



Alcohol Fraud

Legislative measures to tackle existing and emerging threats to the UK alcohol duty regime

Summary of Responses
17 July 2013

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1. Introduction

Background to the consultation

- 1.1 Tackling alcohol fraud is a priority for the Government. At Budget 2011, the Government announced its intention to explore “*potential legislative measures to tackle existing and emerging threats to alcohol duty receipts*”¹.
- 1.2 This was in recognition of the levels of fraud in alcohol products, notably in the packaged beer sector, resulting in significant tax losses and making it difficult for legitimate businesses to compete on a level-playing field.
- 1.3 Following informal consultation in 2011, the Government announced its intention to formally consult on new legislative measures at Budget 2012.

Consultation

- 1.4 On 26 March 2012, HM Revenue & Customs (HMRC) issued a consultation document “*Alcohol Fraud: Legislative measures to tackle existing and emerging threats to the UK alcohol duty regime*”². The consultation was due to end on 25 June 2012 but was extended until 16 July 2012 at the request of trade associations wishing further time to consider and collate the responses of their members, and for the All Party Parliamentary Beer Group (APPBG) to conclude its inquiry into beer tax fraud (afterwards referred to as the Inquiry)³.
- 1.5 The Government would like to thank all of the many stakeholders who have taken the time to respond and engage with officials during this consultation. The Government would also like to thank the APPBG for its contribution.
- 1.6 HMRC received 55 responses in total to the formal consultation: 28 from trade associations; 21 from individual businesses; 5 from other organisations and 1 individual. A full list of respondents is contained in Annex A (individuals are not identified).

Aims and Objectives

- 1.7 Alcohol fraud in the UK is driven by strong demand for popular brands of alcohol sold at cheaper, duty unpaid prices. Reducing the access fraudsters have to those brands to feed their illicit supply chains, and also the ease with which they can distribute products, is essential to reduce the level of alcohol fraud in the UK.
- 1.8 The aims of the consultation were to:

¹ Source: Budget 2011

² www.hmrc.gov.uk/consultations - click on “lapsed consultations”

³ <http://www.beertaxinquiry.co.uk>

- present options for regulatory change emerging from the preceding informal consultation
- seek the views of industry representatives, legitimate business involved in the alcohol trade in the UK and all interested parties on potential new measures to tackle alcohol fraud
- collect further information and data which can be used to assess the costs, effectiveness, feasibility and proportionality of the potential new measures, and
- invite further suggestions for alternative measures for tackling alcohol fraud.

Points consulted on

- 1.9** The consultation presented two options for legislative change primarily focused on beer: **fiscal marks** for packaged beer and **supply chain legislation**.
- 1.10** It also presented a measure suggested by the Federation of Wholesale Distributors (FWD) to limit opportunities for illicit trading of all alcohol products - **registration of alcohol wholesalers**.
- 1.11** Information and data were also sought on fraud involving wine, including industry's initial views on options to address the illicit wine market, such as registering owners of wine held in warehouse.

Responses to the Consultation

- 1.12** HMRC consulted as widely as possible with stakeholders involved throughout the alcohol supply chain. HMRC invited written responses and also met with representatives from the brewing industry, wholesalers, large and smaller retailers including travel retail, warehousekeepers and importers.
- 1.13** Almost all respondents agreed the need for further action to combat alcohol fraud but there were differing opinions regarding the options for change relating to fiscal marks and supply chain legislation. While most wholesale and retail sector respondents saw these measures as a proportionate and effective response to the fraud, the brewing and warehouse sectors raised concerns regarding whether HMRC's estimates of beer fraud were sufficiently accurate to justify major change, and about the practicality, costs and legality of introducing fiscal marks/supply chain legislation.
- 1.14** Overall, the proposal to register alcohol wholesalers had the broadest of support across the range of respondents. Many respondents believed that the absence of any registration or licensing requirement in this part of the alcohol supply chain was a weakness and that introducing such requirements would allow HMRC to more effectively control the legitimacy of those carrying out wholesale trade.
- 1.15** There were disparate views on the question of wine fraud. Some respondents felt that if measures were adopted which only targeted beer this would lead to displacement of the fraud into this category. However others felt that measures proposed for beer were not necessarily as relevant for wine. In response to the proposal to register wine owners in warehouse, some were concerned that the burdens on legitimate trade could be disproportionate.

2. Responses

- 2.1** This chapter draws out the key messages from the consultation responses. Due to the number of questions, responses have been grouped according to the original grouping of questions in Section 6 of the formal consultation document.⁴

Alcohol fraud – scale and nature (General comments)

- 2.2** The majority of respondents agreed that alcohol fraud is a serious issue and needs to be tackled, although there was disagreement in relation to the scale of the problem. One trade association was strongly of the view that the level of duty fraud is not as high as HMRC has estimated and thought more work was needed to establish more accurate figures. Others had contrasting views and thought that HMRC figures might be too low, based on experiences of the impact of illicit trade on their sector.
- 2.3** Some respondents felt that the consultation did not address the incentives for criminals to engage in beer fraud and pointed to increases in beer duty and a large duty differential between the UK and the near continent as the main incentives for fraudsters. They also argued that the proposals would not increase the risk to criminals of being caught or prosecuted in the UK for smuggling.

Impacts of illicit trading on legitimate businesses (Q1-Q2)

These questions asked for evidence of the extent illicit alcohol has penetrated the legitimate market and the perceived impacts on wholesalers and retailers.

