



Alcohol excise duties

Standard Note: SN/BT/162
Last updated: 12 June 2002
Author: Antony Seely
Business & Transport Section

There are a number of principles which underlie the taxation of alcohol: to encourage its responsible consumption, given the potential effect it can have on one's health and one's behaviour (such as careless driving); to raise revenue; and, to support the drinks industry in the UK. The Single European Market introduced another factor in the determination of duty rates: cross border shopping and smuggling. Since 1 January 1993 travellers have been allowed to import alcohol and tobacco products which they have purchased in the EU for their own use, without paying any additional UK tax on these items. Before that date, shoppers could only import limited quantities of *tax-paid* goods.¹

Duty rates on alcohol & tobacco in this country are considerably higher than in a number of other EU Member States (including France, the Netherlands and Spain). The consequent variation in prices has provided a large incentive for shoppers to purchase alcohol and tobacco products on the Continent. In addition, the abolition of import allowances has acted as an incentive for smugglers to purchase alcohol and tobacco abroad, and resell it illegally when back in this country.

This note examines the impact cross border shopping has had on alcohol duties, before looking at two other issues in alcohol taxation that have been discussed recently: tax neutrality (that is, the principle that different types of drink should be taxed according to the amount of pure alcohol they contain), and the possibility of charging a lower rate of duty on beer produced by smaller breweries (known as a 'progressive' beer duty).

In his Budget speech on 17 April 2002 the Chancellor Gordon Brown announced that small breweries with an annual production of 30,000 hectolitres or less would be entitled to charge a reduced rate of beer duty under a new scheme, to be introduced from 1 June 2002.² The Chancellor also announced that duty rates on beer, spirits and wine would be frozen and that the duty on cider would be cut by 2%. However the duty on premium package coolers (ready-to-drink cocktails containing spirits) would be increased significantly, taxed at the same rate as spirits rather than low-alcohol wine as they had been previously.³

¹ Duty-free sales on journeys within the EU were abolished from 1 July 1999, though they are still available to travellers to and from other countries. For details see, *Duty-free shopping*, Library Research paper 99/74 22 July 1999, available from the Library's internet site: www.parliament.uk/commons/lib/research/rpintro.htm

² HC Deb 17 April 2002 c 584

³ HM Customs & Excise Budget Notice CE2, 17 April 2002

Contents

A.	Duty rates in the UK	2
B.	EU rules on duty rates and cross border purchases	4
C.	Cross border shopping and smuggling	8
D.	Recent debate on the level of alcohol taxes	16
E.	Tax neutrality	19
F.	'Progressive' beer duty	22

A. Duty rates in the UK

Duties on spirits, beer, wine & made-wine, cider & perry, raised £6.6 billion in 2000-01; by comparison duties on petrol and other hydrocarbon oils raised £22.6 billion and those on tobacco raised £7.6 billion.⁴ The tax take from alcoholic drinks is a significant proportion of their price, though this varies considerably between products. Excise duty and VAT taken together account for just under 30% of the price of a pint of bitter when sold in a pub, 51% of the price of table wine, and 61% of the price of a bottle of whisky.⁵ Beer and spirits are taxed according to their alcoholic content; wine, made wine, cider and perry are all subject to specific (ie, by volume) duties.

Most duty rates were last increased in the March 2000 Budget, by 3.4 per cent in line with inflation,⁶ although the duty on spirits has been frozen since 1 January 1998. In the 2002 Budget duties were mostly frozen in value – though, as noted above, the duty on cider and perry was cut by 2% “to support [a] traditional and mainly rural-based industry, which now uses around half the UK’s total production of apples.” It is estimated that freezing duties in the 2001 and 2002 Budgets has cost the Exchequer “around £200 million.”⁷ In addition spirits-based drinks not exceeding 5.5% alcohol by volume (“coolers”) that in the past have been taxed as made-wine are now to be taxed at the same rate as spirits: in effect this will increase the duty on these ready to drink cocktails by 11p per bottle.⁸ The new rates for these cooler products, as well as for cider and perry, came into effect from midnight 27 April 2002.⁹ The Chancellor’s announcement of duty relief for smaller breweries is examined in section F of this note.

Current duty rates on all alcoholic drinks are set out overleaf:

⁴ *Budget 2002* HC 592 April 2002 p 217

⁵ *HM Customs & Excise Annual Report 1998-99* p 86

⁶ HM Customs & Excise Budget Notice BN38/00, 7 March 2000. These duty rate changes took effect from 1 April 2000.

⁷ HM Customs & Excise Budget press notice C&E 1, 17 April 2002

⁸ “Clubbers hit by 11p rise in ready-to-drink cocktails”, *Financial Times*, 18 April 2002

⁹ HM Customs & Excise Budget Notice CE2, 17 April 2002. Further details are given in Customs’ *Alcohol Factsheet*, and on its internet site at: www.hmce.gov.uk/business/othertaxes/alcohol.htm.

	<i>Rate £ per litre of pure alcohol</i>
Spirits	19.56
Wine or made wine of an alcoholic strength exceeding 22 per cent	19.56
Spirits-based 'coolers'	19.56

	<i>Rate £ per hectolitre</i>
Wine or made-wine	
• exceeding 1.2 per cent - not exceeding 4 per cent abv	47.58
• exceeding 4 per cent - not exceeding 5.5 per cent abv	65.42
• exceeding 5.5 per cent - not exceeding 15 per cent abv	154.37
• exceeding 15 per cent - not exceeding 22 per cent abv	205.82
Sparkling wine or sparkling made-wine	
• exceeding 5.5 per cent - less than 8.5 per cent abv	166.70
• 8.5 per cent and above - not exceeding 15 per cent abv	220.54
Cider and perry	
• exceeding 1.2 per cent - not exceeding 7.5 per cent abv	25.61
• exceeding 7.5 per cent - less than 8.5 per cent abv	38.43
Sparkling cider and sparkling perry	
• exceeding 5.5 per cent - less than 8.5 per cent abv	166.70

	<i>Rate per hectolitre per per cent of abv</i>
Beer	11.89

Duty rates for the three main drink categories over the past ten years are shown below:

Duty rates on beer, wine and spirits 1993-2002 (£)

Date	Beer [†]	Wine ^{††}	Spirits [‡]
16.3.93	1.163 ^{‡‡}	132.26	19.81
1.6.93	10.45	132.26	19.81
1.1.94	10.45	134.77	19.81
1.1.95	10.82	140.44	20.60
28.11.95	10.82	140.44	19.78
26.11.96	10.82	140.44	18.99
1.1.98	11.14	144.65	19.56
1.1.99	11.50	149.28	19.56
1.4.00	11.89	154.37	19.56
27.4.02	11.89	154.37	19.56

Notes : † Duty rate in £ for every per cent of alcohol by volume (ABV); ie, beer at 4% ABV would be charged just under £48 per hectolitre at present.

†† Table wine : ie, with strength of 5.5% to 15% ABV.

‡ Duty rate in £ per **litre** of pure alcohol.

‡‡ Duty charged according to original gravity for each degree above 1000. Rather than duty being charged in relation to the volume and strength of the final product, beer duty was charged on the volume and the original gravity (a measure of density) of beer in its unfermented state (known as the “worts”).

B. EU rules on duty rates and cross border purchases

There has been some degree of harmonisation in excise duties – on alcohol, tobacco and hydrocarbon oils – across EU Member States. The current agreement on harmonising duties was reached on 24 June 1991, and incorporated into a number of EC directives adopted on 19 October 1992. Specific minimum rates were set for excise duties on mineral oils, alcohol, and tobacco products, from 1 January 1993.¹⁰ Member States are free to set rates appropriate to their own circumstances, provided they were not lower than the minimum levels specified in the relevant directive. The sheer variation in duty rates between countries made any closer form of harmonisation politically infeasible. In each case, the Council agreed that these minimum rates should be reconsidered every two years. In the case of alcohol, the agreed minimum rates of duty for all five categories of drink are well below the current UK rates:¹¹

Product	Minimum rate	UK rate
Spirits	£428.76 per hectolitre of pure alcohol	£1,956.00
Fortified wines	£35.08 per hectolitre of finished product	£205.82
Still wine	Zero rate “ “	£154.37
Sparkling wine	Zero rate “ “	£220.54 ¹²
Beer	£1.45 per ABV of finished product per hectolitre	£11.89

A first report on duty rates was considered by the European Council of Finance Ministers (ECOFIN) on 23 October 1995, which concluded that further action should be postponed pending a wider analysis of the range of relevant issues.¹³ There do not appear to have been any substantive developments since then.¹⁴

¹⁰ The four directives setting minimum duty rates were: cigarettes (92/79/EEC); other tobacco products (92/80/EEC); mineral oils (92/82/EEC); alcohol (92/84/EEC).

¹¹ For more details see the evidence provided by Customs to the Treasury Committee in 1994 on these provisions (*Cross Border Shopping*, 23 November 1994 HC 35-II 1994-95 pp 47-49).

