



House of Commons
Committee of Public Accounts

HM Revenue & Customs: Renewed Alcohol Strategy

Sixth Report of Session 2012–13

*Report, together with formal minutes, oral and
written evidence*

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Committee of Public Accounts

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Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee is Adrian Jenner (Clerk), Sonia Draper (Senior Committee Assistant), Ian Blair and James McQuade (Committee Assistants) and Alex Paterson (Media Officer).

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Summary

In April 2010, HM Revenue & Customs (the Department) launched its renewed strategy to reduce the amount of tax lost each year due to alcohol duty evasion, principally through fraud which often involves exporting duty unpaid alcohol to the near continent, which is then redirected to the UK and released to the market with no duty paid. In 2010-11, the renewed strategy delivered £433 million in financial benefits against a target of £390 million.

The Department collected £9.5 billion of revenue from excise duties on alcohol in 2010-11. However, it estimates that there is a tax gap—the difference between taxes due and the amount actually collected—of up to £1.2 billion. The Department has not produced an estimate of the tax gap for wine, despite a commitment to our predecessors to do so. Without reliable information on the scale and nature of duty evasion for each category of alcohol (beer, wine and spirits) the Department cannot tailor its approach to target its efforts to tackle evasion to maximise value for money.

The Department does not yet have good enough information on the returns it secures from investing in specific areas of activity to make best use of the additional £917 million it plans to spend on reducing all kinds of tax avoidance and evasion. It told us that the rate of return on its work to reduce alcohol duty fraud is approximately £17 to £1 but it is not clear whether it could target its resources more effectively to secure a better return on its investment.

The Department is consulting on a range of measures to reduce alcohol duty fraud, including a proposal to introduce fiscal stamps for beer, an approach which appears to have been successful in reducing duty evasion on spirits. The Department does not yet have a full understanding of the costs and benefits of these proposals, including the compliance costs for the industry of introducing fiscal stamps for beer and the impact on legitimate wholesalers and retailers.

The Department does not make best use of intelligence and technology to detect and prevent alcohol duty evasion. The Department needs to work more closely with the industry to improve its understanding of legitimate export markets, and improve how it works with the UK Border Force to gather intelligence on illegal alcohol imports. In addition, the Department does not yet use the full capability of the Excise Movement Control System (EMCS), which facilitates the tracking of freight across the European Union, and could be used to target interventions and investigations more effectively. The Department implemented EMCS in phases over two years as planned, but did not make full use of its capabilities when implementation was completed.

Despite an estimated £1.2 billion being lost each year from duty evasion there are very few successful prosecutions for alcohol duties fraud. In the four years from 2006-07 to 2009-10 the highest number of successful prosecutions in any one year was six and the highest number of defendants was 16. The Department does not take enough account of the deterrent effect of successful prosecutions when considering the cost and benefits of pursuing perpetrators through the courts.

On the basis of a report by the Comptroller and Auditor General,¹ we took evidence from the Department on its progress in implementing the revised Renewed Alcohol Strategy since April 2010.

1 C&AG's Report, Renewed Alcohol Strategy: A Progress Report, Session 2010-12, HC 1702

Conclusions and recommendations

- 1. The Department does not have sufficient reliable information on returns from tackling different types of alcohol duty evasion. The absence of this information hinders its ability to direct its resources for tackling evasion to areas which deliver the most benefit.** We also identified this issue in our recent report on the Department's broader Compliance and Enforcement Programme. The Department must gather better information to enable it to secure the best return on investment from its activities in tackling alcohol duty evasion. Better information will enable the Department to secure the best returns on its investment and we look forward to a precise cost-yield analysis next year on alcohol duty evasion as well as other areas of expenditure.
- 2. The Department has not produced an estimate of the tax gap for wine despite its commitment to our predecessors to do so.** The absence of information on the nature and scale of wine duty fraud undermines the basis on which the Department directs its resources to tackling wine duty evasion. The Department should improve its understanding of the scale and nature of wine duty evasion and, in accordance with the commitment it gave our predecessors, publish its estimate of the tax gap for wine.
- 3. The Department does not make good enough use of intelligence to disrupt the organised criminal gangs responsible for much alcohol duty fraud.** As perpetrators of major alcohol duty fraud cross national boundaries, collaboration with the industry, the UK Border Force and other EU Member States is essential if the Department's efforts to establish the scale of the crime and tackle it are to be successful. The Department needs to strengthen its intelligence by developing better links with the industry, the UK Border Force and other EU Member States.
- 4. The Department implemented the Excise Movement Control System (EMCS) two years ago but it is still not using the full functionality of the system to counter alcohol duty fraud.** The Department told us that it now has the capability to use the system to review and interrogate information on movement of excise goods within the EU although it does not yet use its full functionality to help target interventions and investigation. The Department should set out how and when it plans to use the system to its full capability and record the impacts that it secures directly from its use of EMCS.
- 5. The low number of prosecutions for alcohol duty fraud suggests the Department may not be giving sufficient weight to the deterrent impact of pursuing perpetrators through the courts.** In each of the four years to 2009-10 there were convictions in six cases or fewer for alcohol duties fraud. To support informed decision-making on whether to pursue cases, the Department should carry out work to give it reliable information on the likely costs and benefits of prosecutions, including the impact of successful prosecution in deterring organised criminals.

1 The scale of alcohol duty fraud

1. HM Revenue and Customs (the Department) collected £9.5 billion of revenue from excise duties on alcohol in 2010-11. However, the Department estimates that the difference between taxes due each year and the amount actually collected—the tax gap—is around £1.2 billion.² This revenue is lost due to duty evasion, principally fraud. In April 2010 the Department began implementing its renewed strategy to tackle alcohol duty fraud. The renewed strategy focuses on fraud across all forms of alcohol duty (beer, wine and spirits), whereas the previous strategy focused on spirits.³

2. In 2010-11, the first year of its renewed strategy, the Department delivered £433 million of financial benefits through its efforts to tackle alcohol duty fraud against a target of £390 million.⁴ The Department told us that it had spent around £25 million on the strategy, giving an approximate rate of return of around £17 for every £1 spent.⁵ However, the Department was unable to provide clear evidence that it targets its resources effectively to secure the best possible rate of return, and therefore value for money, from the full range of its compliance and enforcement activities, including its work tackling alcohol duty fraud.⁶ We also identified this issue in our recent report on the Department's broader Compliance and Enforcement Programme.⁷

3. The Department does not have accurate data on the size of the tax gap, and has not produced an estimate for the size of the tax gap for wine at all, despite its commitment to our predecessor Committee to do so. The Department told us that, as there is no reliable measure of the amount of wine consumed in the UK, it is difficult to make an informed estimate of the tax gap.⁸ The Department now produces a range for the scale of the beer tax gap, which it estimates is from £250 million to £800 million.⁹ The Department has not assessed the impact of alcohol duty fraud on the legitimate market but told us that the industry estimates that up to £1 billion of trade is lost due to fraud¹⁰.

4. The absence of an accurate measure of the tax gap for each type of alcohol calls into question whether the Department is directing its resources for tackling fraud appropriately.¹¹ The Department told us that it uses intelligence gathered through prosecutions and from the UK Border Force to direct resources to where it believes they will be most effective.¹²

2 C&AG's report, paras 2, 5, 1.2

3 C&AG's report, paras 1.8, 1.9

4 Q113; C&AG's report, para 10, Figure 1

5 Q77

6 Qq 70-81

7 Committee of Public Accounts, Eighty-Seventh Report of Session 2010-12, *HM Revenue and Customs: Compliance and Enforcement Programme*, HC 1892

8 Qq 66-68

9 Q 64

10 Qq 148-153

11 Qq 69-80

12 Qq 48, 69

2 Measures to tackle alcohol duty fraud

5. The Department is consulting on a range of legislative and regulatory measures which it believes could help reduce alcohol duty fraud. These include a proposal to introduce fiscal marks—duty-paid stamps—for beer, supply-chain legislation, and the registration of wholesalers.¹³ The Department’s aim is to prevent duty fraud from becoming endemic in the alcohol industry.¹⁴

6. Among industry representatives there were different views on the merits of the proposed measures to reduce alcohol duty fraud. The British Beer and Pub Association told us that the cost to brewers of introducing fiscal marks would effectively wipe out profits from brewing.¹⁵ However, the Federation of Wholesale Distributors told us that the proposed measures are needed to reverse a decline in revenue for legitimate wholesalers and retailers.¹⁶

7. The consultation gives the Department the opportunity to assess the costs and benefits to the exchequer and the industry of introducing new measures to tackle alcohol duty fraud. The Department told us that it had a lower estimate than industry for the cost of introducing fiscal marks, but, as part of its consultation, it was researching the feasibility of, and costs associated with, applying and removing fiscal marks. In addition, the Department told us it was considering alternative arrangements for smaller breweries.¹⁷

8. Alcohol duty fraud often involves exporting duty unpaid alcohol to the near continent, which is then redirected to the UK and released to the market with no duty paid.¹⁸ The Department told us that while there are legitimate reasons for suppliers to move UK-produced beer between the UK and Europe, the volume of UK-produced beer exported to Europe is about three times the amount required for the legitimate market.¹⁹ The Department has estimated that of the 450 million litres of beer exported to Europe annually, up to 180 million litres are being illegally re-imported to the UK.²⁰

