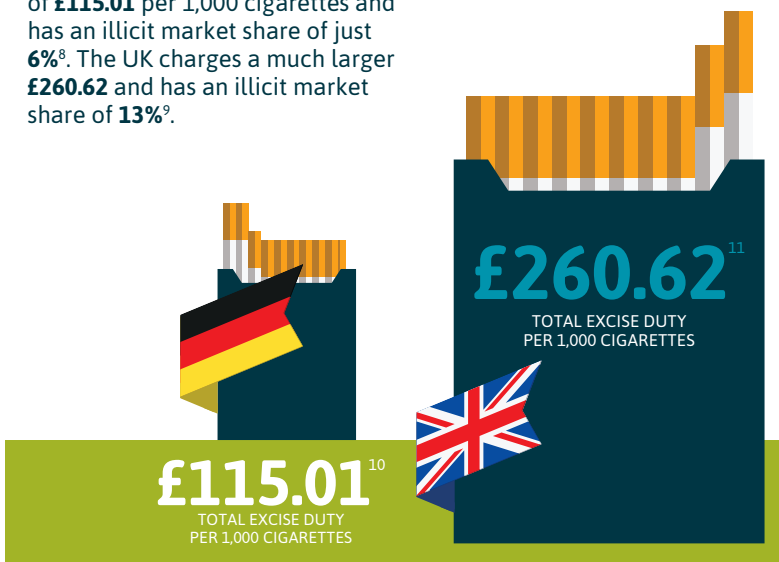
- Tax on cigarettes is made up of specific duty of £207.99 per 1,000 cigarettes and an ad valorem rate of 16.5% of the Recommended Retail Price (RRP)³. VAT is charged in addition.
- A pack of 20 cigarettes with an RRP of £8.50 will be over **80% tax**, while on some of the lowest price cigarettes tax can account for **90%**⁴.
- Between 2010 and 2017 the average duty burden on cigarettes increased by **more than 65%**, while in the case of handrolling tobacco it has increased by **more than 75%**⁵.
- Excise revenues over the same period were more than **£2bn** less than forecast⁶.
- From May 2017 a Minimum Excise Tax of £5.37 per pack will apply. This will impact brands with an RRP below £7.35.



£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 Poland⁷.
- 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**.



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 2015-16¹.
- 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 area².
- 33%** of cigarette smokers have been offered non-UK brands³.
- 25%** of smokers spend more than **£10** a week on non-UK duty paid tobacco products⁴.

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

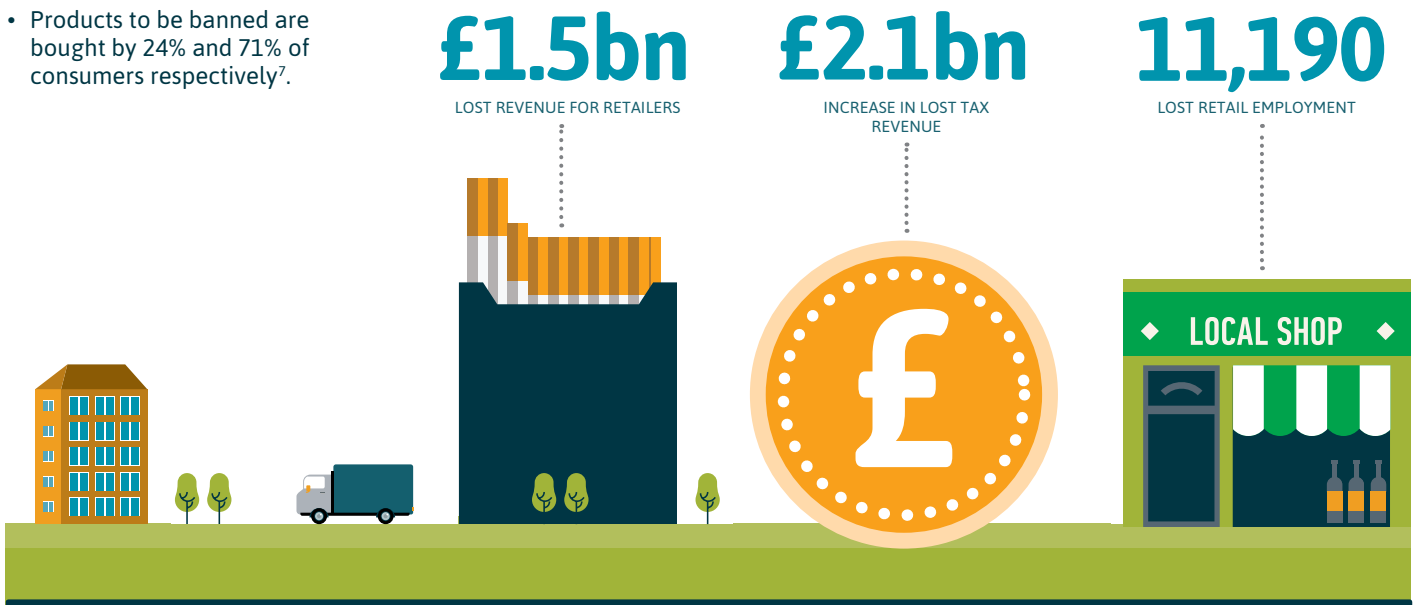
Lost revenue, HMRC central estimates⁶



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 respectively⁷.

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



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.