Tax stamps on spirits

Standard Note: SN/BT/2859
Last updated: 7 January 2005
Author: Antony Seely
Business & Transport Section

In his pre-Budget statement on 10 December 2003 the Chancellor Gordon Brown announced that, subject to consultation, a tax stamp on spirits would be introduced, as part of a wider strategy to reduce excise duty fraud.[1] A 'tax stamp' is a paper strip fixed over the cap of a bottle of spirits, showing that excise duty has been paid on that item. A similar system of 'UK duty paid' marks on packets of cigarettes and hand-rolling tobacco was introduced in July 2001. In December 2001 the Government had consulted on introducing tax stamps but decided not to proceed with the proposal following strong opposition from the trade.[2]

Although the Government invited proposals for "a workable alternative to tax stamps"[3] the Chancellor announced in his 2004 Budget that a tax stamp would be introduced:

> I announced in the pre-Budget report that—owing to continued high levels of spirits duty fraud—we would legislate to implement the Roques report recommendation to stamp spirit bottles unless a workable alternative could be found. In making my decision today that stamps are necessary to tackle fraud, I will help the trade with cash flow costs and defer payment for tax stamps, and I will assist firms with their capital investment. I have also decided—for the seventh Budget in a row—to freeze spirits duty. And I will do so for the remainder of this Parliament. This will be the longest freeze on duty in nearly half a century.[4]

Legislation to this effect was included in the *Finance Act 2004* (specifically section 4 and schedule 1). The new duty stamps system is to be introduced in 2006. Following representation, certain changes to the scheme were announced in the *Pre Budget Report* in December 2004 including the industry's proposal to allow duty stamps to be incorporated into bottle labels.[5] This note discusses the scope of excise duty fraud and the Government's first consultation on tax stamps in 2001 before looking at the 2004 Budget proposals in detail. A second note focuses on the debate there has been about quantifying the scale of duty fraud involving alcoholic drinks.[6]

---

1. HC Deb 10 December 2003 c 1066
2. *Budget 2002* HC 592 April 2002 p 105
3. HM Customs & Excise Business Brief 26/2003, 10 December 2003
4. HC Deb 17 March 2004 c 329. A regulatory impact assessment, including an assessment of the trade's alternative proposals, was published the next month: HM Customs & Excise, *Tackling Spirits Fraud: Regulatory Impact Assessment*, 8 April 2004.
5. Cm 6408 December 2004 paras 5.95-7
6. "Tax stamp on spirits: the level of excise duty fraud", Library standard note SN/BT/3337, 6 January 2005

Contents

A. The duty on spirits and excise fraud

Excise duties on spirits, beer, wine & made-wine, cider & perry, raised £7.3 billion in 2002-03; of this spirits accounted for £2.3 billion.[7] 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 29% of the price of a pint of bitter when sold in a pub, 44% of the price of table wine, and 60% of the price of a bottle of whisky.[8] 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. In the 2004 Budget duty rates on cider, sparkling wine and spirits were frozen, while rates on beer and still wine were increased broadly in line with inflation.[9] The rate of excise duty on spirits – which is £19.56 per litre of pure alcohol – has been frozen since 1 January 1998.

There 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.[10]

Focusing on diversion fraud, under the Single Market Member States are required to operate a system of duty suspension in order to facilitate alcohol trade.[11] 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

[7] *Budget 2004* HC 301 March 2004 p 256
[8] *HM Customs & Excise Annual Report 2003-03* HC 52 December 2003 (table D1)
[9] HM Customs & Excise Budget Notice CE23, 17 March 2004. These duty rate changes took effect from midnight 21 March 2004.
[10] Treasury Committee, *HM Customs & Excise*, 8 February 2000 HC 53 1999-2000 para 46
[11] 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

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.[12] As a consequence there are distinct differences in the pattern of revenue fraud involving alcohol as opposed to tobacco, as a Customs paper on measuring indirect tax fraud explains:

> 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.[13]

When the Government's current proposals for a tax stamp on spirits were scrutinised at the Committee stage of the *Finance Bill 2004*, the Economic Secretary John Healey, described the nature of spirits fraud in more detail:

> European law enshrines the principle of free movement of goods across the Union and provides for alcoholic goods to be moved around free of excise duty. Alcohol can be moved and sold an unlimited number of times and over an unlimited period without any duty being paid. The papers that travel with a load of alcohol are intended to secure the integrity of the supply chain. Only when the goods are released from duty suspension on to the market does the duty have to be accounted for.
>
> That system guarantees the laudable right of the free movement of goods within the European Union and, by ensuring that duty has to be accounted for only very near to the time of consumption, provides a valuable benefit to the alcohol trade. In practice, however, it is wide open to abuse.
>
> Successful fraud involves five steps. First, the fraudster sets himself up as a legitimate trader—sometimes by hiring or blackmailing somebody else to front up for him. Secondly, he hoodwinks a spirits producer or distributor into selling him a lorry load of duty-unpaid spirits. Experience shows that cash-in-hand to the lorry driver will

---

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

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

> ensure that he ignores the official delivery instructions and takes the load to a lock-up instead. Thirdly, he forges a receipt or bribes the recipient warehouse to stamp it for him anyway, and returns it to the dispatcher who will then have so-called proof of legitimate delivery and a legitimate transaction. Fourthly, either through a complicit retailer or by hoodwinking, he delivers the spirits on to the market at duty-paid prices. Pocketing the £5-a-bottle profit, he does not pay the duty, and except in a rare cases where enough evidence is available, he does not go to jail, because once the bottles are on the shelves, no one can tell which ones are duty paid and which are not. Fifthly, he repeats that process—lorry after lorry after lorry.
>
> In short, that is a high-reward, relatively low-risk activity. The distribution system, set out and constrained in European legislation, provides ample opportunity, and the honest trader and drinker form an easy target.[14]

In July 1997 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. The report was published in July 1998,[15] and on its publication the Government announced a series of measures to tackle both tobacco and alcohol smuggling.[16] Further details of the outcome of this review have been published since then.[17]

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.[18] This included more resources for front-line staff and investigators, a national network of x-ray scanners, a substantial publicity campaign and the introduction of 'UK Duty Paid' marks. In the latter case all cigarette and hand rolling tobacco packets bought and sold in the UK have had to carry a fiscal mark – a label stating 'UK duty paid' – since 1 July 2001. This allows for smuggled tobacco being illegally resold in this country to be spotted more easily. It is *not* an offence to possess tobacco without the pack mark if it is bought legitimately from abroad, either as Duty Paid or as Duty Free (ie, from outside the EU).[19]

In addition Customs tightened up its policy towards seizing the assets of smugglers,[20] including any vehicle used to smuggle goods – and it is clear that this had a substantive impact on the smuggling of both tobacco and alcohol, cutting the revenue evaded from cross-

---

14 HC Deb 27 April 2004 cc 762-3

15 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.

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

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

18 For details see, HM Treasury, *Tackling Tobacco Smuggling*, March 2000; *Budget 2001* HC 279 March 2001 p 101; HM Customs & Excise, *Tackling indirect tax fraud*, November 2001 p 10.

19 HM Customs & Excise press notice 26/01, 29 June 2001

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

Channel smuggling by an estimated 76 per cent.[21] In 1999 revenue evaded from cross-Channel smuggling of alcohol was estimated to be £285 million;[22] in 2001 the figure was estimated to be £50 million.[23]

In June 2000 the Paymaster General 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 over the period 1995-1998.[24] It has been estimated that frauds between 1993 and 2000 led to alcohol duty evasion of £668 million from diversion onto UK markets.[25]

The report was completed in December 2000, with 65 recommendations 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. In March 2001 the Treasury Committee requested that both the report and the Government's response to it should be published,[26] which occurred in July.[27] 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.[28]

---

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

22 HC Deb 26 November 1999 cc 254-5W

23 *Measuring Indirect Tax Fraud*, November 2001 p 22

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

25 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).

26 *HM Customs & Excise: collection of excise duties*, 22 March 2001 HC 237 2000-01 para 9

27 HM Treasury, *The collection of excise duties in HM Customs and Excise: Report by John Roques and government response* Cm 5239 July 2001

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

On the specific question of a tax stamp for spirits, the Roques report said the following:

> I understand that the Department is now considering the use of tax stamps, which are about to be introduced for cigarettes, in respect of bottles of spirits. Any measure which allows enforcement staff and the public alike to identify illicit excise goods is to be applauded and I recommend that the Department 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.[29]

In November 2001 the Treasury Committee took evidence on the report and the Government's response – though this particular issue was not discussed.[30] Subsequent work by the NAO on alcohol fraud did not discuss tax stamps at any length,[31] though its analysis of the problem gives some indication of the attractions in such a system *(emphasis added*):

> Alcohol diversion fraud, particularly spirits, is attractive to criminals as the illicit product has not been subject to duty in the UK or elsewhere and is sold at or near legitimate duty paid prices. *It is consequently difficult to differentiate illicit product from legitimate product at the retail stage*. This makes this type of fraud both highly profitable and relatively uncomplicated.[32]

B. First consultation on a tax stamp

In November 2001, the Government published a paper on its strategy to deal with indirect tax fraud, which discussed – among other issues – the particular problem of spirits fraud:

> 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

---

29 Cm 5239 July 2001 p 87

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

31 "Part 3: Managing the risks of alcohol fraud" in *Audit of HM Customs & Excise systems and accounts 2002-03*, 18 December 2003 HC 52 2003-04.