- 2.4** The responses clearly indicate that honest businesses in the alcohol supply chain are suffering from the impacts of illicit trading. Wholesalers in particular report large reductions in sales of key brands of popular packaged beer and wine over the last few years, which they attribute to competition from the illicit market. The FWD estimated that lost trade in packaged beer cost the wholesale sector approximately £605 million in turnover per annum. Some retailers also felt very strongly about the impact of illicit alcohol and stated they would be put out of business if illicit trading was allowed to continue.
- 2.5** Other respondents argued that it would be difficult to distinguish the impact of illicit trade from other factors so falling sales could also be attributed to, for example, reduced consumer spending or changing behaviours. Representatives of the on-trade in particular believed other factors including competition from, for example, supermarkets also needed to be taken into account.

The nature of beer fraud (Q3-Q4)

Respondents were asked if they could provide extra data to help assess the level of actual consumption of UK produced beer on the near continent and any practical steps the beer industry could take to prevent criminals accessing goods for fraud.

⁴ www.hmrc.gov.uk/consultations - click on “lapsed consultations”

- 2.6** Those who did respond felt it was difficult to make an accurate estimate of consumption of UK produced beer in other countries but pointed to Intrastat data as a potential source of information. Some respondents felt there was a legitimate market abroad for UK beers pointing to the dominance of lager in the EU beer market and the significant presence of UK produced beers. One trade association believed more work was needed to accurately map the market.
- 2.7** Brewers thought a partnership approach with HMRC was required including sharing intelligence and implementing rigorous supply chain policies. This view was endorsed by others in the beer supply chain.

Tackling Beer Fraud: Fiscal Marks

- 2.8** Out of a total of 55 responses, 51 specifically commented on the introduction of beer fiscal marks.
- 2.9** The majority of responses disagreed with the proposals to introduce fiscal marks. The general view of brewers and those whose business involves holding or moving duty suspended alcohol, for example, excise warehousekeepers, was that fiscal marks would be costly to introduce and therefore disproportionate. Others suggested they would be ineffective in tackling fraud, or that the policy unfairly targeted beer as opposed to other alcohol products susceptible to fraud. Some respondents believed that the adoption of fiscal marks as proposed - with a targeted restriction to the duty suspension system - could also risk infringing domestic and European Union legislation. Some respondents also believed the proposals were based on systems in place for radically different markets (spirits and tobacco), which face very different challenges in terms of combating illicit trade and in terms of the quantities involved, the value and tax per unit, margins, supply chains and risk profiles. Associations representing the wine and cider sectors were also concerned fiscal marks would be introduced for their products without proper consideration of the impacts.
- 2.10** The practicalities around application and removal of the marks were of specific concern to UK and foreign brewers, third party importers and traders dealing in duty paid beer. Some importers claimed the requirement for a mark could effectively end their business as the additional costs would make it unprofitable.
- 2.11** The Inquiry concluded that fiscal marks (and supply chain legislation) could detrimentally impact the brewing industry. It felt the extension of a fiscal marking scheme from spirits to beer would be “*extremely problematic*” and considered the case for fiscal marks was premature. It strongly recommended that other options referred to in their report, for example, suggestions to strengthen HMRC’s current enforcement strategy should be worked through and fiscal marks kept as a fallback option if these measures should fail. It concluded that more work was needed on the proposal to make it more credible as an anti-fraud measure and a workable option for the alcohol industry.
- 2.12** However, the wholesale sector and some retailers strongly believed fiscal marks were an essential element of control and had the potential to have the greatest impact on levels of fraud. They stated their businesses are currently placed at a

disadvantage to others and they are unable to compete with illicit trade. Some retailers did have some concerns around the detail of a fiscal marking scheme including the transparency of any exemptions and the additional burdens of checking the requirement for a brand to be marked. Some of these retailers made their support for fiscal marks conditional on the scheme being transparent and simple to operate at retail level. Travel retailers, including registered mobile operators and export shops etc. were concerned by the impacts of fiscal marks and requested an exemption from the requirements. Hauliers were also concerned about the impacts of new sanctions.

Which products would fiscal marks apply to? (Q5-Q10)

This section generally asked for data to establish a better picture of the quantities and characteristics of beer sold on the UK market and responses on proposed qualifying criteria for fiscal marking and specifically an exemption based on production volumes (not exceeding 200,000 hectolitres per year).

- 2.13** Generally, data for the whole market was not available but some figures were provided by individual respondents. One association thought one per cent of total packaged beer would be excluded by the proposed exemption for beers of two point eight per cent abv or below and three per cent of packaged beer if the fiscal mark requirements only applied to brewers producing above 200,000hls.
- 2.14** Some respondents thought there should be no exemptions as it would cause distortions in the market and would only encourage displacement. Others considered craft, niche beers should definitely be excluded. Representatives of smaller producers thought a fiscal marking scheme without exemptions would impact on their ability to export and act as a barrier to growth putting UK businesses at a competitive disadvantage. Concerns were expressed around the transparency of exemptions and how the supply chain would know which products should carry a fiscal mark. One suggestion was to mark products to show they were exempt or to include statements on invoices/electronic administrative documents.
- 2.15** Many larger brewers were concerned that setting an exemption threshold on the basis of brewery size would lead to unfair treatment particularly for their smaller niche brands that may not be frequently subject to fraud.
- 2.16** Overseas brewers importing into the UK felt that if this type of exemption was introduced it should be based on production volumes for the UK market as their production levels exceeded the suggested exemption level of 200,000 hectolitres although their supplies to the UK were far less. Generally, they thought fiscal marks could restrict sales to the UK as it would not be cost effective having a separate line for UK marked product. Importers were also concerned that the costs and impacts of applying a mark to individual cans and bottles would be significant even with potential exemptions.
- 2.17** One respondent suggested an alternative to production levels based on brewers submitting annual packaged volumes by beer brand. Any brands over an agreed cut-off point would be subject to stamping. Brands caught by the requirements could be listed on the HMRC website.