¹² Figure for sparkling wine of 8.5% - 15% ABV. Since 1 January 1997 a lower rate of duty has been charged on sparkling wine of 5.5% - 8.5% ABV, which is £166.70 per hectolitre at present. In a recent report the Scottish Affairs Committee argued that these minimum rates strongly discriminated against spirits (*The drinks industry in Scotland*, 14 November 2001 HC 324 2001-02 p xxii).

¹³ HC Deb 3 November 1995 cc 505-506W

¹⁴ Recently the *Financial Times* reported that the Commission has prepared draft proposals, for low tax countries such as Germany and Spain to gradually raise duty levels up to those charged in high tax countries, such as Finland and the UK (“Brussels could pull a low-tax pint for Britain – but not until 2038”, 22 February 2002).

The Government's approach to this issue was given in a written answer in November 1998:

Mr. Gill: To ask the Chancellor of the Exchequer what plans he has for the harmonisation of liquor duties with other EU countries.

Dawn Primarolo: Member States are free to set excise duty rates at the levels they feel are appropriate to their own particular circumstances, subject only to the agreed minimum rates. The Government believe that there should be a levelling up of the minimum rates of excise duty on beer and wine but recognise that progress is likely to be in the long term. The mechanism for achieving this aim is through the European Commission's biennial reviews of the minimum rates of excise duties. The Commission's report on alcohol minimum rates, due by 31 December 1996, is awaited.¹⁵

The issue was raised in a report by the Commission published in May 2001, on the priorities for tax policy:

In line with the objective of ensuring the smoother functioning of the Internal Market and the wider objectives of the Treaty, the Commission services have to prepare reports and proposals concerning the Community's minimum levels of excises on alcohol and tobacco ... As regards the report on excise duty levied on alcohol and alcoholic beverages, the Commission services are in the process of consulting Member States and trade associations concerned on the issues to be dealt with in the report. These issues are the proper functioning of the internal market, competition between the different categories of alcoholic drinks, the real value of the rates of duty and the wider objectives of the Treaty (such as health and agricultural policy). The Commission intends to adopt the report on alcohol taxation later this year.¹⁶

In this context it is worth mentioning the legal efforts of the Shepherd Neame brewery to have the two increases in beer duty announced in the July 1997 Budget and the March 1998 Budget struck down as being incompatible with European law.¹⁷ In August 1997 Shepherd Neame advised H M Treasury they would seek a Judicial Review of the duty increase announced in the July 1997 Budget; in November a High Court Judge granted the company leave to apply for Judicial Review,¹⁸ though the High Court Decision ruled in favour of the Government on 21 January 1998.¹⁹

The Treaty base for the legislation establishing minimum duty rates is Article 93 of the Treaty, which states that "the Council shall, acting unanimously on a proposal from the Commission ... adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties

¹⁵ HC Deb 16 November 1998 c 367W

¹⁶ European Commission, *Tax policy in the European Union: priorities for the years ahead COM(2001) 260 final*, 23 May 2001 p 15

¹⁷ The duty on beer was increased by 3% from 1 January 1998, and a further 3.2% from 1 January 1999; both increases were in line with inflation.

¹⁸ "Shepherd Neame granted judicial review on beer duty", *Financial Times*, 7 November 1997

¹⁹ "Law report: beer excise duty increase lawful", *Times*, 2 February 1998

and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market.”²⁰ Shepherd Neame argued that this established a legal obligation on Member States to abstain from measures which could jeopardise the achievement of further approximation, and that the increase in beer duty was just such a measure. The Court ruled that the brewery had failed to establish that it was a Treaty objective to achieve further approximation of excise rates beyond the minimum rates contained in the Rates Directive, as Article 93 made no assumption as to what was necessary to achieve the proper functioning of the internal market:

Unless there was a clearly established concept of the internal market, there could be no decision as to the extent to which harmonisation was necessary to ensure its establishment and functioning pursuant to article [93]. The tension between wider objectives in the Treaty of Rome and further approximation raised difficult issues. The Commission had not yet been able to resolve those difficulties even to the extent of making a proposal for further approximation. It could not be assumed that discussions would lead to the conclusion, even within the Commission, that further measures of approximation were a desirable objective. The highest it could be put, in his Lordship’s view, was that further approximation was a possible step forward in the achievement of a properly functioning market.²¹

The brewery took the case to the Court of Appeal, but in February 1999 the Court threw out the company’s claim.²²

The introduction of the Single European Market on 1 January 1993 meant the abolition of traveller’s allowances - the limits placed on the amounts of tax-paid goods (goods liable to excise duty and/or VAT) which individuals could buy for themselves. Agreement between Member States on this issue was reached in November 1991, and is enshrined in EC directive 92/12/EEC.²³ Article 8 of directive 92/12/EEC states that, “as regards products acquired by private individuals for their own use and transported by them, the principle governing the internal market lays down that excise duty shall be charged in the Member State in which they are acquired.” This establishes the rule that provided a traveller’s imports are for their own personal use, they are not liable to pay any further excise duty on returning home.

Each Member State may set indicative levels of alcohol and tobacco purchases, to help Customs officers distinguish between genuinely private imports and commercial importation. Below them, imported goods will be chargeable with UK duty only if they are sold or have been purchased for someone else. These limits – or guide levels – are specified in Article 9 of directive 92/12/EEC, and implemented in UK law by the *Excise Duties (Personal Reliefs) Order* SI 1992/3155. For alcoholic drinks, the guide levels are: 10 litres spirits; 20 litres fortified wines; 90 litres wines (of which, no more than 60 litres sparkling); and, 110 litres beer.

²⁰ Prior to the Treaty of Amsterdam this provision was contained in Article 99 of the Treaty.

²¹ “Law report: beer excise duty increase lawful”, *Times*, 2 February 1998

²² HM Customs & Excise press notice 6/99, 12 February 1999

²³ Council Directive 92/12/EEC of 25 February 1992

In assessing whether goods are for personal use, the important distinction is between commercial purchases and non-commercial ones. The *Excise Duties (Personal Reliefs) Order SI 1992/3155*²⁴ lists a variety of factors to be used by customs to determine whether goods are imported for a commercial purpose: it should be noted that the onus of proof *falls on the traveller* if purchases exceed the guide levels.²⁵

The two terms - personal use and personal consumption - have been used widely and interchangeably in discussions of this issue, and many travellers have been confused as to whether they are allowed to buy goods for, say, a wedding party, - which would be for their own use - or if they have to actually consume all of their purchases themselves to avoid paying extra duty. Notably during a debate on traveller's allowances held during the Committee stage of the *Finance (no.2) Act 1992*, the then Paymaster General, Sir John Cope, used both expressions, but he underlined the point that the legislation is focused on whether purchases are made with a commercial aim, rather than the way in which non-commercial purchases may be distributed. In answer to Paul Boateng's criticism that he had confused the issue, Sir John said, "I do not think that I made an error about personal use ... If a person brings in bottles of wine and gives them away as gifts ... that is not dutiable, but if money changes hands, it becomes dutiable."²⁶

In recent months there has been some concern about Customs officers stopping travellers and seizing their goods if they are carrying more than the guide levels,²⁷ and in this context a recent PQ on the proportion of travellers who are actually stopped by Customs is instructive:

Mr. Howard: To ask the Chancellor of the Exchequer how many people entering the UK were questioned by HM Customs and Excise in each of the last five years on suspicion of alcohol smuggling; how many were carrying more alcohol than the suggested guidelines for imports for personal use; and how many of these were allowed to enter the country on the grounds that the alcohol was for personal use.

Mr. Boateng: This information is not available in the format requested. Customs carefully target their anti-smuggling activity on those thought likely to be smuggling, and have no interest in legitimate cross-border shoppers. Accordingly only a very small proportion of the 90 million travellers who enter the UK each year are stopped by customs officers. Indeed, in 2000-01 less than 0.2 per cent. of the estimated 14 million travellers through the channel ports had goods seized by customs. The majority of people entering the UK with goods in excess of the minimum indicative levels were able to satisfy customs that the goods were for their own personal use.²⁸

²⁴ as amended by SI 1999/1617

²⁵ For more details see HM Customs & Excise, *A Customs guide for travellers entering the UK : Customs Notice 1*, June 2001 (available on Customs' site at: www.hmce.gov.uk/notices/1.htm), and "Personal imports of duty paid goods", SN/BT/1223, 24 October 2001.