32 HC 52 2003-04 p 27

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; 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.

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.[33]

To this end Customs issued a consultation paper on introducing a tax stamps system for spirits in December 2001 (comments were invited by 5 March 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

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

> 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.[34]

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 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.[35]

The use of tax stamps was criticised by, among others, the Scottish Whisky Association[36] and in an early day motion put down at this time by Annabelle Ewing MP, reproduced below:

> 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

[34] HM Customs & Excise Business Brief 20/2001, 13 December 2001

[35] HM Customs & Excise, *Tax stamping of spirits*, December 2001 pp 8-9

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

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.[37]

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."[38] Details were given in a press notice:

> It was clear from [the consultation exercise] … 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.[39]

C. Proposals in the Pre-Budget Report in 2003

In his pre-Budget statement on 10 December 2003 the Chancellor Gordon Brown announced that the Government would consult on the introduction of a tax stamp:

> While tobacco fraud, VAT fraud and oils fraud are now in decline, recent trends suggest that despite the freeze in spirits duties for six Budgets, an estimated one bottle in every six of spirits sold in this country is evading duty, so I will now make provision to implement in the next Finance Bill the Roques report recommendation that we stamp spirits bottles. If, after discussion with the industry, there is still no workable alternative proposed, we will legislate. If we have to impose stamping, the

37 EDM 842 of 2001-02, 12 February 2002. The motion attracted 19 signatures. A similar EDM which was put down following the 2003 *Pre-Budget Report* attracted 12 signatures (EDM 272 of 2003-04, 11 December 2003).

38 *Budget 2001* HC 592 April 2002 p 105

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

> Economic Secretary will discuss with the industry the most cost-effective scheme and I will then consider extending the freeze on the duty on whisky and all spirits, not just for one year but for every year of this Parliament.[40]

Following the statement, John McFall raised concerns over this proposal with the Chancellor:

> **Mr. John McFall:** … May I address the Chancellor as the chairman of the all-party scotch whisky group and tell him that there is already dismay in the Scottish whisky industry about the stamping of bottles? It is a £2 billion industry that is crucial to manufacturing, so may I have an assurance that he will work with me and the industry to ensure the unanimous introduction of the initiative? …
>
> **Mr. Brown:** … I put it to the House that if one in six bottles of spirits are escaping duty, it is incumbent on a Government who have taken action on cigarette and other smuggling to take action on that. If the industry can come up with a better proposal to deal with the problem, we will consider it, but if it cannot come up with a better way to stop the erosion of duty we shall legislate for the stamping proposal in the next Finance Bill. If we have to do that, I shall work with the industry and the Economic Secretary will consult the industry on the most cost-effective scheme. At the same time, we would freeze duty on whisky and spirits for the whole Parliament. We understand the industry's difficulties, but it must work with us to eliminate such loss of revenue, which is completely unacceptable and based not on accident or avoidance, but simple fraud.[41]

Gavin Hewitt, Chief Executive of the Scotch Whisky Association, gave the industry's initial reaction, stating "tax stamps would be a backward step damaging productivity and competitiveness and that alternative, more risk-based measures would be more effective."[42]

The case for tax stamps was set out in some detail in the *Pre-Budget Report*:

> Evasion of duty on spirits remains a particular problem. This involves well-organised criminal gangs who abuse trade facilitation provisions in UK and EU law that enable alcohol products to be moved and to change ownership many times before duty is paid. Fraudsters obtain spirits products in duty 'suspense' and divert them for consumption on the domestic market without payment of duty. *Measuring and tackling indirect tax losses*, published alongside this Pre-Budget Report, shows that losses from spirits fraud have been increasing markedly, and in 2001-02 were higher than at any time in the previous decade. In the last two years, HM Customs and Excise have taken steps to improve their capacity to identify and prevent alcohol fraud, including the implementation of recommendations made by the Roques report into excise diversion fraud.[43] However, the Government believes that more needs to

---

40 HC Deb 10 December 2003 c 1066

41 HC Deb 10 December 2003 cc 1077-8

42 Scotch Whisky Association press notice, 10 December 2003

43 *The collection of excise duties in HM Customs and Excise, Report by John Roques and the Response by Her Majesty's Government to the recommendations in the report*, July 2001