Application of the fiscal mark (Q11-Q15)

This section asked for responses regarding application of the mark at manufacturing stage and potential costs and practical implications.

2.18 Brewers generally considered the costs of application at manufacturing stage would be prohibitive pointing to the number of brands and can and bottle designs which would require marking. It was generally thought by the brewing sector that fiscal marking was not economically viable for beer and could force some smaller brands out of the market. However, one respondent suggested this should not be a problem as brewers generally change can designs on a frequent basis. Respondents also mentioned problems with the visibility of marks on beer largely sold in multi-packs and thought checking of primary packaging was impractical and prohibitively expensive. Marking at secondary packaging level was dismissed as it was considered easier to counterfeit the mark. Other comments included the possibility of having to increase label sizes and associated costs, the increase in stock-keeping units, extra warehousing space/increased costs for warehousekeepers requiring new stock-keeping systems to identify marked product, greater transport costs and so on.

Application in other Member States/third country (Q16)

This question asked for the costs and impacts of fiscal marks for foreign brewers.

2.19 Some foreign brewers claimed that fiscal marks would effectively close down the UK as a viable market for their products. They were specifically concerned that accurate forecasting and production just for the UK market was not possible or cost-effective leading to lost sales opportunities. Importers also thought the checking of fiscal marks on foreign produced beers would be a barrier to trade and highly impractical.

Duty payment and movements in duty suspense (Q17-Q23)

This section asked for responses to a proposed "brewery gate" duty point and a restriction to duty suspended movements of fiscally marked products.

2.20 A number of respondents claimed that targeted restrictions to the duty suspension system for beer would be difficult to operate in practice, as well as unfair to those who would no longer be able to trade in duty suspension. The legality of the proposal was also questioned as it was claimed that it could lead to unjustified barriers to trade. Impacts would be felt by brewers, warehousekeepers, importers, drawback traders and retailers including the travel retail sector. These included the negative effects on cash flow, bad debts, increased storage and transport costs, lack of flexibility to change the destination of goods originally intended for a different market and so on. It was suggested the proposal could cause a loophole for fraudsters who could buy marked product in duty suspense from overseas warehouses. It was also suggested that it gave legitimate wholesalers and retailers a clear incentive to purchase beer abroad rather than from UK brewers to enjoy the cash flow benefits of duty suspension.

2.21 Others, however, believed that there was no commercial advantage to using the duty suspension system for packaged beer destined for UK sale, and that the majority of legitimate wholesalers and retailers choose to purchase goods duty paid. It was also suggested that an increase in duty deferment dates might be offered to mitigate any potential impact of restricting UK duty suspended movements.

Removal of the Fiscal Mark (Q24-Q27)

This section requested comments on the practicality and costs of removing a fiscal mark including businesses that source duty paid beer.

2.22 Suggestions for removal included using black-out labels, scraping off the mark or applying a sleeve over it. However, respondents generally thought that any of these suggestions would be problematic for the business carrying out the operation, potentially damaging to the container and would impact on quality and appearance. It was also considered a particular barrier for small brewers trying to break into the export market, traders sourcing product duty paid and the travel retail sector. A number of respondents thought the costs of removal would far exceed the net profit margin on individual units.

Application post-production (Q28-Q30)

This section asked for practical ways to apply a fiscal mark post-production, any associated costs and how often this may be required.

2.23 Those who responded to this section did not believe it was economically viable to manually apply a fiscal mark and thought the cost elements would be in the same region as removal. An indicative average cost was approximately ten – fifteen pence per unit. It was thought approximately 7.4 million of the estimated 1.2 billion bottles and cans imported per annum would require a manually applied mark. Similarly, beer which changed markets from the EU to the UK would require marking but it was not felt possible to quantify these volumes. One respondent noted that it would be more viable for a fraudster to apply a mark than the legitimate trade as they would not be paying the duty and VAT.

Enforcement (Q31-Q32)

This section asked for any other impacts on the legitimate trade of fiscal marks and impacts on fraud.

2.24 Wholesalers and representatives of many smaller retailers generally believed that fiscal marks could reduce the overall levels of fraud and therefore improve their trade. One response suggested that in periods following evidence of sustained local HMRC enforcement activity, sales of 'high risk' brands could increase ten-fold in the legitimate market. This respondent suggested that this type of result could be achieved across the UK with the introduction of fiscal marks. In particular, wholesalers noted that sales of legitimately traded beer had fallen by over 15 per cent in their sector in a time period in which spirits, which were already subject to duty stamps, had increased by just under the same quantity.

2.25 However other respondents felt there was no credible evidence to show beer fiscal marks would have a significant impact on fraud and highlighted the need for additional enforcement if they were to be introduced. Some respondents also questioned whether duty stamps had been successful in reducing spirits fraud. There were also concerns that fiscal marks could be easily counterfeited if applied as a separate stamp. One respondent did suggest development of a phone application to check the validity of marks. Some respondents also claimed that fiscal marks on beer would simply lead to the fraud displacing to wine and other drinks. It was also alleged that the presence of a fiscal mark on products could be misleading as to whether duty had actually been paid and that this could in some cases make fraud easier.