²⁶ Standing Committee B 16 June 1992 c.47

²⁷ for example, "Brussels probes Customs over confiscations", *Financial Times*, 29 June 2001 & "Customs defiant over searching for alcohol", *Financial Times*, 6 August 2001

²⁸ HC Deb 11 December 2001 c 773W

C. Cross border shopping and smuggling

The rates of excise duty on alcoholic drinks in this country are significantly higher than those in most other EU Member States.²⁹ In the UK beer is charged duty at 34p per pint – compared with 4p in France, 3p in Germany and 7p in the Netherlands.³⁰ Duty on a 70cl bottle of spirits is set at £5.48 in this country, compared with £2.47 in France and £1.17 in Spain.³¹ Duty on a 75cl bottle of table wine is £1.16 in the UK, compared with 4p in France and 0p in Spain.³²

The variation in duty rates, and consequent variation in prices, has provided a large incentive for shoppers, and smugglers, to purchase alcohol, and tobacco, abroad, and - in some cases - resell it illegally when back in this country.³³ Five years after the inception of the Single Market, the annual cost of revenue lost from cross-border shopping was estimated to be £375 million for 1998 – of which £285 million came from alcohol sales.³⁴

For goods smuggled into the UK, the Exchequer loss is two-fold: first, in respect of the tax (excise duty and VAT) which should have been paid on those particular goods when sold in the UK ('revenue evaded'); second, in respect of the purchases consumers would have made in the UK, had they not been substituted by these illegal sales ('revenue lost').³⁵ In both respects tobacco products – especially hand rolling tobacco – has accounted for the lion's share of these costs – though the total annual cost of cross-border smuggling of alcohol was estimated to be £500 million in 1999 (£285 million of which was revenue evaded). By comparison, the estimated cost of tobacco smuggling in the same year was £2,110 million.³⁶

It is worth noting that here are a number of types of excise fraud, including:

- the smuggling of duty paid goods (the 'white van trade'), where goods bought ostensibly for personal use are sold on in the UK without payment of UK duty and VAT;
- 'diversion fraud', where goods destined for export are in fact diverted to the UK home market without payment of VAT or UK duty;
- large-scale smuggling of alcohol and, particularly, tobacco from countries outside the EU by concealment or misdescription in order to evade duty and VAT.³⁷

²⁹ Generally duty rates are comparable to those in the UK or higher in Denmark, Finland, Ireland and Sweden.

³⁰ as at July 2001, for beer of 5% ABV or 12.5⁰ Plato. HM Customs & Excise, *Alcohol Factsheet*, October 2001 p 7

³¹ as at July 2001, for spirits of 40% alcohol by volume. *Alcohol Factsheet*, October 2001 p 7

³² as at July 2001, for wine of 11.5% alcohol by volume. *Alcohol Factsheet*, October 2001 p 8

³³ Two reports by the Treasury Committee provide some background on the first impact of the Single European Market in this respect: *Cross Border Shopping* HC 35 1994-95 23 November 1994; *The Cross Border Market in Excise Products* HC 24 1995-96 16 November 1995.

³⁴ HC Deb 26 November 1999 cc 254-5W

³⁵ Customs assume that between 70 per cent. and 80 per cent. of all alcohol purchased abroad substitutes for similar purchases in the UK (100 per cent. assumed for tobacco products).

³⁶ HC Deb 26 November 1999 cc 254-5W

³⁷ Treasury Committee, *HM Customs & Excise*, 8 February 2000 HC 53 1999-2000 para 46

On the matter of diversion fraud, under the Single Market Member States are required to operate a system of duty suspension in order to facilitate alcohol trade.³⁸ The system allows registered traders or warehousekeepers to produce, process, store and move goods without payment of duty – keeping them in an approved excise warehouse, so they can time the payment of the duty nearer to the time when they actually sell the goods. Duty only becomes payable when the goods are released for consumption, or acquired by an unregistered individual. ‘Outward’ diversion fraud occurs when duty suspended goods destined for export, or for another UK excise warehouse, are illegally diverted from an excise warehouse on to home or overseas markets without payment of duty. ‘Inward’ diversion fraud occurs when duty suspended goods imported to an excise warehouse are illegally diverted on to the UK market – once they clear frontier controls – without payment of duty.

The duty-suspended movement of tobacco is more restricted than alcohol. UK manufactured tobacco products must be removed to home-use directly from the manufacturer’s premises. Also, most exports are made directly from the manufacturers premises.³⁹ As a consequence there are distinct differences in the pattern of revenue fraud involving alcohol as opposed to tobacco, as a recent methodological paper by Customs observes:

The majority of cigarette fraud involves large-scale smuggling by freight – principally in either deep-sea containers or ‘roll on roll off’ lorries. Most of the remainder is smuggled in light vehicles through the Channel ferry ports and the Channel Tunnel (the so-called ‘white van trade’) ...

In the case of beer and wine, revenue losses from fraud are relatively small and are largely the result of cross-Channel smuggling from duty paid sources in other Member States. In the case of spirits, the principal feature of the fraud involves the diversion of duty suspended goods moving between excise warehouses for consumption on the domestic market. These goods are mostly manufactured in the UK and distinguishing between legitimate and illicit spirits at the retail stage is difficult. Customs estimate that about half of all illicit spirits are sold to consumers through retail outlets at legitimate retail prices.⁴⁰

The influence of both legal cross border shopping and illegal smuggling on setting duty rates was acknowledged by the then Chancellor, Kenneth Clarke, in each of his 1994, 1995 and 1996 Budgets, and in the last two of these Budgets Mr Clarke froze duties on beer and wine, and cut the rate of duty on spirits (in two steps, in November 1995 and November 1996).⁴¹ In the first of these Budgets Mr Clarke had initially proposed freezing duties,⁴² but following the Government’s defeat on increasing the rate of VAT on fuel and power from 8% to 17.5% some

³⁸ For details see National Audit Office, *Losses to the revenue from frauds on alcohol duty*, 19 July 2001 HC 178 2001-02 pp 1-5

³⁹ HM Customs & Excise, *Tax stamping of spirits*, December 2001 p 7

⁴⁰ *Measuring Indirect Tax Fraud*, November 2001 p 2

⁴¹ HC Deb 28 November 1995 c 1065; HC Deb 26 November 1996 c 168

⁴² HC Deb 29 November 1994 cc 1095-1096

days later, introduced a number of revenue raising measures, including a second round of duty increases for tobacco and hydrocarbon oils, combined with a 4% increase in alcoholic duties.⁴³

The then Financial Secretary, Dawn Primarolo, now Paymaster General, asked Customs and Excise to carry out a review of alcohol and tobacco fraud in partnership with the trade, at the time of the Labour Government's first Budget following the General Election in July 1997. The report was published in July 1998,⁴⁴ and on its publication the Government announced a series of measures to tackle both tobacco and alcohol smuggling.⁴⁵ Further details of the Government's response to the Review's recommendations have been published since then.⁴⁶

Historically the costs of tobacco smuggling have dwarfed those of alcohol smuggling, and evidence that the problem was worsening in the mid-late 1990s saw a major three year initiative on the part of Government announced at the time of the March 2000 Budget.⁴⁷ These measures included:

- an additional 955 front-line staff and investigators: 640 deployed in the first year, with a further 175 staff to be deployed during 2001-02 and 140 more due to be deployed in 2002-03;
- introduction of a national network of x-ray scanners designed to detect large volumes of smuggled goods concealed in freight containers, with twelve scanners now in operation;
- the introduction of 'UK Duty Paid' marks on packets of cigarettes and hand-rolling tobacco, with new penalties for those caught dealing in unmarked tobacco or allowing their premises to be used for the sale of unmarked tobacco;
- a £3 million publicity campaign to remind would-be smugglers of the penalties for being caught, and to discourage ordinary members of the public from buying the illicit goods used to fund organised criminal networks.⁴⁸

In addition Customs tightened up its policy towards seizing the assets of smugglers,⁴⁹ including any vehicle used to smuggle goods – and it is clear that this has had a substantive impact on the smuggling of both tobacco and alcohol, cutting the revenue evaded from cross-

⁴³ HC Deb 8 December 1994 cc 473-476

⁴⁴ HC Deb 28 July 1998 c 214W; HM Customs & Excise, *Report of the alcohol & tobacco fraud review*, January 1998 [Dep 98/83]. Section 4 of the report provides more details on the types of alcohol and tobacco smuggling there are.

⁴⁵ HM Customs & Excise press notice 19/98, 28 July 1998

⁴⁶ First in answer to a PQ (HC Deb 10 February 1999 cc 256-258W), and more recently in a deposited paper (HM Treasury/HM Customs & Excise, *Alcohol and tobacco fraud review: update on implementation of recommendations*, November 2001 Dep 01/140).

⁴⁷ The Government's strategy is set out in *Tackling Tobacco Smuggling*, March 2000 which built on the recommendations made in a report by Martin Taylor to the Chancellor in November 1999 (HM Treasury/HM Customs & Excise Budget press notice HMT/C&E 1, 22 March 2000). The paper is on the Treasury's site at: www.hm-treasury.gov.uk/mediastore/otherfiles/433.pdf.

⁴⁸ HM Customs & Excise, *Tackling indirect tax fraud*, November 2001 p 10. This report is on Customs' site at: www.hmce.gov.uk/forms/budgetnotices/pbr-2001/fraud-complete.pdf.