> be done. [In Budget 2002] … the Government decided, in view of trade concerns, not to proceed with tax stamps at that time, and instead to explore other options for preventing fraud, including establishing in partnership with the trade a Joint Spirits Fraud Task Force aimed at tracing and tracking illegal spirits consignments. Earlier this year, Customs launched a further consultation[44] on a package of regulatory measures aimed at reducing the opportunities to commit alcohol fraud within the duty suspension system.[45]

However responses to this consultation exercise had "suggested that … the most significant proposals (for radically reducing the movements and sales of alcohol in duty-suspension) would not deliver a significant anti-fraud benefit."[46] In a subsequent debate on tax stamps, the Economic Secretary John Healey gave more details:

> The consultation contained options aimed at reducing movement and sales of undutied, unsecured alcohol. We proposed to place a limit of one or two movements on sales in duty-suspended goods destined for the UK market. However, it became clear in detailed discussions with the trade that those proposals would not be effective, since EU law prevents us from limiting duty suspension for goods sourced from outside the UK and requires us to allow goods bound for other EU states to leave under duty suspension. There is also evidence that some retailers would either source more spirits from abroad or move their warehouse operations abroad to avoid a more restricted regime for intra-UK movements.[47]

The *Pre-Budget Report* went on to argue that tax stamps appeared to offer the only viable solution, but that – if adopted – the design of the scheme would take on board concerns about its costs for spirits producers:

> Decisive steps are needed to attack the capacity for diversion within the existing duty suspension system and the inability to distinguish duty paid from illicit product in market settings. The Government has therefore decided:
>
> - to introduce during 2004 new regulatory controls to support the fight against alcohol fraud, including changes to the regulations governing warehousekeepers, producers and owners of duty-suspended alcohol, requirements for notification of cash transactions and advance payments, and a scheme for recognising transporters with good compliance histories;
> - to make preparations for the implementation from early 2006 of the Roques report recommendation to introduce tax stamps for spirits. This would enable UK duty-paid spirits to be clearly identified by consumers, traders and Customs, and reduce both the opportunities for and profitability of diversion fraud. The Government plans to legislate for tax stamps in the 2004 Finance

[44] HM Customs & Excise, *Reducing opportunities for alcohol fraud: Consultation Document*, July 2003. The consultation ran from July to October that year.

[45] *Pre-Budget Report* Cm 6402 December 2003 p 119

[46] HM Customs & Excise, *Measuring and tackling indirect tax losses: an update on the Government's strategic approach*, December 2003 p 17.

[47] HC Deb 20 January 2004 c 428WH

Bill. However, it will also consider any new proposals the spirits industry wishes to put forward in the coming months for alternative measures that would be as effective in tackling spirits fraud as tax stamps; and

- to set a target for Customs to reduce substantially the illicit share of the spirits market. Precise details of the target will be announced as part of the 2004 Spending Review…

The Government recognises that the implementation of tax stamps in particular would involve increased costs to the legitimate trade. Therefore, once tax stamps were implemented, the Government would consider:

- how the current deferment arrangement for spirits duty could be extended as far as practical in recognition of the cash flow effects of purchasing tax stamps; and
- freezing spirits duty for the remainder of this Parliament.[48]

At this time it was the Government's estimate that tax stamps would cut revenue losses from spirits fraud "by at least £160 million a year from 2006–07"[49] while the level of fraud itself was estimated to have peaked in 2001-02 at £600 million, equivalent to "16 per cent of the UK market":[50]

Table 4.6: Spirits Revenue Evaded and Avoided (£million) [1]

	1999-00	2000-01	2001-02
Cross-border shopping[2]	100	150	150
Illicit (Fraud and Smuggling)	350	450	600
Total non UK duty paid[3]	450	600	700

[1] Includes duty and VAT although this will overstate losses to the extent that VAT is collected on sales of illicit alcohol through normal retail outlets.

[2] Includes intra-EU duty free as well as EU duty paid. Details of changes to the methodology for estimating cross-border shopping are contained in Annex 3.

[3] Figures are independently rounded to the nearest £50m. As a result components may not appear to sum.