2.26 Other impacts not already mentioned elsewhere included claims that there would be increased wastage of products largely due to the difficulties/economics of changing destination (and therefore marking) of products once they have been packaged; loss of tax revenues from lost sales; reduction in consumer choice caused by some lines becoming uneconomic and so on. Some retailers and hauliers were also concerned about the application of new sanctions which may be used to penalise genuine mistakes rather than stop fraudsters.

Implementation (Q33-Q36)

This section asked for industry's views on potential lead-in times and total costs of implementation.

2.27 Several responses suggested a reasonable lead-in time would be between 9-15 months based on the average shelf life of beer.

Summary of Impacts (Q37-Q39)

This section asked for comments on the initial assessment of impacts of fiscal marks that had been prepared by HMRC.

2.28 Generally, respondents to these questions considered the summary of impacts in the consultation document under-estimated the cost to business. In particular, the main association representing the brewing industry specified one off costs between £6m, if exemptions proposed in the consultation were confirmed, and £32m if no exemptions were allowed. They believed that these costs could potentially be doubled if secondary packaging was also required to be marked. They suggested ongoing annual costs for the brewing industry between £26m-£31m caused primarily by reduced line efficiency and extra transport and warehousing costs, with the possibility that these numbers could increase depending on the final design of the scheme. One third party importer believed there would be an average cost increase of five per cent for their particular business. The indicative costs of restricting the duty suspension system provided by respondents ranged from £2m - £7m (one-off cost) where actual figures were provided. Some respondents considered the costs would be significant enough to end trade for some businesses.

2.29 Comments on the perceived impacts included:

- distortion of competition between large and small brewers – could lead to market closure for small businesses

- application/removal of fiscal marks could effectively end trade between Northern Ireland and the Republic of Ireland
- reduction in growth in the beer sector
- limitation on third party importers' ability to compete
- impact on jobs
- significant trade lost from the removal of drawback trade
- any perceived benefits will not extend to the on-trade as their supply chains considered secure and likelihood of costs of fiscal marks being passed down
- impossible to undertake an accurate impact assessment until more robust estimates of the scale of the problem are available and scheme design finalised
- impacts on cash flow for all sectors.

Tackling Beer Fraud: Supply Chain Legislation

2.30 Out of a total of 55 responses, 30 specifically commented on the introduction of supply chain legislation for packaged beer.

2.31 There was a general consensus that supply chain legislation could only be effective if it was applied to the whole supply chain; however, a number of perceived obstacles were presented including infringement of competition law. Many respondents also agreed that a track and trace system would involve major cost and investment across industry and would take some years to develop.

2.32 The Inquiry looked at three aspects of supply chain legislation: knowing your customer and market; oversupply and track and trace. In summary, it found that HMRC's proposals could potentially impose very high costs on industry, particularly if supporting track and trace technology had to be developed from scratch. Instead, it recommended a *"significant change in culture of collaboration by all parties"* and believed that the adoption of other options put forward in their report could remove the need for track and trace solutions. Recommendations included the development by the brewing industry of a good practice guide for due diligence, better collaboration between brewers and HMRC to increase knowledge and help secure supply chains, and more work to establish levels of oversupply of beer to the near-continent to enable brewers to better identify potentially fraudulent supplies.

Who would beer supply chain legislation apply to? (Q40)

This question sought opinions on the most effective way to target supply chain legislation.

2.33 The majority of respondents said that supply chain legislation could only be effective if it was applied to all businesses in the alcohol supply chain (in other words, all producers, all brands, full length of supply chain). They commented this would provide a level playing field, avoid displacement to non-UK producers or other brands, and avoid general confusion over which producers or brands were included or excluded from the scheme.

2.34 Some respondents suggested that brewers producing small volumes of beer for the UK market should be excluded because their brands have limited

involvement with the fraud and the cost to their business would be unjust. One respondent highlighted that supply chain legislation would impose a huge burden on the beer and pub sector.

Suppliers' obligations (Q41)

This question asked whether supply chain legislation would achieve the aim of controlling the supply of beer into illicit supply chains.

2.35 The majority of respondents said that applying supply chain controls to the full supply chain would be a significant help. A number of responses highlighted that brewers are already operating effective 'know your customer' procedures without legislation and that these are making significant progress. However, various other respondents commented that there was too much self-regulation for suppliers and their obligations should be formalised because duty fraud in recent years showed the voluntary approach is not working.

2.36 Several respondents emphasised that if supply chain legislation was introduced fraudsters would simply displace to non-UK suppliers or would shift from premium brands to counterfeit or smuggled goods.

Supply chain policy (Q42)

This question asked what additional requirements should be included to ensure the effectiveness of supply chain legislation.

2.37 A few respondents suggested introducing an additional requirement of contracts between brand owners, suppliers and distributors that would set formal agreements on the price and full supply chain for the brand. A further suggestion was made that HMRC should be provided with details of all overseas sales. A number of respondents commented that the Excise Movement & Control System (EMCS) should be managed and organised better to provide effective control over supply chains. One respondent added that penalties and sanctions should be made significant enough to deter fraud.

Working with HMRC (Q43-Q46)

This section asked for views on tracking and tracing packaged beer to enable brewers and HMRC to investigate the supply chain following seizures of product above a specified limit.