9. The Department uses the Excise Movement Control System (EMCS) to track the movement of legal exports within the EU. The system could also be used to target interventions and investigations of suspected illegal alcohol movements more effectively. The EMCS was implemented in 2010 and has been fully operational since January 2012. However, the Department has not yet used the full capabilities of the System to detect and prevent fraud.²¹ The main threat of fraud on alcohol duty comes from organised criminal

13 Q 3

14 Q 49

15 Q 34

16 Qq 2-3

17 Qq 138-141, 145-146

18 Q 13

19 Qq 60-62

20 Q 103

21 Qq 31, 44, 104-111

gangs which operate across national boundaries.²² The Department is working with the authorities across Europe to detect illegal operations and with the UK Border Force (UKBF) to intercept illegal alcohol imports at the border. But the Department accepts that it needs greater input from the UKBF to gather intelligence effectively.²³ Collaboration with the industry, the UKBF and other EU Member States is essential if the Department's efforts to establish the scale of alcohol-duty fraud and to tackle it are to be successful.²⁴

10. The authorities can use a range of sanctions to deal with perpetrators of alcohol duty fraud, ranging from civil measures such as revoking retailers' licences to sell alcohol and seizing vehicles used to transport alcohol illegally, to criminal prosecution. The Department told us that civil sanctions can have a deterrent effect on the perpetrators of alcohol fraud where sanctions affect the livelihoods of those involved.²⁵

11. Despite an estimated £1.2 billion being lost each year from duty evasion there are very few successful prosecutions for alcohol duties fraud. In each of the years from 2006-07 to 2009-10 there were no more than six successful prosecutions, and in each year there were no more than 16 defendants.²⁶ We asked the Department about the revenue loss prevented by prosecutions. The Department subsequently provided a note suggesting that revenue losses of over £120 million had been prevented as a result of interventions into criminal activity made from 2008-09 to 2010-11.²⁷

12. Criminal investigations can be complex and costly, particularly where large-scale alcohol fraud crosses national boundaries and, the weight of evidence required to secure a conviction can be high.²⁸ However, this should not prevent the Department from seeking to prosecute offenders. The Department told us that it has used a range of measures to reduce the burden of securing evidence and its first consideration in cases of alcohol fraud is whether it can prosecute. However, the Department does not appear to fully understand the costs and benefits of prosecutions, including the deterrent effect of prosecution on large-scale alcohol fraud.²⁹

22 Qq 4, 51, 111-113

23 Q 48

24 Qq 43, 52-54, 113

25 Qq 49, 94-97

26 C&AG's report, Figure 7

27 Ev 23

28 Q 5

29 Qq 49-51, 126-129

Formal Minutes

Thursday 12 July 2012

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon
Mr Jackie Doyle-Price
Matthew Hancock
Mr Stewart Jackson
Fiona Mactaggart

Meg Hillier
Mr Austin Mitchell
Nick Smith
James Wharton

Draft Report *HM Revenue & Customs: Renewed Alcohol Strategy*, proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 12 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Sixth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Monday 16 July at 3.00 pm]

Witnesses

Wednesday 25 April 2012

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James Bielby, Chief Executive, Federation of Wholesale Distributors, **Simon Drew QC** and **Brigid Simmonds OBE**, Chief Executive, British Beer and Pub Association Ev 1

Dave Hartnett CB, Permanent Secretary of Tax, **Lin Homer**, Permanent Secretary and Chief Executive and **Mike Norgrove**, Director Excise, Customs, Stamp Duty and Money Laundering Regulations, HMRC Ev 6

List of printed written evidence

| | | |
|---|--------------------------------------|-------|
| 1 | British Beer and Pub Association | Ev 20 |
| 2 | Federation of Wholesale Distributors | Ev 22 |
| 3 | HMRC | Ev 23 |

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2012–13

| | | |
|---------------|--|---------|
| First Report | The Government Procurement Card | HC 1915 |
| Second Report | Mobile Technology in Policing | HC 1863 |
| Third Report | Efficiency and reform in government corporate functions through shared service centres | HC 463 |
| Fourth Report | The completion and sale of High Speed 1 | HC 464 |

Oral evidence

Taken before the Committee of Public Accounts on Wednesday 25 April 2012

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon
Matthew Hancock
Mr Stewart Jackson
Fiona Mactaggart

Austin Mitchell
Ian Swales
James Wharton

Amyas Morse, Comptroller and Auditor General, NAO, **Gabrielle Cohen**, Assistant Auditor General, **Paul Keane**, Director, NAO, and **Marius Gallaher**, were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Renewed Alcohol Strategy: A Progress Report (HC 1702)

Examination of Witnesses

Witnesses: **James Bielby**, Chief Executive, Federation of Wholesale Distributors, **Simon Drew QC**, and **Brigid Simmonds OBE**, Chief Executive, British Beer and Pub Association, gave evidence.

Q1 Chair: Welcome. Apologies for being so late—it is very rude, but we have to clear reports as well as take evidence. We work at a bit of a pace. This first phase of the evidence session is an opportunity for experts and people who are users of Government policy to talk a little bit about how it works for you. We recognise that the three of you may have different views. We want this to last for only about half an hour, so it is quite a short phase. We thought it might be best, starting with you Brigid, if you very swiftly give us your view in as close to 60 seconds as you can. Then we can take the questions from there.

Brigid Simmonds: Good afternoon. My name is Brigid Simmonds and I am the chief executive of the British Beer and Pub Association. The BBPA clearly recognises that duty fraud is an issue. We are very keen to work in partnership with HMRC—we have been doing that for nine months. We have produced a charter of actions that we could take, but we feel there is a lot more that HMRC could do, and that its current strategy has not been given time to be fully implemented. We feel that fiscal marks, tax stamps and the supply chain legislation are absolutely disproportionate and will put many breweries in this country out of business.

Q2 Chair: That was very succinct. Thank you, James.

James Bielby: We are the Federation of Wholesale Distributors. We manage the distribution of food and drinks, with other goods—total value of about £28 billion each year. About £9 billion of that would be in alcohol. We employ 70,000 people directly. Our members typically supply independent stores and catering and the public sector. Alcohol fraud has disproportionately hit revenues, so we have seen a 9% decline in sales on beer from 2007 to now, at a time when the sector overall has been about 17% in growth. We welcome the NAO Report and some of

its recommendations about moving forward into other policy areas.

Q3 Chair: Including trademark?

James Bielby: Including fiscal marks, supply chain legislation and registration of wholesalers, which is something that we have designed, which forms part of the latest consultation to come out of the Treasury.

Q4 Chair: Simon, you have done some prosecutions and things.

Simon Drew: I am Simon Drew. I am counsel rather than a member of the trade. My experience is in prosecuting large-scale duty evasion frauds. The principal thing I would say is that there is a very clear link between alcohol fraud and cigarette duty evasion. The most important thing from where I sit is that it is very strongly linked with organised crime and international organised crime. That is the principal area in which large-scale fraud and duty evasion is concerned. That is where concentration needs to be, so far as resources, intelligence and international co-operation are concerned, all of which are serious, major problems in getting investigations and prosecutions off the ground.

Q5 Chair: I shall start with you. Why do we do so few prosecutions?

Simon Drew: Certainly, so far as I see it, investigation is very labour-intensive. The most recent fraud that I prosecuted required 220 hours of covert surveillance, which is an awful lot of customs officers' investigation time. There was a lot of recording of conversations. It is very technical, very difficult to do. There are lots of disclosure issues.

Many of these investigations are interlinked with lots of other ongoing investigations and prosecutions. There is a complex web between those who are involved in these frauds, and it is wrong to see them

as very clear, obvious enterprises. There are all sorts of links across not only this country but mainland Europe, particularly eastern Europe. They are very difficult to penetrate and investigate. That is a real problem, because the big fish are not in this country, but are mainly abroad. They are difficult to get hold of. The case that I have just been dealing with involved one of the big fish. We were even able to identify where he was. He was subject to extradition proceedings and brought before the court in the country from where he was to be extradited. The court said, "Thank you very much indeed. We will now release you on bail. Please go and catch a plane to the UK." Surprisingly enough, he didn't. So far as prosecuting the large-scale enterprises are concerned, those are the sorts of issues that we have to face when it comes to prosecuting.

Q6 Chair: The Report says that the Department emphasises civil proceedings. What is your view on that?

Simon Drew: The advantage of civil proceedings is that they will result in some sort of resolution so far as principally the export/import duties are concerned, but in reality that does not touch international crime or the organisations behind this at all. How much and what proportions will be dealt with by way of civil penalties and what really needs to be dealt with by way of proper criminal investigation, perhaps I am not the right person to say.

Q7 Mr Jackson: Are you saying that it is a resources issue alone or are you saying that the evidential test by the CPS is too high for this particular crime?