The industry argued that these figures grossly over-estimated the problem, and that the level of spirits fraud was of the order of £100 to £150 million, rather than £600 million. At the request of the Public Accounts Committee,[51] the National Audit Office prepared a review of these estimates, which it completed just prior to the 2004 Budget. It concluded that neither of the estimates produced by the Scottish Whisky Association or Customs could "be accepted as unequivocally reliable" and that "great care is needed in determining what reliance is to be placed on the results at present available."[52] Even without definitive figures the Government

---

48 *Pre-Budget Report* Cm 6402 December 2003 p 119-120
49 HC Deb 5 January 2004 cc 167-8W
50 *Measuring and tackling indirect tax losses*, December 2003 p 18
51 HC Deb 12 February 2004 c 1554W
52 NAO, *Estimating the level of spirits fraud: memorandum by the Comptroller and Auditor General*, 10 March 2004 (UP 6 2003/04) p 4. As noted above, this issue is discussed at more length in Library standard note SN/BT/3337, 6 January 2005.

has emphasised that the sums of money at stake are considerable; as Customs' regulatory impact assessment, published after the Budget, observed, "large consignments of high-value, low-volume product are being moved under duty suspension and sold repeatedly and across national borders without any tax being paid or any guarantee that it will be. A container-load of vodka can be worth over £100,000 in evaded duty alone."[53]

In evidence to the Scottish Affairs Committee at this time, David Hubbard, Head of Excise Group at Customs, set out Customs view that, while it would not be a 'panacea' to eliminate spirits fraud, a stamp scheme would "make a substantial in-road into that fraud":

> Our assumption, and it is not just a guess, it is based, for example, on our operational experience of introducing fiscal marks for cigarettes, is that the introduction of a clear marker like a tax stamp will change the receptiveness of retailers and, of course, consumers to an illicit product. If it is not tax stamped everyone will know, subject, of course, to the possibility of counterfeiting, which I am sure we will revert to later in the discussion, but everyone will know that if it has a tax stamp it is tax-paid, if it does not have a tax stamp it is plainly illegal; and that changes the whole environment, the whole nature, of the retail market which the fraudsters are facing.[54]

One related benefit from tax stamps was highlighted by the Chancellor when he appeared before the Treasury Committee after the 2004 Budget:

> In order to prosecute under the law, Customs must have evidence of what is called "guilty mind", in other words, be able to prove that the party they find with the illicit product was knowingly supplying it for sale without duty having been paid. Of course, without a stamp on the bottle, that is difficult to prove, but if there was no stamp on the bottle in future, having had a policy of stamping the bottles, then it would be easier for them to take that prosecution forward.[55]

The introduction of tax stamps was the subject of a debate in Westminster Hall on 20 January 2004, when several Members raised strong objections to the proposal.[56] In his speech Alan Reid focused on the compliance costs for producers – in particular, the cost in buying duty stamps well before the product would be sold:

> Costs would be involved in altering production lines and bottling plants so that stamps could be fixed to the bottles. Administrative costs would be involved in security and in procedures for handling the stamps, which would be valuable commodities, worth £5.48 each in excise duty. There would also need to be procedures to deal with damaged stamps. Tax stamps would make free and open European trade impractical. Currently, the destination of bottles is unknown at the

---

53 *Tackling Spirits Fraud: Regulatory Impact Assessment*, 8 April 2004 p 18

54 *Third report: the proposed whisky strip stamp*, 26 April 2004 HC 419 2003-04 Ev 26

55 *Sixth report: the 2004 Budget*, 6 April 2004 HC 479-II 2003-04 Qs 405-6. For its part the Committee concluded that this was one of the issues raised in the course of its inquiry which was "not examined in sufficient depth during the inquiry to support specific conclusions" (HC 479 2003-04 p 33).

56 HC Deb 20 January 2004 cc 405-428WH

production stage, but a tax stamp scheme would force producers to decide at the bottling stage whether bottles were destined for the UK market or abroad. That would reduce flexibility and inevitably increase costs.

The main cost of the scheme, however, would be incurred in buying the stamps up front, long before the industry could recoup the money by selling the bottles. At present, duty is paid only when the bottles are sold. Having to buy the stamps at the bottling stage would mean that the industry had to find extra working capital, with consequential interest repayments.[57]

D. Budget 2004

In his Budget speech on 17 March 2004 the Chancellor announced that consultation with the trade had failed to produce a workable alternative, and that as a consequence, a tax stamp on spirits would be introduced.[58] Retail containers of spirits would, subject to certain exceptions, be required to bear a duty stamp indicating that UK duty has been paid. Retail containers of wine or made-wine with an abv over 22% will also be subject to the same requirements.[59] The requirement for UK retail containers of spirits to bear a tax stamp would apply equally both to imported and to home produced goods.[60] *Budget 2004* set out a number of further measures to "minimise and offset the compliance costs to the legitimate trade" from the introduction of a tax stamp:

- freeze the duty on spirits for the remainder of this Parliament – the longest duty freeze since the 1950s, so that by 2005-06 the total tax on standard bottle of spirits will be £1.33 lower in real terms than if duty had risen in line with inflation since 1997 and 36p lower than now, helping to absorb the costs associated with tax stamps;
- establish a £3 million fund to provide targeted grants to UK-based alcohol traders making capital investment in approved tax stamping equipment, subject to further detailed consultation with the trade;
- meet the ongoing printing and distribution costs of tax stamps in full and further examine the scope for reducing security costs, as part of detailed implementation discussions; and
- subject to further detailed consideration and discussion with the trade, seek to operate a system requiring no advance payment for tax stamps in order to minimise adverse cash flow impact. If such an approach proves unworkable, HM Customs and Excise will further examine the scope for extended deferment arrangements to accompany a pre-payment system.[61]

Following the Budget the Scotch Whisky Association issued a press notice saying, "We are bitterly disappointed that the Chancellor has not joined with us and taken advantage of the

[57] *op.cit.* c 405WH
[58] HC Deb 17 March 2004 c 329
[59] HM Customs & Excise Budget Notice CE18, 17 March 2004
[60] HC Deb 24 March 2004 c 847W
[61] HC 301 March 2004 pp 121-2.

very real benefits of our alternative anti-fraud package which offered the Treasury an effective solution to fraud, and more money, more quickly, than tax stamps. Tax stamps will impose financial pain on legitimate businesses, particularly smaller enterprises, but will not defeat the fraudster."[62] The *Times* reported other manufacturers' disappointment:

> Richard Ambler, managing director of Blavod Extreme Spirits, a relatively small vodka company, said: "Everybody's pretty shocked. Although Brown had talked about it, nobody thought he'd actually do it. It's very anti British industry. It's going to damage us personally and the spirits industry generally, particularly the smaller to medium-sized businesses." At the other end of the scale, Allied Domecq, the world's second biggest drinks company, said it was "extremely disappointed", estimating that stamping bottles with a duty-paid strip would slow down its bottling process by about 25 per cent. A spokesman for Allied claimed that the experience of other countries showed that such stamps could easily be counterfeited, adding: "This has not been very well thought through."[63]

These concerns appear to have been shared by many Members. An EDM opposing the introduction of tax stamps attracted 95 signatures.[64] The Scottish Affairs Committee published a detailed report strongly opposed to the scheme, arguing that "the Government appears to be reacting in response to what is an unconfirmed level of fraud, with the possibility of major implications for the industry …. we are convinced neither that strip stamps would be the best way to tackle such fraud, nor that the Government has exhausted all possible alternatives."[65]

Following the *Pre-Budget Report* in December 2003 the industry had proposed a number of alternative proposals to tax stamps, through the Joint Alcohol and Tobacco Consultation Group (JATCG).[66] In Customs' view they fell well short of a workable solution:

> As a whole, the package contains a number of inherent weakness; it leaves the door open for displacement to other types of fraud, most notably inward diversion; it stands to be undermined by a complicit party; and it does not address the issue of identification - the ability for consumers, retailers and Customs officers to distinguish readily between licit and illicit product. As a consequence the anti-fraud impact of the package falls significantly short of that estimated for tax stamps. Based on the same assumptions about fraud levels, Customs cautiously estimate that tax stamps will produce additional revenue of £160 million in 2006/07. Using a similar methodology to that used for assessing the revenue impact of tax stamps, and with the same assumptions about fraud levels, Customs estimate that the industry's package of alternatives would be unlikely to have an impact of more than £70 million, and probably less.[67]

---

62 Scottish Whisky Association press notice, *Whisky tax stamps dampen industry spirits*, 17 March 2004
63 "Tax stamps put drinks makers in low spirits", *Times*, 18 March 2004
64 EDM 958 of 2003-04 "Whisky strip stamps" 31 March 2004
65 *Third report: the proposed whisky strip stamp*, 26 April 2004 HC 419 2003-04 para 42
66 For more details see HC 419 2003-04 para 26, Ev pp 2-3
67 HM Customs & Excise Business Brief 08/04, 17 March 2004

The legislative provisions to introduce spirits stamps – which now form section 4 and schedule 1 of the *Finance Act 2004* – were the subject of a long debate at the Committee stage of the Finance Bill on 27 April 2004.[68] On this occasion the Economic Secretary John Healey summarised the key differences between the Government's proposal to deal with spirits fraud, and the industry's suggested alternative:

> In essence, the trade's measures seek to tackle fraud by tightening weak points in the supply chain, increasing the vigilance of the legitimate trade and Customs, and thereby stemming the supply of fraudulent product to retail shelves. Consumers' and traders' ability to tell whether duty has been paid does not come into play.
>
> By contrast, duty stamps straitjacket the fraudsters on both the demand and supply sides. On the demand side, they ensure that consumers and traders have a clear and immediate visual means of identifying whether a bottle is licit or illicit. Even if some people are none the less prepared knowingly to buy dodgy goods, most will not be. The rules of the game will fundamentally change: people certainly will not be prepared knowingly to pay the full prices they unknowingly pay now for many fraudulent, illicit bottles on which duty has not been paid.
>
> On the supply side, it will be impossible for a would-be fraudster to convince an honest alcohol trader that he is dealing in duty-paid goods if there is no stamp on them. It will be much easier for Customs to finger those caught in the act of diversion fraud. The difference, bluntly put, is between tightening the boundaries of the playing field for fraudsters and closing the ground. It would be misleading to suggest that the decision to proceed with duty stamps rather than the trade's alternative package was a marginal one.[69]

One particular criticism made by the Scottish Affairs Committee was that tax stamps were an old-fashioned way to tackle fraud, expensive to stick onto bottles and easy to counterfeit; part of the Government's response – published in July – is given below:

> The Government is aware that tax stamps have been around since the mid- to late-nineteenth century, being first regularly applied to cigar boxes during the American Civil War. However, when considering a design for its stamp, the Government will have at its disposal the very latest, cutting-edge, twenty-first century security printing technology. This will include advanced inks, papers, adhesives, and hidden security features and will give the stamp an appearance and functionality unimaginable in the nineteenth century.
>
> It is also important to recognise that today stamps are used on alcohol products in over forty countries around the world and are generally regarded as efficient and effective tools, not only in the facilitation and control of revenue collection but, also, in tackling fraud. It is, of course, relevant to note that not all duty stamps that are used are "a thin, sticky label stuck over the top of the bottle". For example, some countries

---

68 HC Deb 27 April 2004 cc 757-820
69 HC Deb 27 April 2004 cc 766-7

use a frangible, vinyl-substrate label on the side of the bottle; others use a holofoil disc - each have their advantages and disadvantages. The Government is exploring all the options for the UK duty stamp … Customs' officials have held discussions with anti-counterfeiting technology specialists and several members of the security printing industry. Anti-counterfeiting technology has improved considerably in recent years and is continuing to progress. A number of security requirements have been identified and Customs will look to take into account all the technologies available in considering the final stamp design.[70]

E. Recent developments

At the time of the *Pre-Budget Report* the Government published revised estimates of the level of spirit fraud over the last four years, suggesting fraud peaked at £450 million in 2001-02 (compared with the estimate made a year previously of £600 million), and that it had fallen to £250 million in 2002-03.[71] The revisions were "due to technical improvements made by the Department for the Environment, Food and Rural Affairs in the adjustment of data for the consumption of spirits purchased through off-licence outlets."[72] In the Government's view, "this progress does not remove the need or case for further measures, but emphasises the importance of implementing those measures in a way that keeps the compliance costs for the legitimate trade to a minimum."[73] As a consequence the Government put forward a number of changes to the scheme:

> In light of the work that has been done with the industry and of updated estimates of spirits fraud, the Government therefore:
>
> - **has decided, based on industry proposals, to make targeted exemptions from the duty stamps regime.** Specifically, goods sold by Registered Mobile Operators (such as ferries and airlines) and export shops will be exempt from the requirement to bear duty stamps, and duty stamps will not be required for bottles of spirits of less than 30 per cent alcohol-by-volume. If exemption of liqueurs as a class can be achieved in a way that avoids complexity, uncertainty and revenue risk, the Government is attracted to the case for doing so;
> - **has decided to adopt the industry's proposal to allow duty stamps to be incorporated into bottle labels.** This will significantly reduce upfront and ongoing compliance costs for the majority of the industry. The Government is also minded to allow additional flexibility in the format of stamps for those businesses that would prefer to affix duty stamps in the form of traditional 'strips'; however, it wishes to discuss further with the industry printing arrangements and design details, such as the appropriate levels of security features and brand specificity, before making a final decision;

70 Scottish Affairs Committee, *Second special report*, 5 July 2004 HC 822 2003-04 pp 6-7
71 HM Customs & Excise, *Measuring and tackling indirect tax losses: an update on the Government's strategic approach*, December 2004 p 12
72 HM Customs & Excise Business Brief 33/04, *Tackling alcohol fraud*, 2 December 2004 p 7
73 Cm 6408 December 2004 paras 5.96