2.38 Respondents either considered the proposed 5,000 litre seizure notification level "*not unreasonable*" or suggested it should be reduced to avoid fraud continuing through a bigger series of smaller sales. They made it clear that further consultation would be essential to establish a clear and certain notification level that brewers and HMRC could act on proportionately.

2.39 The majority of responses from the brewing industry stated that no technology exists to individually mark each can and bottle. They generally considered that a track and trace system would involve major cost and investment across the industry and would take some years to develop. One association commented that marking at can and bottle level is not practically possible because of the level of reduction that would be required to production line speed. A specialist technical company, however, stated that track and trace technology does exist, can run at speeds exceeding the maximum speeds of existing production lines

and could be used to identify the intended customer if there were ‘control points’ in the supply chain. A couple of associations suggested that track and trace information could be added to the existing “best before” date and included on general stock keeping records. Some respondents also made a suggestion of tracking and tracing at pallet level using existing tracking systems or a labelling system similar to the Serial Shipping Container Code (SSCC).

Implementation (Q47-Q51)

Views sought on how supply chain legislation could be introduced, whether there were non-legislative options that would achieve the same effect and the potential cost of implementation.

- 2.40** Once again many respondents said that supply chain legislation must apply to the full supply chain, in the UK and abroad, to achieve its aim. The point was made that fraud often occurs further down the supply chain and not at the first movement. However, a couple of associations stated that it would be difficult for brewers to obtain details of the full supply chain because their customers would be afraid of losing custom to the brewer. They also stated that brewers would in fact be infringing on competition law by requesting this information from their customer. One respondent explained that supply chain legislation would be difficult to implement because there is no correlation between beer exported and subsequently re-imported. Another practical obstacle raised was that loads are often not supervised or loaded by the driver who is then left to confirm goods by commercial documentation only.
- 2.41** Several respondents suggested a review and enhancement of the voluntary supply chain best practice and anti-illicit trade controls currently used by the brewing industry and extending these voluntary controls to all parties in the supply chain.
- 2.42** Of the few responses received from industry regarding the cost of implementing a supply chain policy and track and trace system, all agreed the cost would be high. Costs of £10 million to generate and store data and £400,000 for each new packaging line were quoted. A specialist technical company emphasised that supply chain legislation is limited if it is not supported by digital technology and other systems of control.

Summary of Impacts (Q52 - 54)

This section asked for comments on the costs and impacts of introducing supply chain legislation.

- 2.43** The majority of respondents agreed with the assessment that supply chain legislation would be a significant burden on brewers and packagers of beer. Some associations added that there would be significant costs to wholesalers too. One respondent commented that supply chain legislation does not meet proportionality, effectiveness or fairness criteria.
- 2.44** In general, respondents did not agree with the economic and equality impacts.

Comments made included:

- the extra cost to UK brewers, and not overseas brewers, could result in supplying the UK from sister breweries on the continent rather than breweries in the UK. This would lead to a loss of jobs in the UK brewing and supply chain industries and a loss of revenues for the Government
- any extra requirements placed on foreign breweries would erect a further barrier to them trading with the UK
- the duty differential between the UK and the continent should be considered
- specialist stock-keeping units packaged overseas would become obsolete.

An association reported negligible cost for small businesses if exemptions were applied, but added that the market would close for small businesses if there were no exemptions.

Alternative measures

- 2.45** The consultation also asked respondents to put forward alternative measures which would achieve the same objectives as the proposed options – to reduce the volumes of packaged beer entering illicit supply chains. All respondents who commented recognised that the problem of alcohol fraud needs to be tackled, with many proposing that the best way to tackle this issue already lies within the capabilities of HMRC and UK Border Force.
- 2.46** The main brewing association put forward a ten point action plan, the emphasis of which was on enhancing collaboration between HMRC and industry and working towards a voluntary code aimed at tightening procedures in the alcohol supply chain. A number of respondents also felt that the capability within EMCS was not being used to its full potential.
- 2.47** The majority of respondents commented that UK borders are not secure enough, leading to the belief that fraudsters will always try and smuggle as there is insufficient deterrent to stop them. Some respondents commented that some of the additional funding given to HMRC as part of the Spending Review for compliance activity should be used to increase the staffing at UK borders to create a stronger deterrent for fraudsters. An “excise goods to declare” lane and proposals specifically to record and check the EMCS Administrative Reference Codes (ARC) which accompany movements of excise goods in duty suspension were also put forward.
- 2.48** The Inquiry made a number of recommendations regarding enforcement options and alternative measures. It concluded the current alcohol strategy was not wrong but could be improved with effective co-operation and improved partnership between Government agencies; and improved communication and collaboration between HMRC and industry. It also considered EMCS should be more fully utilised.

Registration of Wholesalers

Out of 55 responses, 29 commented on the proposal to register alcohol wholesalers.