⁴⁹ HM Customs & Excise press notice 8/2000, 9 February 2000

Channel smuggling by an estimated 76 per cent.⁵⁰ As noted above, in 1999 revenue evaded from cross-Channel smuggling of alcohol was estimated to be £285 million;⁵¹ in 2001 the figure is estimated to be £50 million.⁵² Customs policy towards vehicles seizure has been modified recently, in light of a Court case considering the proportionality of Customs decision whether or not to restore a vehicle seized for use in smuggling tobacco. Details were given in a press notice,⁵³ and a written answer:

Barbara Follett: To ask the Chancellor of the Exchequer if HM Customs and Excise will change its vehicle seizure policy in relation to alcohol and tobacco smuggling as a result of the Court of Appeal decision in the Lindsay case.

Mr. Boateng: The Court of Appeal confirmed in the Lindsay case that Customs vehicle seizure and non-restoration policy in relation to those who smuggle alcohol and tobacco for profit was justified and proportionate. It also confirmed that vehicles used to smuggle on a non-profit basis were similarly liable to seizure. However, the Court considered that in not-for-profit cases a proportionate response, depending on the individual circumstances, would be to offer to restore such seized vehicles. Accordingly when Customs detect commercial for profit smugglers, any vehicles used in such smuggling will remain subject to the existing tough seizure and non-restoration policy. However, Customs have now further developed their vehicle seizure policy, taking into account the clarification provided by the Court of Appeal.

When Customs detect not-for-profit smugglers their goods and vehicles will be seized but vehicle restoration will ordinarily be offered in the first instance for a sum equivalent to the revenue evaded. There will be a rising scale for any subsequent offences up to non-restoration. Customs will reserve the right to vary their restoration terms according to the aggravating or mitigating circumstances of any individual case. This policy will allow Customs to continue their successful approach of hitting those who smuggle for profit with tough sanctions that strike at their illicit trade and also provides a real and proportionate penalty for those who break the law, albeit without such profit making motivation. It represents a fair and balanced policy.⁵⁴

There has been one further important development in relation to excise fraud involving alcohol. In June 2000 the Paymaster General Dawn Primarolo commissioned a full independent investigation, headed by John Roques, an ex senior partner of Deloitte and Touche, into the collection of excise duties, following an internal Customs assessment which had found serious weaknesses in the Department's control of excise duty collection, in particular the mechanisms for releasing dutiable spirits and wine from bonded warehouses

⁵⁰ *Tackling Indirect Tax Fraud*, November 2001 p 13

⁵¹ HC Deb 26 November 1999 cc 254-5W

⁵² *Measuring Indirect Tax Fraud*, November 2001 p 22. Estimates for legal cross border shopping of alcoholic drinks show some growth in spirits and wine sales, and stability in beer sales (*op.cit.* pp 12-17). The paper is on the Customs site at: www.hmce.gov.uk/forms/budgetnotices/pbr-2001/measuringtaxfraud.pdf

⁵³ HM Customs & Excise press notice PR34/02, 2 May 2002

⁵⁴ HC Deb 2 May 2002 cc 932-3W

over the period 1995-1998.⁵⁵ It is now estimated that frauds between 1993 and 2000 led to alcohol duty evasion of £668 million from diversion onto UK markets.⁵⁶

The Roques Report was presented to Ministers in December 2000, making a total of 65 recommendations designed to strengthen the excise holding and movements systems, improve controls on investigations and establish clearer lines of accountability for revenue issues at senior levels within Customs. The Treasury Committee looked at this issue in March 2001, requesting that both the report and the Government's response to it should be published,⁵⁷ which occurred in July.⁵⁸ In its response to the Committee, the Government set out the key measures that had been implemented, or were being considered, in the wake of the report:

The Roques report made 65 recommendations of which Customs fully or partially accept 62. The majority of these recommendations were implemented by July 2001. Key measures include

- A more rigorous approach to the approval of warehouses,
- Tightening the registration procedures for warehousekeepers and the owners of goods,
- Improving the information on the holding and movement of excise goods where the duty has not been paid,
- Improving the exchange of information with other Member States,
- Increasing the checks on warehousekeepers' compliance with holding and movement regulations,
- Tightening controls on hauliers,
- Considering the use of tax stamps for alcohol, and,
- The deployment of additional staff for excise warehouse controls.⁵⁹

Recently the Treasury Committee has taken evidence on the report and the Government's response to it.⁶⁰

At the time of the *Pre-Budget Report* in November 2001, the Government published details of its strategy to deal with all forms of indirect tax fraud – including alcohol fraud, and specifically fraud involving spirits; an extract from this paper is reproduced below:

⁵⁵ HM Customs & Excise press notice PR26/2000, 30 June 2000

⁵⁶ Another £216 million was accounted for which involved goods diverted overseas where duty would have been due in the country of import had the goods not been fraudulently diverted (*Losses to the revenue from frauds on alcohol duty*, 19 July 2001 HC 178 2001-02 p 2).

⁵⁷ *HM Customs & Excise: collection of excise duties*, 22 March 2001 HC 237 2000-01

⁵⁸ HM Treasury, *The collection of excise duties in HM Customs and Excise: Report by John Roques and government response* Cm 5239 July 2001. This is available on Customs' site at: www.hmce.gov.uk/about/reports/roques.pdf

⁵⁹ *The Government's response to the Committee's sixth report of session 2000-01*, 30 October 2001 HC 315 2001-02 p iv

⁶⁰ *HM Customs and Excise - the Roques report: Minutes of evidence*, 14 & 28 November 2001 HC 371-ii 2001-02

The great majority of alcohol excise duty comes from beer, wine and spirits. The illicit market for beer and wine is relatively small and has traditionally resulted from cross-Channel smuggling of duty paid goods from other EU Member States. However ... activity at the Channel ports is already having a tangible impact in reducing smuggling of beer and wine. The Government therefore believes that the next major challenge lies in tackling large-scale spirits fraud.

The principal feature of spirits fraud involves the diversion of duty-free goods moving between excise warehouses for consumption on the domestic market. These goods are mostly manufactured in the UK and distinguishing between legitimate and illicit spirits at the retail stage is difficult. Customs estimate that about half of all illicit spirits are sold to consumers through retail outlets at legitimate retail prices. Fraudulent traders therefore make a huge mark-up on the fraud by exploiting consumers who are often unaware that they are purchasing illicit goods. Spirits fraud is estimated to have cost up to £450 million in revenue losses in 1999-2000, equivalent to 15 per cent of the UK market.

To tackle spirits fraud, and in particular the problem of inward diversion, Customs have so far:

- established a specialist team to check and “discredit” the paperwork covering the movement of duty suspended goods in freight consignments;
- implemented a tougher HGV seizure policy, targeting those hauliers who fail to conduct simple checks to ensure they are not caught up in fraud;
- commenced the redeployment of an additional 146 assurance officers to strengthen the excise holding and movements system;
- started a review of all warehouse approvals; and
- increased the resources deployed to excise intelligence and research.

The Government believes that further action will be necessary to reduce revenue losses from spirits fraud and to reduce the competitive disadvantage suffered by legitimate wholesale and retail traders. The Government has therefore decided to press ahead with the next stage of the strategy which involves:

- increasing the rate of checks carried out on spirits consignments when they enter the UK under duty suspension;
- applying improved intelligence to help target additional checks on suspicious consignments, helping to limit the impact on legitimate traders and hauliers;
- strengthening the controls on bonded warehouses within the UK;
- consulting widely on the costs, benefits and practicalities of introducing a tax stamps system for spirits, designed to assist in the identification of smuggled products;⁶¹ and
- if it is decided to proceed with the tax stamps system, introducing new sanctions for those found to be dealing illegally in un-stamped goods.

⁶¹ The Roques report recommended that “that [Customs] moves as quickly as possible to introduce tax stamps for spirits, and associated sanctions, to protect both excise revenues and the UK’s whisky production industry” (Cm 5239 July 2001 p 87). A similar system of ‘UK duty paid’ marks on packets of cigarettes and hand-rolling tobacco was introduced in July 2001 (HC 279 March 2001 p 101).

A key issue in the consultation process will be the development of a system which keeps compliance costs for legitimate businesses as low as possible, consistent with the aims of the strategy.

To measure the impact of this strategy, the Government will set Customs the objective of achieving gradual reductions in the market share of illicit spirits over the next three years.⁶²

To this end Customs issued a consultation paper on introducing a tax stamps system for spirits in December 2001; the consultation period finished on March 5 2002. A press notice issued at the time gave some details how the system might work:

A tax stamp is a special stamp that would be issued by Customs to producers and importers of spirit products. The issue of the stamp would form the basis for paying excise duty. As the duty is effectively paid in advance of the product being delivered onto the UK market, a stamp would provide for both greatly enhanced security and control of duty payment and certainty that product bearing a tax stamp is UK-duty paid.