Simon Drew: Neither of those two things exactly. What I am saying is that from an investigatory side it is technically often extremely difficult, because you have to get information and evidence from abroad a lot of the time. If you are solely confined in your investigation to the UK when it in fact has a large-scale international dimension, you have a major problem, because you only have half, if not less than that, of the picture. You have to get your resources abroad and you have to get co-operation from international police forces and investigating agencies. So far as the evidential threshold is concerned, you are always going to have a criminal standard, whatever you want to call the offence, and the investigation is obviously going to have to meet that, however you approach that. It is not really an evidential threshold that is needed, but actually getting the material in the first place that is the real root problem.

Q8 Mr Jackson: Is there any light at the end of the tunnel with respect to EU law or a regulatory regime or framework?

Simon Drew: No. The reality is, particularly the further east you go, the more protected the organised criminals are. There are some countries in which, frankly, those who are running these operations are virtually safe.

Q9 Mr Bacon: They are probably running the Government as well in some of those countries. Better strike that from the record.

Ms Simmonds and Mr Bielby, you obviously take different positions on fiscal marks. Briefly, if I characterise where I think you are coming from, could you attack each other's positions to help clarify things? Ms Simmonds, you represent the BBPA, so you represent retailers—pubs—and also the people who own them, who are in many cases large breweries, and you think fiscal marks were a bad idea, because they add to cost.

Brigid Simmonds: Yes.

Q10 Mr Bacon: Mr Bielby, you represent the wholesalers: the distributors in the middle who act not only for big breweries who are trying to distribute their beer—obviously, if it is to their own pub, they will do it directly—and all kinds of other products that end up in pubs. You are seeing a significant decline in your sales at a time when beer sales are going up, and you think fiscal marks are a good idea, even if there are some costs, because your members are really seeing the effects of what is essentially a rise in criminal activity that is avoiding the tax that should have been paid.

James Bielby: Beer sales are in decline, in value terms. I need to make that clear. The overall sector is in growth.

Q11 Mr Bacon: Exactly. So why is Ms Simmonds' view—that fiscal marks would be disproportionate and too expensive—wrong?

James Bielby: That is probably a question for Brigid to answer herself, rather than my pre-empting her.

Q12 Matthew Hancock: She is not going to say why you think she is wrong.

Q13 Mr Bacon: I will come to Ms Simmonds in a moment. You obviously do not think that they are disproportionate. The figures that you have just quoted are startling in a way. You obviously do not think that the cost would be disproportionate. Can you talk about why not and the supply legislation and how you would see it acting in reality?

James Bielby: Certainly. Our view is that it is better to prevent the product reaching the market, rather than picking it up later on. If you look at the figures, about 500 million litres of beer are exported to the EU each year from the UK. That is British-brewed beer exported to the near continent. The legitimate market for that product is probably about 150 million litres. The rest of that product is diverted back on to the UK market without the duty being paid. If there was a duty stamp affixed to the product at the point of production, that product would no longer be allowed to go to markets where there was no demand, so there would be no over-supply to fictitious markets. Therefore that product would no longer be diverted back on to the UK market.

Q14 Mr Bacon: The Committee saw that problem with cigarettes on a very big scale a few years ago, with cigarette companies using the phrase "DNP"—

25 April 2012 James Bielby, Simon Drew QC and Brigid Simmonds OBE

duty not paid—in their emails to describe aspects of their marketing strategy. They took into account the grey market in the way they did their advertising.

James Bielby: Yes, and if you look at the fact that spirits have a duty mark, which was put on three or four years ago, the level of duty fraud on spirits has gone down markedly. There is a precedent for its success. If you assume that 90% of UK beer brewed in the UK is for UK consumption, it should be possible for brewers to forecast which product is going to a market where there is legitimate demand for that product and produce products without a duty stamp on it at that point.

Q15 Chair: What is your view on the cost argument? Let me just ask James that question. Do you think that it is affordable? How do you think it is affordable, whereas the BBPA thinks that it is not?

James Bielby: We are talking about packaged beer, cans of beer. Those products are being changed all the time, so within our market, which is supplying it to the retailers, there are price-marked packs, promotion packs, different SKUs, different colours and different things all the time. I don't buy the argument that there is a cost because the production design is changing all the time, and the stamp would be an integral part of the design. It would not be affixed. It would not be a label. It would be part of the actual tin.

Q16 Mr Bacon: We have had this issue in food labelling. I have looked at it a lot. I have tried four times to change the law on food labelling. I am told by food labelling machinery manufacturers that actually they change the things extremely regularly. Ms Simmonds, you are basically saying that this is disproportionate, that it is costly and that it presumably would not solve the problem or, if it would, it would be too costly to do it. Is that right?

Brigid Simmonds: Absolutely. Can I say first that beer consumption has gone down by 25% in the last six years? We have seen a 42% increase in taxation. Brewers are making only 1p a pint in this country. Even the OBR figures do not believe that Treasury will get any more money from the increased taxation that will go up over that period within the next few years. We are a British industry, 87% of beer is produced here.

We are proposing to put tax stamps on beer, suggesting that it is very similar to spirits. Well, for spirits, in the UK, 110 million bottles are produced. For beer, 5.6 billion cans or bottles would be required to have this fiscal mark. It is not simple. Not only would they have the fiscal mark, but that fiscal mark would have to be removed otherwise it could not be sold somewhere else within the EU. In fact, earlier this week I was watching 200 bottles a minute being filled and having labels put on them. It is disproportionate, and I do not believe that it would solve the problem. There is not a problem with counterfeit beer, which is the issue with spirits. In fact, we have had people die because of counterfeit spirits. We admit there is a duty fraud problem, but nothing as great as HMRC is actually believes it to be. Its methodology is frankly a finger in the air. It is

disproportionate to require fiscal marks and I do not think that it would solve the problem.

Q17 Chair: James, you shook your head. We need to understand the debate.

James Bielby: As for the difference between spirits and beers, the counterfeit argument is one, but we are talking about the obliteration of that mark. You would have a forecast to know where there is a market for the legitimate demand for your product in other member states. You would be able to forecast the demand for that product and adjust production lines accordingly. It would not be like you were producing 100% of your lines with the mark, then obliterating the mark. It is a different dynamic to spirits.

Brigid Simmonds: But we have four international brewers; they are the biggest brewers in this country: Carlsberg, AB Inbev, Heineken and Molson Coors. They are international global businesses and, as a country, we want to encourage international global movements. It is not as simple as just moving from one country to another. You would have to have separate spaces in your distribution areas. We are prepared to work with HMRC. We would give them, and do give them, lots of information about how we sell to legitimate customers.

Q18 Mr Bacon: Is it not precisely because beer is of relatively low value and very heavy, mainly liquid? Becks beer or whatever it is—although it sounds German and tastes German—is actually brewed in the UK. Presumably that happens on the basis that the brewers figure out how much demand there is for Becks beer or whatever it is in the UK, and act accordingly. That would be my guess. Obviously, it is 50 times larger; 110 million versus 5 billion. The lines go much faster, but are those items as they are going through being stamped in any way? Are they being date stamped?

Brigid Simmonds: No, they have labels on the back with things like the Government's chief medical officer's guidance, but they are not being stamped in the way that you are talking about.

Q19 Mr Bacon: Well, I think that cans of beer are date stamped at the moment.

Brigid Simmonds: Yes, they are date stamped.

Q20 Mr Bacon: Something is going through that changes now. That is correct, is it not?

James Bielby: It is the total part of the production line.

Q21 Mr Bacon: Something is going through the production line now, which is a stamp that does not just say "Stella Artois" and always says "Stella Artois", but changes through time.

Brigid Simmonds: It does change through time, but then how do you make that mark, particularly on a can, removable?

Q22 Mr Bacon: Well, that speaks to the question of whether you are planning to take a whole load of that beer that you have made in Britain, because you thought that you wanted to save on the cost of

transport, and decide that you suddenly want to shove it over to Belgium.

Brigid Simmonds: It is not only that. Our exports in this country have doubled. There is an increased interest in things such as craft beers. There is clearly a market out there, and you would stop that market happening for this country, because people would say, “We cannot go through the cost of putting on those stamps and still make money in exporting those beers.”

Q23 Ian Swales: Can I ask one simple question? Is it not true that pubcos get bottles marked differently from the ones that go into supermarkets and that one pubco’s bottle is marked differently from another pubco’s bottle?

Brigid Simmonds: I will write to the Committee, but not as far as I am aware, no. Whether you produce bottles of—

Q24 Ian Swales: I know from a relative who ran an Enterprise Inn that if he went and bought bottles at Sainsbury’s, which to the naked eye looked exactly the same as the ones that he got from Enterprise, Enterprise would know. He was stopped when he ran out one time and had to buy stuff from the supermarket. It was clear to the people from Enterprise that those bottles were different from the other bottles. There already is a routine of doing different bottles, patterns or whatever for different uses, so clearly, as Mr Bacon said, the industry is able to flex the way it produces things, depending on what is needed.

Brigid Simmonds: Yes, but it is in an industry where you are making only 1p a pint. The other thing that is totally disproportionate about this is, why are you going to do it only on beer and not on wine? We feel that we are an industry that is being picked on because we are British, frankly. Only 0.02% of wine is produced in this country; you are not going to propose fiscal marks for wine, and if you did impose fiscal marks on beer, all that would happen is that fraud would move to wine.