General comments

- 2.49** This option was originally proposed by representatives of the wholesale sector as a means to tackle competition within the sector from illicit products. The consultation document asked for views on the proposal to introduce a registration scheme for wholesalers and gave a brief outline of specific obligations to make it more difficult to deal in illicit product; the introduction of specific sanctions and penalties and additional record-keeping requirements.
- 2.50** Nearly all respondents offered positive opinions on this option. A number of respondents saw that the current lack of any requirement for registration (or licensing) of wholesalers had the potential to create a blind spot for the authorities in which criminals could more easily operate. Some respondents also considered it anomalous that this part of the alcohol supply chain did not require authorisation, particularly as it was often the point at which criminals fed products into legitimate supply chains. Many respondents believed that this option would allow the authorities to more effectively monitor and control the trade population. The ability to remove or reject registration was seen as a particularly important benefit as this could provide a barrier to criminals trying to enter legitimate supply chains.
- 2.51** All those who responded considered that the scheme would be effective only if it was adequately policed and enforced rigorously. A number of respondents doubted that a scheme without a high level of controls could have a significant impact on fraud. Respondents also suggested that adequate resources needed to be put in place to ensure that those approved on the register are legitimate.
- 2.52** In general, respondents considered wholesaler registration would be a reasonable and proportionate step to take to combat the fraud. Some respondents noted that the support of legitimate wholesalers for this regulation of their own sector underlined why it was justified.
- 2.53** Generally, the retail associations that responded were in favour of a wholesaler registration scheme and thought this would be a definite benefit to their sector as it would help them prove the legitimacy of their source. However, there were reservations from larger retailers who were concerned they could be included in the scope and compliance requirements of the scheme if selling to other retailers.
- 2.54** The Inquiry was generally supportive of this proposal although it suggested that HMRC should also consider whether a licensing scheme, similar to the retail licensing scheme operated by local councils, could possibly achieve the necessary objectives but at lower cost.
- 2.55** Some respondents commented that more detail was required on how the scheme would work so that wholesalers could think through the implications more clearly. One respondent felt another level of bureaucracy was not required when fiscal marks should be sufficient to track illicit products. Others felt that this option should work alongside the other anti-fraud measures and its success was dependent on the introduction of fiscal marks in order to monitor legal trade. A few were unclear how it could provide significant benefits given a register for

warehousekeepers already existed which in their view has not stopped fraud and also appears difficult to enforce.

How might registration work? (Q55-Q58)

This section asked for views on the extent of HMRC's powers to authorise, refuse or revoke a registration, the costs of the proposed scheme and whether it would be successful in tackling alcohol fraud.

2.56 Responses to this section tended to be more general. There was very little information provided on actual costs. Some of the responses included:

- any scheme should be kept as simple as possible in order to keep costs to a minimum, for example, similar to the VAT system there would have to be a mechanism for checking the validity of a registration
- HMRC needed to be more efficient in informing the industry of any changes to the register to avoid trading with unregistered businesses
- HMRC should have the right to refuse applications provided that the term "wholesaler" is properly defined
- the scheme should be extended to require anyone wishing to deal in wholesale quantities of alcohol to register - whether licensed under the Licensing Act 2003 or not.

Exclusions (Q59-Q60)

This section asked for comments on a possible de-minimis level for registration.

2.57 Some of those who responded to this question thought there should be no exclusions as it diluted the impact of having a register and one respondent believed all wholesalers should be registered irrespective of the quantities they dealt in. Another respondent believed the proposed de minimis levels were too low as they would capture retailers and a more realistic level would be anyone selling more than 50 cases at any one time. One respondent thought any new registration scheme should not include brewers who are already authorised under different excise legislation.

Obligations on the customers/suppliers of wholesalers (Q61-65)

This section asked for the practical implications and costs of new obligations under the scheme for both customers and suppliers.

2.58 Overall, the responses suggested that there was recognition of the need for many of the proposed obligations. Only a limited number of concerns were expressed. Suppliers of wholesalers believed there would be significant benefits of knowing a wholesaler was registered. It was also suggested that HMRC recommend as part of due diligence that retailers only use registered suppliers. Some thought that those who unknowingly purchased illicit alcohol should not be penalised and one respondent thought penalties should be proportionate. It was also suggested there should be a specific criminal offence for buying from unregistered wholesalers but a mechanism to check the validity of a registration would be necessary. A number of respondents believed that someone that could demonstrate that they had purchased from registered wholesalers should be protected from punitive action by HMRC or other authorities. There were also

some concerns about the practicalities for larger retailers checking customers purchasing for their own business.

Record-keeping Q66-Q68

This section asked for details of the current levels of record-keeping across the sector and the costs and practical implications of maintaining specific records, for example, to allow stock reconciliation to invoices.

2.59 Responses to the question regarding the impacts and costs of the proposal to include registration numbers on sales invoices ranged from negligible to dependent on the structure and size of the specific wholesaler. However the general feeling was that costs would not be significant.

2.60 It was thought by many that it would be difficult to maintain a system which would help reconcile purchases with sales unless it was completed manually. It was felt that it was difficult to achieve a direct link between computer records to specific cases.

2.61 In response to the question regarding other solutions available which would help match goods in stock to purchase invoices, it was thought the cost would be far too prohibitive as the solutions which do exist are expensive, for example, RFID tags. It was concluded that matching to purchase invoice was not possible. One respondent suggested extending the use of the current W1 stock return completed by warehousekeepers.

Summary of Impacts

This section asked for comments on the projected impacts of introducing a registration scheme for wholesalers.

2.62 There was very little information provided on costs as it was felt more detail was needed around the workings of the scheme. It was thought that one-off costs would depend on the level of information required for registration with minor one-off costs if invoices and signage had to change. Indicative one-off costs for system changes to incorporate a registration number on paperwork were at least £20,000 for larger wholesalers. A supplier of wholesalers also stated they could not foresee any significant costs of complying with any new requirements. Costs would also depend on the need and frequency of checking customer authorisations.