In addition, it would provide high visibility of the duty status of the product, so enabling easy identification of non-UK duty paid goods - through the absence of a tax stamp - by enforcement agencies and the public. In this way, those dealing illegally in unstamped goods would be doing so knowingly which, coupled with associated offences, would make their prosecution easier.⁶³

Further details were given in the consultation paper:

- A 'tax stamp' would take the form of a paper strip stamp, printed to a high security specification and affixed over the container closure, enabling identification of those bottles of spirits on which UK excise duty has been paid. The stamp would break when the bottle is opened.
- The system would require that spirits bear a tax stamp before they were removed to domestic use from an excise warehouse within the UK, or when they were delivered direct onto the UK market from import (i.e. both third country imports cleared at the port and acquisitions made under the Registered Excise Dealers and Shippers (REDS) and Occasional Importer schemes). Stamps would be made available to businesses situated overseas that intend to export into the UK.
- The stamp would be purchased as appropriate by producers, bottlers and importers at a price that includes (or is equivalent to) the duty due on the product in question. Such payment would be made to Customs and Excise under the current duty deferment arrangements. Customs would arrange the delivery of

⁶² *Tackling indirect tax fraud*, November 2001 pp 18-19

⁶³ HM Customs & Excise Business Brief 20/2001, 13 December 2001

stamps to the trader. The stamp would need to contain certain information such as the size of the bottle and the alcoholic strength of the product.

- Drawback (repayment of duty) would be allowed for any of the reasons contained in “The Excise Goods (Drawback) Regulations 1995” (e.g. exportation, warehousing for export, or planned destruction), subject to the conditions set down therein. Additional provisions would also be introduced allowing refunds in cases where, for example, stamps were damaged.
- Excise warehousekeepers receiving duty-suspended, unstamped, product for subsequent delivery onto the domestic market would need to affix the stamps to the bottles before they were removed to domestic use. Retailers would also have a responsibility to ensure that they only purchase, display and sell stock bearing a valid tax stamp.
- Accompanying offences and sanctions would be introduced, including penalties for those found to be handling or dealing in unstamped product.⁶⁴

The use of tax stamps has been criticised by the Scottish Whisky Association⁶⁵ and in February 2002 Annabelle Ewing MP has put down an early day motion opposed to these proposals:

That this House notes with concern the UK Government's plans that a Tax Stamp be put on every bottle of whisky sold; believes that whilst effective measures must be taken against fraud, this scheme as a device to prevent it is fundamentally flawed; further notes that the DTI in 1997 wrote to the Norwegian Government when it was considering a similar scheme to warn that it was 'likely to be inefficient and ineffective as a means of combating fraud and illicit trade'; further notes that it would apply to spirits only and not to wine and therefore would discriminate against home grown drinks and in favour of imported wines; further notes that if implemented, it might cost even a small distiller £6.5 million a year in extra costs; further notes that the US, Greece and Ecuador have abolished strip stamps, whilst Germany, Belgium and Norway have abandoned plans to introduce them; and calls upon the UK Government to abandon its plans to introduce this discriminatory and hugely burdensome scheme on the Scotch Whisky industry.⁶⁶

However in the 2002 Budget the Government announced it had decided against the introduction of tax stamps, but rather it would agree “a joint programme of co-operation with the spirits industry to trace and track illicit consignments of spirits.”⁶⁷ Details were given in a press notice issued at this time:

⁶⁴ HM Customs & Excise, *Tax stamping of spirits*, December 2001 pp 8-9. The paper is available on Customs' site at: www.hmce.gov.uk/business/consultations/alcoholtaxstamps.pdf

⁶⁵ Scottish Whisky Association press notice, *Treasury strip tease drives industry wild*, 12 February 2002

⁶⁶ EDM 842 2001-02 “Whisky tax stamp” 12 February 2002. To date the motion has attracted 19 signatures.

⁶⁷ *Budget 2001* HC 592 April 2002 p 105

The Pre-Budget Report announced that there would be consultation on the costs, benefits and practicalities of introducing a tax stamps system. It was clear from this consultation process that the introduction of tax stamps would have a severe impact on the productivity and compliance costs of the spirits industry, which - if passed on in full - could have had a significant impact on retail prices for spirits.

The Government does not currently consider those costs proportionate to the benefits of tax stamps, particularly if alternative means of making progress to those objectives can be pursued. Customs will therefore work together with the industry on a joint strategy to identify, trace and track illicit consignments of spirits, radically increasing their exchange of information and making fraud easier to detect through the development of product testing kits and enhanced bar code data. Additional funding will also be made available to Customs this year, enabling them to step up the volume of intelligence-based checks on inward freight consignments of duty-suspended spirits (making full use of the national network of x-ray scanners), increase disruption of the criminal gangs engaged in spirits fraud, and strengthen their controls on UK excise warehouses.⁶⁸

D. Recent debate on the level of alcohol taxes

In both the July 1997 Budget and the March 1998 Budget the Chancellor Gordon Brown announced that duty rates on alcoholic drinks would be increased in line with inflation only.⁶⁹ Despite this the drinks industry was severely critical of these increases, arguing that this would encourage cross border shopping and smuggling, and reiterated its calls for a substantial cut in duty rates.⁷⁰

For some time the industry has argued that cutting duty rates would boost domestic consumption of alcohol, more than outweighing any effect that lower rates might have on Exchequer revenues. In a report on cross border shopping in 1994 the Treasury Committee concluded there was insufficient evidence for this assertion, but recommended that “the rate of excise duties on alcohol products should continue to be assessed in the light of the expected yield to the Exchequer, but that the Chancellor should take full account of the potential disadvantages of any significant widening in the level of duties in the UK and its near Continental neighbours.”⁷¹ In a follow-up report the Committee recommended “the rate of excise duty on alcohol products [should] be evaluated in terms of the total expected yield to the Exchequer, with a fundamental part of this being an assessment of the likely losses of revenue to cross border purchases following an increase in the rate of UK duty. This needs to be balanced against health, social, and industrial policy considerations.”⁷²

⁶⁸ HM Customs & Excise Budget press notice C&E1, 17 April 2002

⁶⁹ The second of these inflation-only increases, which took effect on 1 January 1999, did not apply to the duty on spirits, which was frozen.

⁷⁰ ““Only smugglers will gain from duty rise””, *Times*, 18 March 1998

⁷¹ HC 35-II 1994-95 p xx. The Committee also suggested that the guide levels for personal imports should be lowered, so that the onus of proof that purchases are for personal use should switch to the individual importer, and that the UK push for closer harmonisation of duties across the EU.

⁷² HC 24 1995-96 p viii

At this time the Institute for Fiscal Studies did some analytical work to test this assertion, published in their *Green Budget* in October 1995. The authors pointed out that equalising duty rates would not, in itself, remove the incentive for cross border shopping; comparing the pre- and post- tax prices of wine, spirits and beer products sold in the UK and in France, they found that for wine, all of the retail price differential could be explained by the difference in excise duty, but that the equivalent figures for spirits and beer were 77% and 63% respectively.⁷³ Other work done by the IFS on the elasticity of demand for alcohol (the degree to which alcohol sales are responsive to price changes) suggested an increase in the rate of beer duty would actually increase Exchequer revenues.⁷⁴ As the Institute argued in a subsequent report in January 2000, in considering the impact of duty changes, it is important to take a wider view than that of just domestic alcohol sales:

This Budget, as with all Budgets, there will be pressure on the Chancellor from the alcohol and tobacco industries to cut duty. To the extent that it would lead to lower prices, cutting duty would reduce the financial incentive to shop across the border — either legitimately or illegally — and so there would be an increase in domestic sales. One consideration for the Chancellor is whether cutting duty would enable him to recoup some of the revenue that he is losing to legitimate and illegitimate imports or whether it would result in further revenue losses.

Following a cut in excise duty, domestic sales would rise, but less revenue would be collected on each unit sold. The overall effect on revenue would depend on the balance of these two effects. For the overall effect to be positive, the additional revenue from the increase in sales would have to outweigh the loss on each unit that was being sold in the UK before the cut in duty. Whether this would be the case depends on how responsive the tax base, i.e. domestic duty-paid demand, is to changes in price (the own-price elasticity of demand). The more responsive domestic demand is to changes in price, the more likely it is that the increase in sales following a cut in duty will be large enough for the extra revenue collected to outweigh the revenue lost on each unit that was previously being bought at the higher rate of duty.

As well as the effect of cutting duty on beer on revenue from beer, for example, it is also important to consider the effect of cutting duty on demand for, and therefore the revenue from, all other goods (the cross-price effects). If the price of beer goes down (following a tax cut), then people may switch away from buying other types of alcohol such as wine or spirits (if they are considered to be substitutes) and hence there would be a fall in revenue from wine and spirits. In this case, we are less likely to see an increase in total revenue following a tax cut on beer. Alternatively, beer and wine may be complements, in which case when the price of beer falls, not only do people buy more beer, they also buy more wine. This means there would be an increase in revenue from wine, so we are more likely to see an increase in total tax revenue following a tax cut on beer.