I have to be honest and say that I will have to write to the Committee about whether Enterprise sell specific products in pubs, but under EU law, stamps would have to be removable and there is no doubt that it would affect export. We have had a discussion with the Commission. Another thing that we feel is disproportionate is the suggestion that those that produce less than 200,000 hectolitres would not be affected by those stamps. You would have to have an encyclopaedic knowledge in a pub to know which types of beer had to have those stamps and which types do not.

Q25 Ian Swales: Do you accept Mr Bielby’s figures? I think he said earlier that 0.5 million litres were exported and he suggested that 350,000 of those litres were re-imported¹.

Brigid Simmonds: We would not accept those figures, nor do we accept HMRC’s figures. There were two different methodologies.

James Bielby: Those are HMRC figures, they are not our figures.

Brigid Simmonds: Can I explain how HMRC produced the figures? HMRC actually produced—

Q26 Chair: I do not want to go down that road. I will tell you, Ian, why I am stopping it. It is a bit like the argument that we had last week, or when we looked at HMRC last time. Clearly these are guesstimates, and I think that we will just get involved in a ridiculously—

Ian Swales: I was just trying to understand the scale of the problem.

Brigid Simmonds: Can I say one very quick thing? The guesstimate assumes that under-reporting increases by 50% for beer. That is not the same for spirits. If they used the same methodology, we would have no duty fraud at all. It is a guesstimate.

Q27 Ian Swales: My final question is for Mr Drew. Very quickly, in a few sentences, can you walk us through what a typical fraud is—the type of thing that you are prosecuting? What is actually going on physically? The thing that baffles me is, how on earth does this quantity of material move around without people being able to get a handle on it?

Simon Drew: The principal ones that I have been dealing with have been denaturised alcohol, so you are dealing with meths or something similar to that—alcohol, but in an industrial state, normally 96% to 97% alcohol. It has special products in it that mean that you cannot consume it. There is a system whereby you can filter it and produce almost pure alcohol, which is then bottled, often in this country, and then sold as if it is—

Q28 Ian Swales: Bottled as what?

Simon Drew: As Gordon’s gin or whatever. There are companies that are bottling these things and they are going out into the ordinary market.

Q29 Ian Swales: So that is counterfeit material.

Simon Drew: It is particularly counterfeit material that we end up dealing with. In the duty evasion on alcohol going out and coming back in again, very little comes about that actually ends up getting prosecuted, because it is very difficult to find. One of the principal issues that you need to address is that the borders leak very badly, and that needs to be sorted.

Q30 Ian Swales: So the main thrust of the prosecutions is illicit alcohol—industrial-scale alcohol being moved around that can be made anywhere, then converted into gin, vodka or whatever.

Simon Drew: Absolutely, and you can move it around within the UK because it appears to be a perfectly legitimate product.

Q31 Matthew Hancock: One simple follow up on that: if it is very difficult to prosecute, how can we have confidence in the figures I heard earlier—of the 500,000, only 150,000 are really exported and the rest is consumed onshore?²

¹ NAO correction: figures should be 500 million litres of which 350 million were re-imported (see Q13)

² NAO correction: see question 13

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Brigid Simmonds: We are doing some independent research with KPMG, which we will share with the Committee and HMRC, on the figures HMRC put forward that we are concerned about. You can understand why with spirits you would want to do fraud, because the duty on spirits is about £13 on a £17 bottle. For beer, it is only 52p out of 89p. It is not as attractive in that sense.

We believe there is much more that HMRC can do. Under their current strategy, the Excise Movement and Control System, does not have the software that allows HMRC to interrogate it, because it would add an enormous extra cost. We feel that that should be the next step. There are many other things that they could do with the industry, in having more intelligence officers, which they are going to recruit, before they go down the line of tax stamps or supply chain legislation—

Q32 Matthew Hancock: Mr Drew, do you think that those figures are reasonable, or is it impossible to know the scale of the problem?

Simon Drew: It is impossible to know the scale of the problem, but I think there needs to be a lot more investigation and a lot more intelligence.

Q33 Matthew Hancock: On spirits or on beer?

Simon Drew: Both.

Q34 Chair: I have one question for Brigid, then I will ask you all what you would do if you were sitting in charge of this at HMRC. Brigid, are you saying that it would cost 1p a pint to put this stamp on?

Brigid Simmonds: I am saying that it would effectively wipe out the only profit that brewers make in this country.

Q35 Chair: But if it is 1p a pint on 50 million—

Brigid Simmonds: On 5.6 billion, we are talking about—cans and bottles.

Q36 Chair: Right, that's £50 million, and I do not believe that that is the profit of the beer industry.

Brigid Simmonds: We are producing figures for the Treasury at the moment, looking at beer. One problem that means it is quite difficult to get at in this country is that a lot of family brewers own things other than pubs—

Chair: But it just does not seem credible.

Brigid Simmonds:—but brewing is not making any money because the tax has gone up so much.

Q37 Chair: I do not think it is credible to us to say that the whole industry only makes £50 million profit.

Mr Jackson: Profit on beer.

Q38 Chair: On beer. Do you think that is credible?

Brigid Simmonds: No, the whole industry makes more than that.

Q39 Chair: Quite, so it does not wipe out the profit.

Brigid Simmonds: What I am saying is that the cost would—there are two things. It would probably add 1p a pint to the average pint. I am still closing 16 pubs a week, which is something we are—

Q40 Chair: Your argument was that it would wipe out the profit, and all I am saying to you is that that does not seem credible.

Q41 Matthew Hancock: Is the 1p a pint the retail profit or the wholesale profit?

Brigid Simmonds: The four big brewers in this country only made £50 million in total profit last year.

Q42 Chair: And they are—how much?

Brigid Simmonds: They are probably 77%, but of course, the reason why they are still in business, which is why I think we need to protect, something that is such a good British industry, is that they are part of international markets and are therefore making more money elsewhere .

Chair: I am amazed they stay in business if that is all they are making.

Matthew Hancock: No, the point is they do because they are global. That is true anecdotally. I know that from the big brewer in my constituency.

Chair: Yes, but if that is all the profit they are making—

Matthew Hancock: From their UK business.

Chair: Oh, from their UK business. Okay.

Brigid Simmonds: Absolutely.

Q43 Chair: Mr Drew, tell us what you would do if you were in charge of this policy in HMRC.

Simon Drew: From my perspective, and it is only from the little bit that I do, my principal interest would be more intelligence, more international co-operation, more internal co-operation with the police and the UK Border Agency—I see that they are not here, but I think you need to hear about that in order to understand what is happening at the margins, which is where the vast majority of the illicit material is coming and going from.

Q44 Chair: Just expand on the UKBA point.

Simon Drew: Well, they are the ones who are controlling the import and export points, not Customs and Excise.

Brigid Simmonds: I would agree with that point. One of the problems that we have is the Administrative Reference Codes, which are being used more than once because they do not think that they are going to be stopped. May I just go on with my little part of this?

Chair: Go on.

Brigid Simmonds: We have provided HMRC with an action plan. Individual brewers would supply HMRC with a breakdown of sales—we will do that anyway. We would have a rigorous “know your customer” programme. We would have a dedicated point of contact with HMRC, but we do think that HMRC have to use the EMCS rather better and they need to have more technology. It need pre-notification of these ARC numbers, separate lanes at ports, technologies for bulk scanning, regular and high-profile searches, visual warnings and publicity for tough action—that brings us back to Simon—taken against those who are criminals. . We believe that there is a lot more that HMRC could do. It has not got the resources that it needs and is somehow choosing to make the industry

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pay for its lack of resources. I do not think that that is the way to do it.

Chair: Finally, James.

James Bielby: Just on that cost issue, you are assuming in your conclusion, in terms of the effect on profit, that your premise is correct and I am not sure that 1p per can, or whatever it might be, is correct. I would be interested to interrogate those numbers. I do not disagree with anything that my colleagues have said. The fiscal marks are a good step, as is supply chain legislation, so there are civil penalties against companies, whoever they may be, for supplying to markets that do not exist—not dissimilar to that seen against the tobacco industry—and the registration of

wholesale. Our members are actually calling for a burden to be placed on themselves, because it is the only point in the supply chain that is currently unlicensed. We are happy to acknowledge that and do our part. We want to pick up the bill for that, because it is hitting our members' profits. You are talking about £50 million in profits, but our margins are wafer thin and every day that this goes on those margins are being eroded.

Brigid Simmonds: We would support that. That is the point in the supply chain where the problem lies.

Chair: Thank you all very much indeed. That was very helpful. We will now move to the main session.

Examination of Witnesses

Witnesses: **Dave Hartnett CB**, Permanent Secretary for Tax, HMRC, **Lin Homer**, Chief Executive and Permanent Secretary, HMRC, and **Mike Norgrove**, Director Excise, Customs, Stamp duty and Money Laundering Regulations, HMRC, gave evidence.

Q45 Chair: Welcome. I am going to start with you, Lin, because, a point was raised by the lawyer, Simon Drew, which is not in our briefing or the report, which I thought was quite interesting. It is slightly your old hat and slightly your new hat, but it was about the role of UKBA in what appeared to be failing—is it in there? I never saw it in the report.

Lin Homer: There are certainly references—

Q46 Chair: Well, I missed it. It was the role of UKBA in efficiently and effectively stopping these coming across the border. Do you want to comment on that? Clearly Simon Drew saw that as a weakness in the current regime.