2.63 One respondent felt that the type of business having to register should be considered carefully. It was also felt that any unnecessary bureaucracy could fall disproportionately on small businesses.

Tackling Wine Fraud

2.64 Out of 55 responses, 8 specifically commented on this section and 4 responded on the proposal to register wine owners in warehouse.

2.65 The consultation document acknowledged that wine fraud is a significant problem but HMRC needed to better understand both the legitimate and illicit wine

markets. It asked for respondents' views on a specific anti-fraud measure to register owners of wine in warehouse and requested further information to help better understand the legitimate and illicit wine markets and aid in the calculation of a credible tax gap estimate for wine.

- 2.66** Generally, those who commented on this section believed that wine fraud should be tackled alongside beer and agreed in principle with introducing measures to tackle wine fraud. It was thought by some that it was unfair to target beer and not wine and a few respondents thought it would be preferable to have a single effective solution for all types of alcohol subject to fraud to avoid displacement. However, one respondent was concerned that any measure suggested for beer would also be implemented for wine without proper consideration. It was suggested as an alternative to anti-fraud measures that HMRC target the small percentage of the trade who continue to be involved in duty fraud and close the loopholes already exploited for all alcohols before considering further legislation.
- 2.67** The Inquiry also concluded that any legislative measures introduced for beer would immediately move the fraud into wine and, therefore, any measures should be accompanied by measures to prevent this displacement into wine, cider and reversion back to spirits.

Registration of wine owners in warehouse (Q72)

This section asked for views on the effectiveness of this proposal as a useful anti-fraud measure.

- 2.68** There was a mixed response to this proposal from the few that responded. Particular respondents felt it would be useful to register wine owners as an anti-fraud measure. However, others expressed strong concerns that this would impose disproportionate burdens on the legitimate trade to tackle the few who operate outside the law. It was felt that policymakers needed to be clear about what and who was being targeted to avoid large numbers of low risk operators being saddled with bureaucracy.

Application (Q73 – 79)

This section asked for views on potential exclusions from registration and alternative ways to target the scheme.

- 2.69** There was general agreement with the proposal to exempt certain categories of trader on the grounds of being “low risk” and it was also suggested HMRC could risk assess specific brands of wine and exclude anyone dealing in these brands. One respondent doubted whether a simple quantitative limit was adequate particularly as some ‘en primeur’ traders can deal in large volumes.

The illicit wine market (Q80-Q82)

This section asked for information to aid the calculation of a wine tax gap estimate.

- 2.70** Wholesalers stated they believed the illicit wine market is having a substantial impact on legitimate businesses “*who are seeing huge reductions in sales of major brands when illicit product is available*” However, it was difficult to calculate actual losses as there was an absence of a point in time where sales were not affected by fraud. The assumption that a tax gap for wine was more difficult to

calculate due to increased consumption of wine at corporate events as opposed to other alcoholic drinks was questioned by one respondent.

Gathering more information (Q83-Q89)

This section asked for details of the impacts of the illicit wine market and more information regarding illicit supply chains.

2.71 It was generally thought that wine fraud was a national rather than a regional problem and duty evaded wine posed an increasing threat to UK revenues. Counterfeit brands were also recognised as a problem. In response to the question whether illicit brands had a common source it was felt that the ease of sale in the market was a bigger factor than specific countries or supply chains. Others felt the routes to market for illicit wine were the same as beer.

2.72 When asked about indicators of illicit product, respondents said it was safer to buy direct from primary sources, however, buyers were aware of minimum costs including duty costs when buying from third parties. Illicit wine normally would be sold at or below the duty and VAT price unless on an exceptional basis.

Summary of Impacts

This section asked for comments on the projected impacts of introducing a requirement to register wine owners in warehouse.

2.73 One respondent commented on the summary of impacts and agreed with the assessment made.

3. Government response

- 3.1** The Government is grateful for industry's constructive engagement during the consultation period. The scale and nature of alcohol fraud warranted serious consideration of new measures to tackle this problem. All responses to the consultation, including consideration of concerns raised, have been analysed and assessed. From that the Government has concluded:

Fiscal marks

- 3.2** The potential for fiscal marks to be a powerful tool to tackle excise fraud remains, but the Government is aware that this proposal carries significant costs for the UK brewing industry and those involved in legitimate import and export trade. The consultation responses have shown potential costs to UK brewers of at least £6m set-up costs and £26m annual costs largely related to adaptations to packaging procedures and issues related to stock management.
- 3.3** Specific concerns have also been raised by importers regarding the practicality and costs of applying free-standing marks, and the removal of marks that had already been applied at packaging. Initial assessment of the costs to businesses involved in these processes have potential to be prohibitive and risk acting as a restraint on trade - making it more difficult for companies disassociated from the beer packaging process to enter the UK market.
- 3.4** Overall, the Government recognises that a beer fiscal mark scheme would introduce significant extra costs to the UK brewing industry. Therefore, the Government will not be proceeding with the introduction of beer fiscal marks at this time to allow exploration of other, less burdensome options to address alcohol fraud.

Supply Chain Legislation

- 3.5** The model of supply chain legislation consulted on by HMRC has already been adopted in the field of tobacco, aided by international agreements that make tobacco 'track and trace' systems mandatory. Tobacco supply chains are generally shorter and comprise of a comparatively smaller number of businesses involved in production and supply. These factors, that combine to make supply chain legislation an effective proposition for tobacco, are largely absent for alcohol weakening its effectiveness as a policy and the justification for implementation.
- 3.6** Specifically, legislation could only require suppliers to identify their first customer, and would be ineffective for products manufactured outside the UK due to the inability to control non-UK manufacturers or insist that their products should comply with track and trace requirements. This would give non-UK producers an advantage and would risk a displacement of the fraud to non-UK goods. Consequently, the Government will not introduce supply chain legislation for alcohol at this time.