⁷³ Institute for Fiscal Studies, *Options for 1996: the Green Budget*, October 1995 pp 70-75

⁷⁴ Ian Crawford & Sarah Tanner, *Alcohol taxes and the Single Market: commentary 47*, April 1995

The size of these cross-price effects, measured by cross-price elasticities, is important when considering the effect on total indirect tax revenue of cutting duty on a particular type of alcohol. Also important for the total revenue effect is the rate at which the complement or substitute is taxed. The more heavily the complement or substitute is taxed relative to the good itself, the more likely it is that the change in revenue from the complement or substitute will outweigh any opposite effect from revenue on the good itself. This is because, for a given change in demand, the higher the tax rate is, the greater the change in revenue will be. In the UK, spirits are taxed at a higher rate than beer or wine. Excise duty plus VAT on spirits, as a proportion of final price, is 61% compared with 29% on beer and 50% on wine^{75 76}.

The Treasury Committee returned to this question in their report on Customs in February 2000, noting later work by the IFS which found that a cut in duty in beer or wine would lead to a reduction in overall indirect tax revenue. In the case of spirits the duty rate appeared close to the rate that maximised revenue, so that either a cut or increase in the duty rate would lead to a fall in indirect tax revenue.⁷⁷ The industry and the All-Party Parliamentary Beer Group were critical of this work, and the Committee's report includes the IFS' response to their criticisms.⁷⁸ The Paymaster General also rejected the industry's case in evidence to the Committee:

561. Just to cite one of the associations, the Brewers' and Licensed Retailers' Association are arguing that a duty cut of just a few pence could eliminate beer bootlegging altogether. Do you agree with them?

(*Dawn Primarolo*) No, I do not agree with that. I do not think that their economic model stands up to scrutiny and it is a question of loss of revenue for the Government as well. I do not believe their views are corroborated elsewhere. For instance the Institute for Fiscal Studies looked at whether a reduction in rate would actually lead to a reduction in smuggling and more revenue for the Government. That is not the case and our economic models are not showing that in the Treasury either. I can see why they might welcome that, but that is not the case. I have just been informed that on the figures with alcohol smuggling has basically been—it sounds like a pun—flat for about the last two years. What we are seeing is an increase in cross-border legitimate shopping in the figures which points to the fact that Customs and Excise are being successful in combatting this particular area.⁷⁹

⁷⁵ Tax as a proportion of price is calculated using typical prices of a pint of beer at 3.9% abv on licensed premises, a 75cl bottle of table wine at 5.5–15% abv in retail outlets, and a 70cl bottle of spirits at 40% abv in retail outlets, taken from HM Customs and Excise, *Annual Report 1998–99*.

⁷⁶ Institute for Fiscal Studies, *The IFS Green Budget: commentary 80*, January 2000 pp 111-112

⁷⁷ Ian Crawford, Zoë Smith & Sarah Tanner, "Alcohol taxes, tax revenues and the Single European Market", *Fiscal Studies* vol 20 no 3 1999 pp 287-304

⁷⁸ Treasury Committee, *HM Customs & Excise*, 8 February 2000 HC 53 1999-2000 pp 101-103, 247-249

⁷⁹ *op.cit.* p 205. James Plaskitt MP had asked this question. The issue was raised during the Committee Stage of the Finance Bill in June 1999 the Government successfully resisted an amendment to cut beer duty by about 75% (SC Deb (B) 17 June 1999 cc 708-720).

For its part the Committee concurred that there was insufficient evidence that duty cuts could boost revenues, and went on to note that the determination of duty rates went beyond the question of their impact on smuggling:

The Government has a right to set its excise duty rates at the levels it sees fit, within the framework agreed with international partners, and to defend those levels when undermined by criminality. It must take a wide range of factors into account, including health policy objectives and the need to raise revenue, as well as the impact of duty rates on smuggling. Considering all these factors, and accepting that cutting duty rates, especially on tobacco, might help reduce smuggling, we recognise that the Government's policies on the level of duty rates will rightly be guided by far wider considerations than those concerned exclusively with alcohol and tobacco smuggling.⁸⁰

E. Tax neutrality

To a certain extent, current excise duties are related to alcoholic strength. In the case of beers and spirits, the stronger the alcoholic strength of the product, the greater the rate of duty. In addition, higher strength categories of wine are charged higher rates of duty. However, across the full range of alcoholic drinks, the rate of duty charged is not based entirely on the amount of pure alcohol they contain.

In the case of spirits and beer, each unit of alcohol is taxed directly. The dutiable unit for spirits is the 'litre of alcohol', which now attracts a duty of £19.56. A 70cl bottle of whisky of 40% strength would be charged a specific duty of £5.48. Beer is taxed £11.89 for every per cent alcohol by volume. A pint of beer of 5% ABV would be charged a specific duty of 34p. Table wine (wine than is 15% ABV and under) and strong wine (between 15% and 22% ABV) is charged a fixed duty per litre, as is sparkling wine.⁸¹ Focusing on a single category of wine, the implied level of duty per unit of pure alcohol will fall as the alcoholic content increases.

Table wine is charged a duty of £154.37 per hectolitre at present, so that the specific duty on a 75cl bottle of table wine is now £1.16. Wine of 10% ABV is being charged an implied tax per litre of pure alcohol of £15.47.⁸² For wine that has a strength of 15%, the implied duty level is actually £10.31. Given this, the implied tax rates per unit of alcohol are clearly not uniform, with the duty on spirits at – £19.56 – being much higher than that on beer - at £11.89 - and on table wine - at £12.89 (wine of a typical strength of 12%). Of course, the situation for spirits has been worse: prior to the November 1995 Budget the duty rate was £20.60.⁸³ Moreover all alcoholic drinks will also be charged VAT at the standard rate of 17.5%. One way to express the discrimination against spirits is to estimate the proportion of each drink's retail price accounted for by tax (excise duty and VAT combined). If one buys a pint of bitter in a pub, just

⁸⁰ HC 53 1999-2000 pp xl-xli

⁸¹ In the case of sparkling wine, a separate rate of duty has been charged on wine between 5.5% ABV and 8.5% ABV, and wine between 8.5%ABV and 15% ABV since 1 January 1997.

⁸² $(1/0.75 \times £1.16) \times (1/0.10)$

⁸³ HM Customs & Excise, *Alcohol Factsheet*, October 2001 pp 4-8

under 30% of the price goes in tax. If one buys an average bottle of wine in a shop, 51% of the price is tax; for a bottle of whisky the tax take leaps to 61%.⁸⁴

The Scotch whisky industry has argued consistently that this is both unfair, and seriously damaging for a significant sector of the Scottish economy.⁸⁵ The anomaly may appear even worse when one considers most wine consumed in the UK will be produced abroad compared with the role that whisky production has in the Scottish economy,⁸⁶ although critics have argued that arguments for cutting duty on alcohol tend to ignore the substantial economic costs of alcohol abuse.⁸⁷ Even so, the Institute for Fiscal Studies has strongly criticised the disparity in treatment between whisky and other drinks:

There is no obvious economic reason for this tax bias. Additional taxes on alcohol are usually thought of as correcting for the ‘externalities’ of alcohol consumption, i.e. the social costs of drinking such as drink-driving and drunken violence, which are not reflected in the pre-tax price. Since it is the quantity of pure alcohol that does the harm, a uniform tax on alcoholic content across all types of drink would best reflect the social cost of consumption. This would also seem sensible since different types of drink are substitutes for each other.⁸⁸

As the IFS has noted elsewhere, taxing some drinks by volume and other by alcoholic content is odd. “When looked at as a tax on alcoholic content (surely the principal identifying feature of alcoholic drinks and also the reason why they are taxed in the first place), this [duty structure] begins to look like a very odd structure indeed.”⁸⁹ The discrimination of spirits by the tax system compared with wine and beer has had a long history. Indeed the relatively high rate of duty on whisky, gin and other spirits dates from an era when the consumption of wine was relatively small, and the level of spirit drinking was of acute public concern.

Some commentators suggest the period around the World War One was particularly influential in this respect; others would go back as far as the mid 18th Century.⁹⁰ Undoubtedly the structure of duties in the UK throughout this century has consistently penalised spirits over other types of alcohol. The consequent reliance on duty revenues from spirits has discouraged the adoption of a more neutral system. In a debate on scotch whisky held in 1990, Gillian Shephard, then Minister of State at the Treasury, noted, “the present flexible structure allows my right hon. Friend the Chancellor of the Exchequer to take market and industrial factors into account ... To

⁸⁴ *HM Customs & Excise Annual Report 1998-99* p 86. Figures are given as at January 1999.

⁸⁵ Hugh Morison, chief executive of the Scottish Whisky Association, has made the case in an article in the *House Magazine* (“Time to reform archaic duty system”, 22 January 2001). The issue was also raised in a recent debate in Westminster Hall (HC Deb 7 May 2002 cc 51-8WH).