Lin Homer: I have talked this through with Mike Norgrove.

As you say, I have been involved in this from both ends. I think the figures on seizures overall suggest that the relationship between HMRC and UKBA as was, UKBF now, has been productive and positive. The scale of seizures has gone up, but we have also been developing what we call “integrated operations” whereby HMRC staff, UKBA staff and, indeed, police forces and SOCA have worked much more closely together.

Q47 Matthew Hancock: Do you have figures on the increase?

Lin Homer: Between 2009 and 2010, I think wine seizures at the border went up by 60%.³

Paul Keane: We have some numbers in figure 8 on page 26, which goes up to 2010–11.

Lin Homer: The figures there include both inland seizures and at-the-border seizures, both of which have gone up. One of the other things I would say—I remember this from my previous but two jobs—is that, as UK Border Agency, we agreed an annual plan set by HMRC on what they wanted us to concentrate on. Of course, one of the things that we have been trying to do is go more upstream.

In the case of alcohol, we really never want it to leave this country, having been put into suspension, in order to come back. If Mike and the teams seize and intercept alcohol that is going out, it is not there to seize on the way back in. What we think is important is that we do enforce, but in a very joined-up way. I have to say that the figures do support the UK Border Force, as it is now, which continues to be very active at the border on spirits, beer and wine. Indeed, the absence of a wine gap does not stop us focusing on seizures. That is not to say there isn't more to do.

Q48 Chair: With your new hat on, and perhaps with Mike Norgrove's experience, what more would you want from UKBA? Could Mike answer that?

Mike Norgrove: There are two things. First, a continuation of their effort at the border to seize goods, which is really important. As our chief executive, Lin, has said, their performance has improved steadily over the years, and it is now better than HM Customs and Excise was. That is good, so we want it to continue, but it is not just about seizures. We need input from our UKBA/UKBF colleagues into our intelligence gathering. The answer to the problem of smuggled alcohol cannot be to try to stop every single lorry, because that would be a counsel of despair. A huge number of thousands of lorries come through, and our intelligence must prevent that alcohol being available for them to bring in in the first place. So the second thing we want from UKBA is to add to our pool of intelligence on what is happening at the ports and airports.

Q49 Mr Jackson: That is all well and good, but frankly, if you look at figure 7, the number of prosecutions is pathetic. It is all very well seizing goods, but if there is no criminal sanction on the people who are, on an industrial scale, committing this criminal activity, seizures are not going to do the job of acting as a deterrent. If you look at the conviction figures—cases, five; individuals, 16—that is just not good enough. I want to know why that is the case. The trend does not seem to be altering significantly.

³ Seizures of all alcohol in 10/11, including at the border and inland, were by 60% on 09/10 figures.

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Lin Homer: I am sure that you have had some of this discussion with Mr Drew. What we would ask you to think about is the entirety of what we try to do. We are trying to legislate or regulate so that there is an industry where fraud is not endemic—I am sure we will talk about the consultation and some of our proposals in that space. We are then intercepting and disrupting what happens. The work we do, again at the border and in country, is an important part of that. In one undertaking, we swooped on Brighton and closed down 33 retail outlets⁴ in that one town, all of which were selling. In those cases, we might revoke their licence, rather than prosecute them.

Q50 Chair: Why? Stewart was really saying, pour encourager les autres, that it might be a good idea to have a few prosecutions.

Lin Homer: I wasn't trying to avoid the question. I was just getting there.

Q51 Mr Jackson: That's a loss-leader for these people, isn't it?

Lin Homer: If I could return to the big prosecutions, we do think that such prosecutions are essential because the people who are making this fraud continue are serious and organised criminals. They are not the small retailers; they are not the brewers. They are the people who intercept a legitimate product and turn it into a product on which duty has not been paid. To undertake those big prosecutions is a very significant task. It often takes us many years to bring those prosecutions to fruition. We think those are the big impact ones because they take the big players out; they take millions of litres of product out; and they increase the risk for the organised criminals of being in the business.

We do think you have to do things at all levels, but you have got to hit the organised crimes. This is not a white van man issue any longer; this is big organised criminals bringing the equivalent of 28,000 lorry loads per year of illicit beer into the country on which duty has not been paid. No amount of small prosecutions will stop that. As Mike says, you have got to stop the beer going out in order that it is not then brought in and diffused through a massive marketplace, where your tiny little hits will not stop the big guys.

Q52 Mr Jackson: What do you need to do, working with other EU countries, to alter the legal or regulatory framework to ensure that you focus—working with other people, particularly obviously with UKBA—on tackling those long-term criminal gangs that are perpetrating these crimes?

Lin Homer: We do need to keep doing the very large-scale prosecutions. I will ask Mike to tell you a little bit more about how we work together. I think the reason we have started the consultation is that we think we potentially have to do something legislative as well. It is an open consultation. We know that not all of the industry likes the things that we are putting forward.

We think that this is fraud that is easy to perpetrate because the supply chain is long and complex. Something like a fiscal mark or wholesale registration will prevent people from turning a supply chain that starts legal, and may even end with people who think they are being legal, into one being used improperly throughout. That is why, after a lengthy period of working with the industry looking at voluntary areas, we now believe we have got to do something more substantial.

Q53 Chair: So, you think pursuing the criminals, the international gangsters, is too complicated, and you want to spend more.

Lin Homer: No, we think it is absolutely part of it, but five or six of those a year is a significant amount of major prosecution to do. We do not think that that alone is going to be enough. I am not in any sense suggesting that we would back off the big impact prosecutions.

Q54 Chair: Do you want to add to that Mike before I go to James?

Mike Norgrove: Just to say that, as Lin was describing, we have had a range of weapons at our disposal. Lin mentioned action that we took in Brighton recently at retail level, and there were the five or six big criminal cases. In between, as figure 6 shows, we are very active across the range of the market. So we are taking out and confiscating assets; we are preventing future fraud; we have got integrated intervention teams seizing goods and so on—£430 million in the example in figure 6.

It is at all parts of the spectrum, not just the very small and very large. We have to be active in all those. Can I just say something, because Lin mentioned stamps? Even if we were to double our effectiveness at any end of the spectrum or in the middle, the underlying problem would persist. That is the availability of duty unpaid—duty suspended—alcohol, beer in this case, on the market. That leads to a different sort of problem and could involve legislation.

Q55 Mr Bacon: Can I be clear about the cigarettes case? The cigarettes never left the country; they went down the M20 towards Kent and then turned left. Are we talking about physical beer that has physically left the country? When Lin Homer said the equivalent of 28,000 lorry loads, is it stuff that has crossed the channel twice, or is it stuff that does not actually leave the country?

Mike Norgrove: It is exactly like tobacco. Those cigarettes did go to Cameroon, Andorra and Angola and came all the way back again. They did go so far as to export the goods.

Q56 Mr Bacon: Quite a lot of them did; some of them did not.

Mike Norgrove: The big breakthrough we made was when we got UK cigarette manufacturers to stop sending to markets that did not exist—and they were sending the cigarettes abroad. That was the lion's share. The same happens with beer.

⁴ The exercise involved the targeting of 33 retail outlets for counterfeit alcohol and tobacco. As a result of this exercise, a number of outlets were facing reviews of their liquor licence which could see them banned from selling alcohol.

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Q57 Mr Bacon: Do you have evidence that the big brewers are doing the same?

Lin Homer: The volumes really.

Q58 Mr Bacon: The volumes indicate that?

Lin Homer: Yes.

Q59 Mr Bacon: So you reckon the big brewers are sending booze over to Ruritania in volumes that would require every Ruritanian man, woman and child to drink three gallons of beer per day every day for 365 days a year. That is what is happening with cigarettes. Is that what you are saying?

Lin Homer: It is sort of having Carling Black Label every day. The evidence we have is that—

Q60 Mr Bacon: If it were Guinness at least it would be doing them some good.

Lin Homer: Our evidence is based on seizure data that is being taken out and brought back in is the big eight UK-produced beers. About three times as much is going out as we think there is a European market for. So 450 million litres is exported duty-not-paid and we have tried—

Q61 Mr Bacon: This is going directly from the big producers themselves?

Lin Homer: Not directly. These supply chains can be quite long. It may even be when it is already in Europe. That is my point about where the hand-offs come. We think only 180 million litres of that 450 million is genuinely for European drinking. We think that the appetite for the beer is there. We would rather it stayed in this country and the duty was paid on it.

Q62 Mr Bacon: So it is entirely possible that when the brewers are fulfilling a big order for some beer from a bloke in Belgium, as it were, they understand that to be an entirely legitimate order but somewhere along down the supply chain it ends up transforming itself?

Lin Homer: Yes. I think that is why when we talk about what we do next, you see a reaction from the brewers who do not want their trade made any more difficult. We certainly do not want to undermine their success, but wholesalers and retailers are quite interested in what we are talking about because obviously legitimate wholesalers and retailers are being undercut by this beer that comes back in without duty being paid.

Q63 Mr Bacon: One more question, Chair, and then I will stop. When I go into a corner shop and I notice that the price of Beck's—my beer of choice—is surprisingly cheap compared with what I might find in Tesco, a big buyer whom one would expect to have a large market power: is there a connection between what I am experiencing and all this activity?