- **believes there is a case for not attaching a financial liability to duty stamps.** Following intensive work with the trade to examine options for securing payment in respect of duty stamps, the Government is inclined to the view that many of the benefits of duty stamps - including the vital ability to identify illicit product - can be secured, and the most appropriate balance struck between impact on fraud and minimising compliance costs, without the imposition of a penalty on legitimate traders in the event of the fraudulent use of duty stamps by others in the supply chain. It will work further with the industry to examine the implications of this for the impact of duty stamps on both fraud and compliance costs before making a final decision.[74]

At the time of the Budget, Customs estimated the trade's gross compliance costs as follows:[75]

> Of the firms potentially affected there are 9 large, 15 medium-sized and circa 160 small; although the bulk of the burden before offsets will fall on the large firms, the relative impact on small firms will probably be higher. Based on information analysed and agreed by the trade, the gross compliance costs (excluding any offsetting measures) are:

	£m	**£/case (8.4 litres)**	**£/bottle (70cl)**
One-off costs	23.2	£0.66	£0.06
Ongoing costs	53.9	£1.54	£0.13

A more detailed breakdown is provided in the regulatory impact assessment which Customs published following Budget 2004:[76]

> These figures [for the gross costs of a tax stamps scheme] can be further broke down for the whole industry as follows:

Capital costs (one-off)	**£m**
New machinery	15.4
Factory redesign	1.8
Other	5.9
Total capital costs	23.2
Ongoing costs	**£m**
Producers' costs	16.5
Finance costs	23.8
Non-finance costs	7.0
Importers' costs	4.0
Warehousing costs	2.6
Total ongoing costs	53.9

74 HM Customs & Excise Business Brief 33/04 pp 3-4

75 HM Customs & Excise Business Brief 08/04, 17 March 2004. Customs' regulatory impact assessment, cited below, reproduces these figures with the following comment (p 36): "The costs per case figures are industry averages and measure just the total cost divided by the number of cases. The actual cost feeding through to retail prices may be different. A case typically contains a dozen 70cl bottles or equivalent."

76 HM Customs & Excise, *Tackling Spirits Fraud: Regulatory Impact Assessment*, 8 April 2004 pp 37-38

These figures can also be broken down by small, medium and large firms as shown [below]. Except where stated, these numbers refer to costs initially incurred by spirits producers. Clearly there are many other stakeholders such as retailers and consumers, who will be affected and who may end up meeting the compliance costs, but the producers are likely to be affected first. These is considerable variation in costs between individual firms and, because of this, an assessment of the impact on a 'typical business' is not available. However, the likely impact on different business sectors and on different sizes of firm can be assessed.

(Figures all £millions)	Large firm	Medium firm	Small firm	Total
No. of firms:	9	15	c. 160	
Annual volume (cases):	>1m	100k – 1m	≤100k	
Capital costs (one-off)				
> new machinery	12.8	2.2	0.4	15.4
> factory redesign	1.3	0.5	0.0	1.8
> other	4.1	1.5	0.3	5.9
Total capital costs	**18.2**	**4.2**	**0.7**	**23.2**
Ongoing costs				
> producers' costs	13.0	2.4	1.1	16.5
> finance costs	20.6	3.1	0.1	23.8
> non-finance costs	3.4	3.4	0.2	7.0
> importers' costs	0.0	0.0	4.0	4.0
> warehousing costs	0.0	1.1	1.5	2.6
Total ongoing costs	**37.0**	**10.0**	**6.9**	**53.9**
Capital cost per case	£0.73	£0.75	£0.16	£0.66
Ongoing cost per case	£1.48	£1.78	£1.56	£1.54
Capital cost per bottle	£0.06	£0.06	£0.01	£0.06
Ongoing cost per bottle	£0.12	£0.15	£0.13	£0.13

Customs now estimates that the compliance costs of the duty stamp system will be significantly lower as a consequence of the changes announced in the *Pre-Budget Report*:

The potential overall compliance costs for duty stamps were estimated by the JATCG prior to Budget 2004 at £23m start-up and £54m a year ongoing. Under the approach outlined above, and based on estimates provided by the industry, compliance costs could be reduced to £7m start-up and £5m a year ongoing. This means duty stamps remain a proportionate as well as a necessary measure, including in the context of updated estimates of the level of spirits fraud.[77]

[77] HM Customs & Excise Business Brief 33/04 p 8