⁸⁶ Some evidence on the economic impact of the spirits industry is presented in Scottish Affairs Committee, *The drinks industry in Scotland*, 14 November 2001 HC 324 2001-02 para 13-15.

⁸⁷ “Distilled wisdom”, *Economist*, 26 August 1995

⁸⁸ *Options for 1996 : the Green Budget*, October 1995 pp 74-75

⁸⁹ *The IFS Green Budget: commentary* 67, January 1998 p 94

⁹⁰ “Equal measures that would aid Scotch whisky industry”, *Times*, 22 November 1995; “Hangover from a sin tax”, *Financial Times*, 27 November 1995

link duties on the basis of alcoholic strength would limit the Chancellor's room for manoeuvre and produce a major upheaval in the market place."⁹¹

Without losing considerable amounts of revenue from alcohol taxation, equalising duty rates would require significant increases in duty rates on beer and wine – a controversial move in the light of cross border shopping and smuggling. Establishing a unitary tax on alcoholic content would ignore the variation in duty rates elsewhere in the EU, to the cost of Exchequer revenues and, one might add, the domestic beer industry. The Conservative Government opposed calls for a restructuring of alcohol duties for just this reason; Sir John Cope, then Paymaster General, summarised the Government's case at the Committee Stage of the Finance Bill in May 1993:

Of course, from time out of mind, Chancellors of the Exchequer of all parties have taxed individual types of drinks rather than their alcoholic content. There have been variations before. Anyone in the Treasury starts from the historic basis of taxing alcoholic drinks in that way. That method is not exclusive to this country ... We have argued in the European Community that Finance Ministers should be free to set the rates that they think best for their countries for different types of alcoholic drinks, subject to the agreements that we have made ... [If the UK set its duties in line with its neighbours] we might not improve the relative position of our alcohol duties as far as unitary taxation is concerned.⁹²

Similar points were made by the Financial Secretary Paul Boateng, in evidence to the Scottish Affairs Committee in October 2001:

Undoubtedly ... there is an additional burden of taxation on spirits as opposed to wine and beer. That is the case and that is the pattern of taxation that has emerged over the years. The upside—and I think the freeze [on spirits duty since 1 January 1998] indicates this ... is that the system we have, which is one that rejects the concept of unitary taxation, does allow the Chancellor to respond to individual concerns within the industry about changing circumstances within the different sections of the alcoholic drinks industry. That flexibility is there and maintained and, as I have indicated and as I hope the history of the Chancellor's approach to this subject over the last four years has indicated, he does clearly take very seriously, in arriving at his judgment as to what the best interests of the economy are, representations that are made to him.⁹³

The continuing problems associated with alcohol and tobacco smuggling would suggest any substantial change toward a more neutral system is unlikely. For its part the Scottish Affairs Committee has suggested that the Government might consider a more gradual change, keeping spirits duties frozen while other duties were allowed to rise:

⁹¹ HC Deb 20 December 1990 c.573

⁹² SC Deb (A) 25 May 1993 cc 116-118

⁹³ *The drinks industry in Scotland: minutes of evidence*, 31 October 2001 HC 324-i 2001-02 Q706

We would not propose that excise duties should be set solely with regard to the effect on government revenues. Due regard must also be given to the health issues related to alcohol; and how taxes affect employment ... But we could find no sound economic basis for a continuation of excise discrimination against whisky, or against any other spirit. Several benefits might ensue if excise discrimination against spirits were ended. Consumption of spirits could increase relative to wine. This would have a positive effect on the Scottish economy and the trading position of the UK. The evidence from the IFS suggests that this could be achieved at little cost to the Exchequer.⁹⁴ The health impact is likely to be neutral.

We would therefore recommend that the Treasury should continue on a long-term basis, its policy of freezing the tax on spirits until it is comparable with that levied on alcohol consumed in other forms. This would end discrimination against one of Scotland's major indigenous industries, and one of the UK's leading exports.⁹⁵

The Government's views on this recommendation – in the response made by the Government and Scottish Executive to the Committee's report – was as follows:

The Government is very aware of the enormous contribution that the spirits industry in Scotland makes to our local and national economies, particularly through its significance as a major export earner and employer. The importance and particular circumstances of the industry have contributed to the Government's decisions to freeze the duty rate of spirits over four successive Budgets. The Chancellor will continue to make decisions about duty rates on a Budget-by-Budget basis, taking into account all relevant factors. This approach permits individual responses to changing circumstances in different sectors of the alcoholic drinks industry.⁹⁶

F. 'Progressive' beer duty

A common complaint made by smaller breweries is that the structure of the market – dominated by a small number of large brewers – makes it hard for them to have their beers taken on by local pubs, narrowing drinkers' choices. For some years the Society of Independent Brewers (SIBA) has campaigned for a reduced rate of duty to apply on beer produced by smaller breweries: so that breweries whose output was below, say, 30,000 hectolitres per year would pay only half the excise duty which would otherwise be payable on the first 5,000 hectolitres they produce. When output exceeded 30,000 hectolitres, then duty

⁹⁴ The work cited here appeared in *Fiscal Studies* in 1999 ("Alcohol taxes, tax revenues and the Single European Market", vol 20 no 3 pp 287-304), and was summarised in a memorandum submitted to the Committee (*The drinks industry in Scotland: minutes of evidence*, 22 March 2001 HC 114-ii 2000-01 p 141).

⁹⁵ HC 324 2001-02 para 60-62

⁹⁶ Scottish Affairs Committee, *First special report: The Drinks Industry in Scotland: Response by the Government and the Scottish Executive to the First Report of the Committee of Session 2001-02 (HC 324)*, HC 696 18 March 2002 2001-02

would be payable at the full rate on the total output.⁹⁷ The Society's case for a 'progressive' duty system is taken from their internet site:

1. The positive nature of Progressive Beer tax is that it allows small local brewers to compete with regional and national companies. As in any industry small companies provide energy, dynamism and innovation that drives that market sector forward.
2. It helps prevent the centralisation of production and the subsequent abuse of monopoly power all too evident with the U.K. brewing industry.
3. Without a healthy small brewing sector the centralisation of brewing would accelerate leading to job losses, higher prices and less choice.
4. Revitalisation of the U.K. brewing industry would lead to greater export of products, expertise and ancillary supplies benefiting the U.K. economy as a whole.
5. The tremendous tourist potential in these rural areas will be stimulated by the maintenance of these small breweries supporting further their local economies.
6. Small breweries tend to be in rural areas so that those particular micro-economies would benefit disproportionately. These companies help preserve local culture through the maintenance of community pubs which in turn prevents social alienation.⁹⁸

The campaign has received support from the Campaign for Real Ale (CAMRA) and the Independent Family Brewers of Britain,⁹⁹ and recently Norman Baker MP put down an early day motion supporting this reform, reproduced below; to date it has attracted 115 signatures:

That this House notes with concern that over 80 per cent. of the beer brewing market is dominated and concentrated in the hands of four national brewers, Scottish Courage, Bass, Whitbread and Carlsberg-Tetley; notes that many craft breweries are at a major competitive disadvantage and are going out of business at an alarming rate; notes the positive effect that the introduction of progressive beer duty will have on the survival and growth of local small craft breweries; further notes that progressive beer duty will help ensure employment creation, encourage competition, encourage choice and stimulate the growth of related industries; notes that unlike other European markets where progressive beer duty exists, the UK duty regime has failed to adapt to changes in the market; notes that the introduction of progressive beer duty will cost the Exchequer £6 million per annum and will help nearly 300 micro-breweries that each employ under 10 staff; and calls on the Chancellor of the Exchequer to consider the possibility of introducing progressive beer duty on a sliding scale for very small

⁹⁷ "Tax puts brewers of real ale over a barrel", *Financial Times*, 15 November 1997; "Brewers toast watchdog for beer tax move", *Financial Times*, 12 December 1998; "Pilgrim searches for progress in independent beer market", *Financial Times*, 7 June 1999

⁹⁸ www.siba.co.uk The Siba Office, 16 Eversley Road, London, SE7 7LD

⁹⁹ Both groups have internet sites at: www.camra.org.uk, and, www.familybrewers.co.uk respectively.

craft breweries producing annually under 30,000 hectolitres of beer, as well as introducing a floor of 5,000 hectolitres below which duty will not be charged.¹⁰⁰

In November 1998 the Paymaster General, Dawn Primarolo, stated that she had “asked Customs and Excise to review the case for progressive beer duty” and that they would provide her “with advice in due course.”¹⁰¹ At the time of the March 2001 Budget the Government confirmed that it was “minded to introduce a reduced rate of duty on the beer produced by small breweries” to support the industry, and would “be considering the scope for doing so in the coming year.”¹⁰²

Three disadvantages to the introduction of a sliding scale of beer duty might be mentioned, beyond the matter of cost (that is, the tax revenue foregone in cutting the rate of duty). First, it undermines one of the main principles of alcohol taxation: to encourage its responsible consumption. From this perspective, there is no clear reason why the tax system should favour beers produced by smaller breweries, since the social costs that go along with their consumption are exactly the same as all other beers.