Lin Homer: We think one in 10 cans of UK-produced beer that you buy in those shops does not have duty paid on it. Beck's is not on my list of top 10 so you are obviously a superior—

Chair: There is a Norfolk factor. I have a whole load of people with questions: James, Austin, Ian, Matt, Fiona.

Q64 James Wharton: Could you help me to understand the scale of the problem that we are talking about because I am little a bit confused looking at the different figures that are floating about and the disagreement that seems to exist? In 2011, the Department estimated the tax gap for beer as £800 million, which is about 14% of the market. Since the NAO report came out, the lower end of the range is now published as possibly £250 million or 5% of the market. That is a big gap. When you are deciding how to allocate resources to deliver value for money in clawing in as much tax revenue as you possibly can, and rightly should, why do you and the brewing industry seem unable to agree on an estimate? With such a wide range, how do you know that you are allocating resources effectively?

Lin Homer: You have rightly challenged us as to whether we needed to do more work on our low and mid ranges. Since the report was written we have provided some additional information and work on the low and mid range. This is quite a complex area to try to assess. As it is currently worked out we try to triangulate the tax gap on alcohol from more than one direction. So one of the things we do is ask people through consumer surveys how much they have spent on beer and then we look at how much duty has been paid and then we estimate the difference between that. When you do that for beer, because it is a fairly consistent price and fairly consistent duty, we can work out the gaps. But there are obviously some gaps in the accuracy of that kind of exercise.

Q65 Fiona Mactaggart: Exactly. Guess what—we are all concealing things.

Lin Homer: So those are the kind of challenges that we face. Our view is that it is right for us to produce a low, a mid and a top range. I think that, at the front end, your report rather focuses on the top range and the beer makers focus rather on the bottom. We would say that the safe ground is probably more in the middle. But whichever of those figures you look at, this is a substantial and a big enough problem for us to focus on. Our view would be that it does not distract us. If you look at wine, we do not have a wine gap, because we have not yet found a right methodology, but we still put a lot of effort into chasing that fraud down. So it is helpful for us to tell, but I do not think we are in a position where Mike is taking his foot off the brake, because we are looking at the bottom end, and you are looking at the top end.

Q66 James Wharton: I can understand the challenge. I think the Department gave assurances to a predecessor to this Committee as far back as 2004 that, particularly with respect to duty on wine, it would be looking to try to come up with a figure. You say, quite rightly, that you have a range, so you understand that the scale of the problem is significant wherever it lies in that range, and the disagreement. If you do not even have a scale for wine, how do you know that you are not missing a big problem, that you should not be focusing your efforts there, or that your approach is correct? Where you have data, they are very broad and general, and in other areas, which you

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are not tackling as vigorously, you do not seem to have data at all.

Lin Homer: I am going to ask Mike to give you a little bit more about why the wine gap is hard. Nowhere in the world has managed to produce an estimate of a wine gap. How much wine we consume is even harder to gauge than how much beer.

Q67 James Wharton: Should we be talking about the alcohol tax gap as a measure at all? We do not measure it for wine and the range for beer is huge. Is it actually a useful thing to talk about? Should we put that to one side and talk generally about tackling the evasion?

Lin Homer: I think it is useful, and I am sure that we will return to the tax gap. If I can just give one example on wine, wine price is very much more variable than that of beer. The consumer survey asks how much you spend on wine, not how many bottles you consume. We are going to have to think about whether we can persuade them; as you commented, that may still not get us an accurate figure. The other issue is that we drink wine outwith the pub and home. Wine is the sort of corporate events drink of choice as well. It is harder for us to gauge how much business is providing in that space. That is one of the complexities.

We think it is right that you challenge us to do more work in this area, but I suspect that we may find an even bigger range in wine than we find in beer.

Q68 James Wharton: With that understanding, what else do you take into consideration in terms of directing resources? That is what I really want to understand. If you are making decisions to use a limited resource to pursue a certain type of tax evasion, you have to allocate that resource. How do you do it?

Lin Homer: I am going to let Mike have a go at that.

Mike Norgrove: Picking up on the points you raised, in order, the range on beer is quite large from top to bottom. We are now quite close, having published in February this year our low-point estimate, to the brewers' own estimate. Theirs was 6% to 8%, and ours comes to about 5%. So we are getting quite close together.

On wine, the absence of a tax gap does nothing to destroy the effectiveness of our resource deployment. For example, from just seizure numbers, we know that seizures of wine in volume terms account for about a quarter of all seizures; it is about a quarter spirits, about a quarter wine and about a half beer. So we know that this is a big and significant problem. As Lin says, the absence of a tax gap does not affect our resource allocation.

Wine is difficult to estimate, and Lin has given a couple of reasons for that. For one thing—a very obvious one—99% of wine is not produced in this country, so we have no grip or can get no handle, as it were, on the data from the producers, so far as they are outside this country. As Lin says, if we just learn what the expenditure is on wine, we do not know whether that is lots of £2.99 bottles, or lots of £25 bottles.

There are two other complications. Lin has mentioned the corporate expenditure, which is a very high figure. It surprised us that it could account for up to 20% of the market for wine. There is no family expenditure on that; it is companies.

The other difficulty is that the duty on wine is complex, because essentially we charge at three different rates—whether it is ordinary table wine, sparkling wine, champagne and so on, and fortified wine such as port. So expenditure does not help you. It could be relate to two bottles of table wine or one bottle of port. It is fraught with difficulty. We have our best brains working on it. Those people and our analysts are still working on it. We would like to do more, and we hope to get a figure. None of our European or indeed worldwide colleagues have done it yet.

Q69 James Wharton: I want to ask a further question on that which gets to the crux of my concern. One of the parts of my question that you were answering was about why you direct resources in the way you do. The only thing I heard you say that seemed relevant to that was that a quarter of what you seize happens to be wine, so it is significant duty. Then you told me all the reasons why you don't know very much about the range for wine, which I understand, but what are the other factors that are directing where you send resources? I assume you are not basing it purely on, "A quarter of the things that we seize happen to be wine." What other factors are you using?

On where you focus your effort, one of the concerns that I picked up from the earlier evidence was that the beer industry feels a little victimised. You have obviously got better information there, so you are focusing on what you can do, but you need to be seen to be collecting tax revenue wherever it is due. Would you say that you are clamping down, or pushing as hard, in the wine industry as you are in the beer industry?

Lin Homer: I think we are.

Mike Norgrove: Can I pick up on the other factors before we talk about victimisation of the beer industry? The other factor we use on resource allocation for wine, apart from seizures, in a word, is intelligence. We have a multiplicity of sources for understanding what is going on in the market. We haven't got ones that quantify precisely the size of the gap, but we do know generally what is happening. What are criminals doing? What are they discussing on the telephone? The criminals who we have prosecuted, and the courts that have convicted, tell us quite a lot about why people use wine or beer, or why they do not care whether it is beer, wine, spirits or tobacco. Our intelligence picture is a rich one, and it enables us to decide whether we need more at the ports and airports, more criminal investigators, or more people out on the streets looking at the shops and the retail.

Chair: In all this, I get the impression that you have to make a calculation of the return for every pound you spend. I cannot get a feel for this at all from what you are saying. You vaguely know that if you go for seizures, you get them, or that if you vaguely get a bit

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of intelligence, you might as well pursue it. With always-limited resources, where is your best value? Are you best pursuing this or the big corporations, dare I say?

Q70 James Wharton: For my part, one of the key points is that the impression is given that you are going for beer producers because you have good data. You may not be getting the best rate of return, because an awful lot of tax seems to be being missed on wine as well, yet beer is what we constantly hear about being targeted. We want to try to understand whether that is giving you the best rate of return. Are you ignoring a big chunk of the potential tax market that you should be targeting because it is easier not to do so? What is the basis of the decisions that you are making? So far, all the information seems to be very broad-ranged and based on assumptions, telephone calls and seizures, with nothing really concrete. That is quite concerning.

Lin Homer: The point I was going to make links back to the fairly lengthy conversation we had with you when Mike Eland came with me on the last occasion. We talked generally about enforcement and compliance, and how we decide how to spend our business-as-usual money and our new investment. I was going to say that, generally, we think it right to continue to focus on any area in which there is a significant risk to tax yield. We are certainly not simply going for the people who give us the information.

Q71 Matthew Hancock: Can I push on that a little?

Lin Homer: Please do.

Q72 Matthew Hancock: You said that you are not just going where there is information, but in the discussion at that previous session, you gave quite a forensic analysis of the return that you get on investment in different areas. You said that on average you get about 10 to 1, and in some areas you get much higher than that. You are nodding, Mr Hartnett. I am sure you would be disappointed if you did not get the chance to speak.

Mr Bacon: We want you to talk about wine.

Dave Hartnett: I know nothing.

Matthew Hancock: How does the amount of resource that goes into this fit into the bigger picture?

Lin Homer: I think it does fit in. I will let Dave talk about wine—he is an expert. Some elements of our investment in this area are giving us the 30 to 1-plus returns that Mike Eland talked to you about.

Q73 Chair: 30 to 1?