3.7 Instead, HMRC will continue to explore the cost and effectiveness of available and emerging technologies that could help to secure the supply chain and payment of duty, delivering similar results to those intended by this option. We will consult shortly on new proposals to strengthen due diligence obligations of excise traders throughout the supply chain to change the behaviour of those businesses who perpetuate fraud by willingly sourcing goods from the illicit market and protect the majority of businesses who carefully consider who they trade with.

Wholesaler registration

3.8 The Government notes the positive response across all sectors towards the option to register alcohol wholesalers and can also see that there could be benefits in authorising this part of the supply chain, which is frequently the point at which illicit products are distributed. Responses also indicate that whilst there are costs to legitimate businesses, they may not be prohibitive.

3.9 However, the Government also agrees that a wholesaler registration scheme would need a high level of control and robust enforcement if it is to have a sustained impact on alcohol fraud. To establish the particular impacts on the fraud and costs of implementing such a scheme more accurately, we need further information on how such a scheme might operate in practice.

3.10 As a next step, HMRC intends to consult further with relevant sectors informally over the summer of 2013 to refine the design of a registration scheme, and establish the potential costs, benefits and implications that come from that. This will also include seeking views on the specific powers and sanctions that would be essential if the scheme is to be effective. The outcome of this further work will inform the Government's future decision on whether to proceed with a wholesaler registration scheme.

Tackling Wine Fraud

3.11 We are continuing our work to develop an official tax gap for wine and will report our progress in Measuring Tax Gaps 2013.

3.12 The responses to the option to register wine owners in warehouse raised concerns that requiring all owners to be registered, regardless of nature and scale of activity, may lead to disproportionate outcomes particularly for those trading in smaller volumes or niche products where the fraud risk is low. Therefore the Government will not proceed with registration of wine owners at this time.

3.13 HMRC will, however, continue to explore how this measure could be targeted to high risk products as part of a broader review of the Warehousekeepers and Owners of Goods Regulations 1999 that we are conducting.

Additional measures

- 3.14** There was considerable support for the view that HMRC should do more to combat the fraud through enforcement rather than impose new compliance requirements such as fiscal marks. Ideas were put forward to increase the impact of enforcement at the border and inland, maximising the potential benefits of existing systems such as EMCS and through greater collaboration with other agencies and all parts of the supply chain.
- 3.15** HMRC has given full consideration to all industry proposals and will be taking forward a wider programme of change to alcohol policy and enforcement, informed by the consultation, to strengthen its current alcohol strategy. Full details of that programme, including any further consultations required ahead of new legislation, will be published shortly but will include steps to:
- increase collaboration with industry and between enforcement agencies through the formation of a joint alcohol anti-fraud taskforce
 - tighten / 'design out' opportunities for fraud in the excise regulatory system
 - deal more robustly with those found holding or moving illicit goods, and
 - increase co-operation with other EU Member States.
- 3.16** HMRC is already progressing enhancements to the EMCS to improve the targeting and disruption of fraud, to maximise the potential benefits provided by the system. Proposals specifically to check and record the EMCS Administrative Reference Codes (ARC) which accompany all legitimate movements of excise goods in duty suspension and to introduce an 'excise goods to declare' lane are, however, considered incompatible with the requirements of the Single Market and will not therefore be progressed.

Annex A: List of stakeholders consulted

Coventry Trading Standards
British International Freight Association (BIFA)
Road Haulage Association (RHA)
Bridge Vintners
The Brooklyn Brewery
Duvel Moortgat
The Association of Export Breweries of Northern,
Western and Southwestern Germany
United Wholesale (Scotland) Ltd
London City Bond Ltd (LCB)
Brewers of Sweden
Nederlandse Brouwers
Metal Packaging Manufacturers Association (MPMA)
James Clay
P&O Ferries
Chamber of Shipping
Brasseurs-de-france
Port of Dover
British Glass
Irish Brewers Association (IBA)
Association of Convenience Stores (ACS)
Belgian Brewers
Chartered Institute of Taxation (CIOT)
Bargain Booze
Fiscal Consultancy Ltd
Society of Independent Brewers (SIBA)
National Federation of Retail Newsagents (NFRN)
SICPA
National Association of Cider Makers (NACM)
Association of Licensed Multiple Retailers (ALMR)
Cerveceros De Espana
Scotch Whisky Association (SWA)
Tiintax.com
Shepherd Neame
Miller Brands UK Ltd
British Association of Ship Suppliers (BASS)
Wine & Spirits Trade Association (WSTA)
Tesco
Fuller, Smith & Turner
United Kingdom Warehousing Association (UKWA)
British Beer & Pub Association (BBPA)
UK Travel Retail Forum (UKTRF)
Molson Coors
AB InBev UK
Federation of Wholesale Distributors (FWD)
Carlsberg
St. Austell Brewery
The Campaign for Real Ale (CAMRA)
Seabrooks
Individual respondent (unnamed)
Wincanton
Bonded Warehousekeepers Assc'n (BWA)
British Retail Consortium (BRC)
Greene King
Drinks Inc
Thomas Hardy Holdings Ltd