Second a progressive rate of duty would introduce further administrative complexity into the tax system, with no certain guarantee that it would have the desired effect.¹⁰³ Certainly it is an open question whether subsidising the price of beers sold by smaller producers would have a significant impact on the ‘abuse of monopoly power’ that SIBA suggests is being exercised by the larger brewers. Moreover, if smaller producers see their competitive advantage as producing beers of a quality beyond the scope of larger companies - who, one presumes, enjoy considerable economies of scale in producing a limited range of products - then it seems unlikely that they would wish to compete on the basis of price.

Finally, if the underlying problem in the brewing industry is the state of competition, it could be argued that it would be better to deal with the problem directly, in dealing with abuses of market power exercised by these companies rather than providing tax reliefs. Historically this has been the approach taken by governments of both parties to improve consumer choice. Following a very critical report of the industry by the Monopolies and Mergers Commission in 1989, the Conservative Government introduced the ‘beer supply orders’, to require the national brewers to free up pubs from ties, thereby enabling greater market access to smaller beer and soft drink manufacturers.¹⁰⁴

¹⁰⁰ EDM 949 2001-02 “Introduction of progressive beer duty” 6 March 2002. A similar motion was put down in an earlier session, attracting 157 signatures (EDM 125 1998/99 15 December 1998).

¹⁰¹ HC Deb 16 November 1998 c 367W

¹⁰² HC 279 March 2001 p 101

¹⁰³ Notably the most recent major change in beer duty - the replacement of the ‘worts’-based duty with an end product one in April 1993, followed a report by the National Audit Office criticising the tax as being inflexible, with an ‘unwieldy system of allowances and reliefs’ (*HM Customs & Excise: Beer Duty*, 20 July 1990 HC 601 1989-90). For details see, HM Customs & Excise Budget press notice 18/93, 16 March 1993.

¹⁰⁴ *The Supply of Beer* Cm 651 1989. The relevant Orders were SI 1989/2258 and SI 1989/2390.

These regulations dealt with the wholesale pricing of beer and conditions attached to brewers concerning the disposal of licensed premises and the provisions which they could attach to loans. In addition brewers who owned more than 2,000 pubs were required to release from ties one half of those above the 2,000 threshold by 1 November 1992. The orders also allowed - from 1 May 1990 - premises tied to the large brewers to sell draught cask-conditioned beer from another supplier and forbade the imposition of any ties on non-alcohol beers, low-alcohol beers and non-beer drinks.

These provisions were not uncontroversial, and some commentators argued that they had *encouraged* consolidation in this sector – not the opposite.¹⁰⁵ Further regulation to improve the workings of the market was supported on both sides of the House in August 1997, when the ‘guest beer provision’ was amended in August 1997. Under the beer orders both national brewers¹⁰⁶ and large brewery groups must allow their tenants and loan tie recipients to buy one draught cask-conditioned beer from the supplier of their choice; under this Order this requirement was extended to include the choice of a bottle-conditioned beer as well.¹⁰⁷

However, the Government has signalled a different approach in its response to a report commissioned from the Office of Fair Trading, published in December 2000, which recommended that only certain parts of the beer orders should be retained.¹⁰⁸ Initially the then Secretary of State Stephen Byers announced that, with certain reservations, he was minded to follow this course of action.¹⁰⁹ Following developments in the market, Melanie Johnson, Parliamentary Under-Secretary of State for Competition, Consumers and Markets, announced on 19 February 2002 that the report had been considered afresh and that the Government had decided to revoke the beer orders in their *entirety*. The Minister’s statement noted that “the Government is keen to enhance the contribution made by the UK’s small brewing industry to the diversity and competitiveness of the beer market”, and that “it is continuing to consider the scope to introduce reduced rates of duty on the beer produced by small brewers, and will remain alert to the concerns of small brewers about their ability to compete fairly within the UK beer market.”¹¹⁰

Nevertheless in his Budget speech on 17 April 2002 the Chancellor Gordon Brown announced that small breweries with an annual production of 30,000 hectolitres or less would be entitled to charge a reduced rate of beer duty under a new scheme, to be introduced from 1 June 2002:

¹⁰⁵ For example, see Agriculture Committee, *Effects of Beer Orders on the Brewing Industry and Consumers*, 28 April 1993 HC 402 1992-93

¹⁰⁶ Brewers with an estate of more than 2,000 pubs

¹⁰⁷ SI 1997/1740, which amended SI 1989/2390 – with effect from 1 April 1998 (DTI press notice P/97/555, 27 August 1997). A bottle-conditioned beer is one which undergoes fermentation in the bottle from which it is served. The Order was debated by the Second Standing Select Committee on Delegated Legislation on 15 July 1997.

¹⁰⁸ OFT, *The supply of beer OFT317*, December 2000. The report and associated material is published on the DTI’s internet site at: www.dti.gov.uk/cp/beer.htm

¹⁰⁹ DTI Press Notice PN805, 1 December 2000

To encourage one group of small businesses, the nation's small breweries—often village pubs, some two centuries old—I have decided that the duty paid on their own beer will be halved. This is a cut equal to 14p off each pint, to be implemented for village pubs and small breweries by this summer—in time for the World cup. It will also be available in Scotland, Wales and Northern Ireland.¹¹¹

Details were given in a press notice from which the following is taken:

Britain's several hundred small breweries make a valuable contribution to the nation's cultural heritage, particularly in rural communities, bringing both tradition and diversity to the UK beer market. The Government is keen to celebrate the talents and skills of the nation's small brewers, and help them compete effectively for their fair share of the beer market. For more than 20 years, the nation's small brewing industry and real ale drinkers have been calling for the introduction of reduced rates of duty on the beer produced by small brewers, both to help them invest in the growth of their businesses, and to help them compete on price with larger brewers when selling their products to pubs and other retailers.

Following consultation over the past year, the Government has now decided to introduce a relief scheme for small brewers this June, in time for the start of the World Cup, following Royal Assent of the Finance Bill. Under this scheme:

- brewers producing up to half a million litres (around 3,000 barrels or 900,000 pints) per year will receive a 50 per cent cut in duty, equivalent to £40 off each barrel they produce; and
- brewers producing up to three million litres per year will receive progressive rates of relief worth over £120,000 to each brewer, equivalent to a 50 per cent cut on the first half million litres they produce.

9 out of every 10 brewers in the UK will benefit, including all micro brewers and local brewers, the majority of which are based in rural areas. Some of the eligible brewers currently own their own village pubs, and many more are expected to use the savings from the scheme to buy one. Similar duty relief schemes currently operate in seven other EU Member States with strong brewing heritages, including Germany and Belgium, but the UK scheme will be one of the best-targeted, simplest and most generous schemes anywhere in the EU - with the 50 per cent relief for the smallest brewers the maximum available under EC law.

More than a hundred Members of Parliament recently signed a motion calling for the introduction of a relief scheme, although - at £15 million - the cost of the Government's scheme is almost three times as generous as the one they had proposed. The scheme is also strongly supported by the Society of Independent Brewers, the Campaign for Real Ale, the Village Retail Services Association and the Council for the Protection of Rural England.¹¹²

¹¹⁰ DTI Press Notice P/2002/107, 19 February 2002. The issue was raised in a recent debate in Westminster Hall when the Minister set out the Government's reasons for revoking the beer orders at greater length (HC Deb 10 April 2002 cc 45-52WH).

¹¹¹ HC Deb 17 April 2002 c 584

¹¹² HM Customs & Excise Budget press notice C&E1, 17 April 2002

The scheme is to work as follows:

This measure introduces reduced rates of duty for beer brewed by independent breweries which produce 30,000 hectolitres or less per year. Reduced rates will be set at 50% of the standard rate for annual production up to 5,000 hectolitres rising, on a tapered basis, to the full standard rate at 30,000 hectolitres and above.

The duty rate for beer produced by breweries whose annual production is between 5,000 and 30,000 hectolitres will be calculated using the following formula:

$$\% \text{ of duty payable} = \frac{\text{annual production} - 2500 \text{ (hectolitres)}}{\text{annual production}}$$

Annual production will normally be calculated according to production levels over the previous calendar year with special rules applying in particular circumstances such as new breweries.¹¹³

Responses to the Chancellor's announcement were positive from the Society of Independent Brewers and CAMRA¹¹⁴ though there was some criticism that breweries supplying most of the beer consumed in this country were too large to benefit from the scheme.¹¹⁵

¹¹³ HM Customs & Excise Budget Notice CE3, 17 April 2002

¹¹⁴ "Small brewers raise a glass to duty cut", *Financial Times*, 18 April 2002

¹¹⁵ "Brown accused of serving brewers a short measure", *Times*, 18 April 2002