Lin Homer: Yes.

Q74 Chair: So why aren't you putting more into this?

Lin Homer: Part of that large sum that Mike spoke to you about when we were here is going into this area. We have already proposed another £17.6 million to go into special investigators in the area of alcohol, so we are using some of that new investment.

Q75 Chair: But Lin, you are not telling us specifically what we really need to know. You have said that your return here—every pound you spend—

Lin Homer: Not every—some of the investments. This is a range.

Q76 Chair: For every pound you spend, what is your average return in this bit of the evasion?

Lin Homer: I could not give you a conglomerate figure. I can give you some examples.

Q77 Chair: Can any of you?

Mike Norgrove: Just going on figure 6, on the broadest measure of our fiscal outputs, which is £430 million in the year given there, we spent about £25 million. That is 17 to 1.

Q78 Chair: If that is the case, we need to understand whether you are not therefore having regard to that in the determination of the allocation of the new £900 million.

Lin Homer: I think we are.

Q79 Chair: Tell the Committee how.

Lin Homer: We are putting £17.6 million into extra staff.

Q80 Chair: Yes, but that is meaningless to me. You are putting a greater proportion in here than you are in some of the areas that we were talking about when we had Mike Eland here.

Lin Homer: I think that it is certainly getting its share. It is difficult not to dissect it. We talked at some length about Connect, the caseworking system, last time we were here. Linking that back to the prosecutions, if you are looking at serious and organised crime, the investment that we are making in trapping and following patterns through Connect is a very large part of getting those extra special investigation officers the information that they need to have successful prosecutions. So all of the work that Mike is doing to strengthen enforcement and compliance will be underpinning more work in this area.

Q81 Matthew Hancock: Mr Hartnett, you were about to say something.

Dave Hartnett: What I was thinking, which might be helpful, is that there is a progression here over the last few years from—if I can use a big round statement—substantially sorting out whisky largely through stamps, where the gap is very substantially down from what it was. It is a quarter of what it was. As for beer, I do not really agree with the brewers and others who think they are being beaten up on this, because I think what is happening with beer is that we are now addressing that issue in a way not dissimilar from the way we got into whisky. If beer stamps come in, we will see something similar. The challenge—one of the things that my people are doing at the minute—is looking for a basis where we can start with a wine tax gap. The calculation will be far from perfect to start with, but there will be something we could work with. If I may, I want to pick up the Chair's request for more information on cost-yield ratios. The area of this that I know something about is civil remedies. In

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2010–11, we were hugely successful. I think £430 million was brought in at a pretty high cost-yield ratio. That will drop this year. The yield is not as high, because people are starting to react to the measures we are taking, but we can already see that next year there is a strong possibility that the yield will go up even higher as we take new measures. I am sorry if it is going to be a slightly disappointing reply, but the consistency of our analysis on cost-yield will probably come at the end of next year, when we can show progression and we can explain fully what has worked and how we have counted various things. That was what I wanted to say.

Q82 Chair: Okay. Austin, Ian, Matt, Fiona.

Q83 Austin Mitchell: To follow up on wines, I had some Lincolnshire chardonnay about a month ago down the fish dock. It had come four miles to Grimsby; it had not travelled well—it was about 95 octane.

Most wine is imported, so why isn't the main way of dealing with it what Mr Drew suggested: tougher border controls?

Lin Homer: In terms of wine, obviously pretty much all the wine we drink is imported. I think that 1% is British, but with advocates like you for local wine, that may now go down.

Q84 Mr Bacon: I have to say that Norfolk wine is much better.

Lin Homer: There's two of us who might agree on that. Wine is imported and we have to make sure that the supply chain for wine is secure.

Q85 Austin Mitchell: It must be easier to deal with if it is imported.

Lin Homer: What you need to do is have a system where the supply chain is secured all the way through. Obviously, with wine you have many more producers to control. We have to come up with a system, which is why Dave's people are working on it. That can be implemented; it might be similar to fiscal marks, or it might be some kind of passport for the supply so that you can check it all the way back. We are clear that we need to take a similar approach, but it is a much more diffused supply chain than for beer. A huge amount of the beer that is drunk in the UK is produced by four UK producers. Inevitably we have to find something that can deal with the subtleties of that production system.

Q86 Austin Mitchell: I can understand that. I have a couple of questions. Figure 8 on page 26 shows that the figures for confiscation orders fluctuate wildly. Why is that? For 2006–07, none; 2007–08, a quarter of a million pounds; 2008–9, nil; 2009–10, nil; and then we are up to £6 million in 2010. Why this wild fluctuation?

Lin Homer: That is a sufficiently difficult one that I am going to ask Mike to answer.

Mike Norgrove: That really is a one-off. That was a huge MTIC. I know the Committee will be familiar with carousel fraud and VAT. Although that often involves mobile phones and chips and so on, that one

had alcohol as one of the ingredients they were swilling around Europe. It was a big one when we hit that, so that is a real spike.

Q87 Austin Mitchell: Okay.

My final question: with smuggled cigarettes, there is a kind of information network—people snitch on each other. I have had from time to time newsagents and tobacconists say there is a van parked down so-and-so street, or that a garage on William street is open on Sundays and selling smuggled cigarettes. I have never had any information like that on booze. Do you not encourage whistleblowers? Do you not reward whistleblowers? That would be one sure source of information, I would have thought.

Mike Norgrove: It is a reasonable source of information; it is not our best form of intelligence. The difference between tobacco and drink is the very point we have been talking about—tax stamps. It is obvious to your constituents whether a packet of cigarettes has borne UK duty.

Q88 Austin Mitchell: No, but they see it, and these are tobacconists who are competitors.

Mike Norgrove: Sure, but they can tell. They can tell if these have borne duty. They can't tell that with a can of lager. It is lager we are talking about by and large, rather than beer or ale.

Lin Homer: I want to emphasise this point: many of the smaller outlets selling the one in 10 cans that have not had duty paid may not know. I think that is one of the reasons why the legitimate retailers are also keen for us to think about different solutions. The complexity of this supply chain means that the beginning and the end of it can be legitimate, and one bit in the middle can effectively draw the duty out. That is why we have to be quite clever about this.

Q89 Ian Swales: That was the point I wanted focus on, to come back to the enforcement questions that Mr Jackson was asking earlier. You talked about closing down 30 shops in Brighton recently.

Lin Homer: We revoked their licences⁵.

Q90 Ian Swales: Right, so that means that you could go into those shops and know there was something wrong. How did you know that?

Lin Homer: That will have been an investigation. In a sense, that is evidence. It is us sending a signal to the shops that we know, but we will have needed to prove to a high level of evidence that their beer, which does not have a fiscal stamp, has come through a system that was effectively tainted.

Q91 Ian Swales: So you would have tracked some illicit imports, and tracked where they ended up.

Lin Homer: All the way.

Mike Norgrove: That instance in Brighton was a major joint effort between us, trading standards and local police. There was something of a blitz. We knew there was a lot happening in that area. Some of those cases are still under review as to whether their licences will be revoked. That was a co-ordinated action across Government agencies.

⁵ Please see footnote 1

Q92 Ian Swales: Of those 30 retailers, what proportion knew that they were dealing with illicit material?

Lin Homer: That is still in dispute.

Q93 Ian Swales: Approximately, is it all of them, none of them or some of them?

Lin Homer: Truthfully, until the case is concluded, all we can say at the moment is some. One of the reasons why we think we need now to add some extra things to the toolkit is to ensure that, for those people who want to stay legitimate, it will be easier for them to do so. For those who are choosing not to be wholly legitimate, it will be more difficult for them to assert that they were being legitimate.

Q94 Ian Swales: This is the enforcement question: on the assumption that some of them actually knew, what action is taken? If I walk down to the House of Commons shop and steal something, and the worst thing that will happen to me that it will be taken off me as I go out of the door, and I know that I can do the same thing tomorrow, it is not much of a deterrent is it? How are we deterring people like that? What action do we take?

Lin Homer: I want to speak out for civil sanctions as being more than not a deterrent at all. Mike has already said about how to really stop the trade. The duty on beer is 15p a unit, so to stop the trade you must stop the supply—we have no doubt about that. While we are moving towards being successful in that, we must send messages to people that the risks of cheating are high. You can do that through prosecutions. You can do that by revoking a licence. If you no longer have a licence to sell your product, that is quite impactful. You can do it seizing goods. We seized £12 million worth of goods from small outlets⁶. You must put all of that together and make it sufficiently risky for people not to be in it.

Q95 Ian Swales: If I can explore two other parts of the chain: presumably some lorry drivers are knowingly moving material that is illicit.

Lin Homer: We think so.

Q96 Ian Swales: They must be. What happens to them? You seize the vehicle, but what about the lorry driver?

Mike Norgrove: If the vehicle is owned by the lorry driver, that is a big sanction, because we are talking about £70,000 or £80,000 a vehicle. That is a big one. Arrest is an option open to UK Border Agency colleagues. On occasion, we allow some of those loads to run so that we can catch people behind the fraud. When talking about different products—is it beer; is it wine?—it is worth mentioning that the criminals themselves do not mind which it is. Although we were talking about an allocation of resources to beer, wine or cigarettes, the principal target is the people behind it. Putting more effort into enforcement work is a must.

Q97 Ian Swales: It is the deterrent aspect again. If I am a lorry driver and my lorry is seized today, and I

then take a foot passage back to Calais and drive another one tomorrow, will anything stop me doing that?

Lin Homer: If you own the lorry, yes. You must remember that a large number of hauliers are either in a single business or are small. But it is one of the reasons why, in the consultation, we are looking at fiscal marks, supply chain protection and wholesale registration. We agree that we have to look at areas that will impact on all of those behaviours you are describing.

Q98 Ian Swales: My final question: it is certainly anecdotal in the tobacco industry—we have also seen it with things like CDs via the Channel Islands and so on—that the prime producers are involved in the activity. Do you have any evidence that that is the case in the alcohol industry? If so, what should we do about it?

Lin Homer: I think we have done some very good work with the industry in the last year or so. We now have an information base that allows them to know that they are over-providing to Europe. You have had a conversation with them. They have been clear to us that they believe some of the competition laws require them to fulfil a legitimate contract. They are essentially saying to us, “If you can come up with a system that shows us that we are providing to a tainted supply chain, we will stop,” but I don’t think we have evidence that readily does that.

Q99 Ian Swales: You do not have evidence that they themselves are involved in the carousel?

Lin Homer: I do not think that we do have evidence of that, no.

Q100 Ian Swales: On that, it is also the case that one or two of the large supermarket chains have played fast and loose with this kind of thing. Do you have evidence that they are involved?

Lin Homer: You say, “played fast and loose,” but some of our big supermarkets operate both sides of the Channel and there can be very legitimate reasons for moving your supply from your European based—

Q101 Ian Swales: If I am Tesco, which I know has many stores in Eastern Europe, and I order a lorry-load of Carling and, strangely enough, sales in Eastern Europe are not going quite as well as I thought and I bring half of it back, how is that picked up? Isn’t that a temptation for them to be involved in some of the activity that is concerning you?

Lin Homer: Our belief is that, when you have short supply chains with companies that for their own purposes have significant management information systems, that is much less likely than with long supply chains where it is handing off, so we do not think—

Q102 Ian Swales: But do you check it?

Lin Homer: Yes, of course we do, but we do not think we are seeing evidence that that is the position. We think we are seeing evidence of big organised gangs intercepting this over-supply and moving it through a number of stages that make it easy for them then to put it back into the legitimate market looking real.

⁶ Figure also includes seizures from inland distribution sites.

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Q103 Fiona Mactaggart: Part of your strategy depends, as you said, on working with the industry. Would you be surprised to learn that Ms Simmonds described your methodology in working out the tax gap as “a finger in the air”?

Lin Homer: Not wholly surprised, because Mike was listening to her. Mike has already referred to the work we have done over the last period to try to get our views of the tax gap closer together.

Mike Norgrove: I jotted down that particular description, because I think Ms Simmonds used it when she was talking about the 450 million litres and the 150 million litres—or was it 180 million litres? The 450 million litres is the amount of beer produced in this country that goes abroad, and our current estimate is that about 180 million litres of that. The 450 million litres is the brewing industry’s own figure, so that is not a finger in the air—we are relying on that. We have tried to get the best possible estimate of their legitimate market for those products abroad, which has been disappointing. We have not been able to get anything better than 180 million litres, which is essentially our estimate, and it is a generous estimate of the total legitimate demand. We would like a better figure from the industry, who may know more than we do about their markets abroad.

Q104 Fiona Mactaggart: When we were speaking to them, we spoke a lot about marking goods on which duty has been paid. Reading the Report, it seems to me that there is an area that we have not properly investigated, which is the EMCS and the inability to use the capacity of the EMCS properly to track such records, and so on. Could someone please explain to me why the Department’s computers cannot do that?

Lin Homer: It is important to provide a little bit of context around the EMCS. The EMCS was a requirement of Europe that was brought in relatively speedily, and there was a need to have the system up and working so that British industry—

Q105 Chair: When was it up and working by?

Lin Homer: April 2010.

Q106 Chair: So you have had two years since then.

Lin Homer: That was the first stage. In January 2011 the next stage of it came into effect, and in January this year the third stage. I think we would accept that we were not getting full functionality to start with, but in your report—

Q107 Chair: Two years, Lin, if you add it up from April 2010. Here we are in April 2012, and you are still not able to use the info on that.

Lin Homer: I would accept that we did not get full functionality, which is a fair criticism, but we did get functionality. Paragraph 2.14 of your Report, I think, talks about revenues going up, and we think the introduction of EMCS is one of the reasons why revenues went up. They went up by £137 million over the previous system, so we think we have been getting value out of this new system.

Q108 Chair: But you are not able to download the data for detailed analysis so that you know what is happening.

Lin Homer: We can now.

Mike Norgrove: At the time this Report was written, that was true. We have been working on that, and it has now happened.

Q109 Mr Jackson: Yes or no: are you able to take advantage of the counter-fraud functionalities of the system—now, today?

Mike Norgrove: Yes, we can.

Q110 Mr Jackson: All of them?

Mike Norgrove: Not to the maximum possible extent that we would like, but yes we can. We can use the EMCS as a tool to detect and prevent fraud. Just recently, we picked up, uniquely through the EMCS six containers coming from Belgium with a duty value of £250,000. They were stopped at the border by the UKBF and the goods were seized. That is now happening.

Q111 Fiona Mactaggart: It seems to me that if you could use the EMCS—I am not a computer expert—to its full capacity, the industry and the Department might happily work closely together. You would get the legitimate operators in the industry making sure that data were properly shared—because there is a Europe-wide system for sharing data. In a way what is happening is that we are chasing off after a hare, rather than using the Lotus Elan that the EMCS might be. Actually no computer system in government is ever a Lotus Elan; nevertheless we might have a faster, more efficient system where we can actually get the data and so not depend on guesstimates and finding out whether people are lying to us in their drinking habit surveys and so on. We can say that this has gone there and this is where it has landed because there is the potential for European collaboration. I cannot see why every effort is not being put into that.

Lin Homer: I think Richard has obviously made it an aim of this hearing to mention as many Norfolk products as possible. We have moved on to Lotus Elans.

Mr Bacon: Well, we have an ongoing crisis, so if you are able to find a few hundred million pounds to sort the business out, we’d be very grateful.

Lin Homer: Excellent. I do not think that anything we have said suggests other than that we think we should fully exploit this system. I just don’t think it is an either/or. Organised criminals are very good at finding their way around any new system you put in place and we think that you should use every tool available to you to bear down on them. EMCS is very important to us going forward. Intra-EU co-operation is very important for us going forward. Big prosecutions will be. We think this is something where you have to have a range of devices to apply against this very organised illegal market.

Q112 Fiona Mactaggart: Could you give us an example of how you have operated intra-EU co-operation?

Lin Homer: Yes.

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Mike Norgrove: There are two levels here. What happens is that if you are a Scotch whisky producer—a distiller—and you want to send your products, let's say, to Paris, then first of all you are registered, and so is the recipient—he is the registered consignee. Before the movement of those goods starts, they notify the system that here is an export ready to go. The registered consignee has to say, "Yep, they're the goods I want." So you have two legitimate players. We know what is happening and we can interrogate that data and we can see the movement of the goods. That is how it works. That has been fully functional since 1 January this year. The first two wheels were put on in 2010 and the third wheel a little bit later, but it has been fully functioning since January.

We are using that system fully. We are communicating with our colleagues in the other 26 member states. That is working for legitimate traffic. These are people who are registered, who are happy to declare their exports and their imports and their dispatches and their acquisitions. But if you were a nefarious smuggler wanting to receive goods from the UK, you could ring someone up who is producing goods who was not registered. That would be a movement that was off the EMCS. As Lin says, we cannot rely on the EMCS alone to stop this nasty business. We are talking mainly here about organised criminal attacks on our system, and those criminals will not be registered for illicit movements of products around Europe.

Q113 Mr Jackson: I am slightly concerned about your answer. It would be churlish not to congratulate you on exceeding your targets, but the answers seem to be that you are tackling the symptom rather the root cause. The symptom is an economic downturn, so you are catching Bert Scroggins in his white van travelling from Brighton, but you seem to be saying that systemic abuse by criminal activity in large parts of Europe is too big an issue for you to really focus on. It seems to me that there is not this imperative, because you have only just, as the Chair alluded to earlier, got the EMCS up to speed after two years, and you have not fully done it, from my understanding.

Two questions: first, if that computer system is not up and running, what comparative activity are you learning from for other European countries, such as France or Germany, to tackle this issue? Secondly, coming back to Mr Swales' point—we still have to pull our finger out on sanctions. What are the sanctions to prevent people doing this? What are the serious sanctions to change the long-term behaviour of criminal activity? Do you, for instance, invoke the proceeds of crime legislation regularly and routinely and do you envisage doing that in future cases?

Lin Homer: I will ask Mike to give you some of the detail on that, but I want to be clear about your first comment. We have said in terms and I will say it again that we do not think that this is an issue of small-scale activity—white van man or Bert and Joan coming back from Calais with things for Brighton. We are clear that this is organised crime and that is where our focus is. That is not to say that we will not ever focus on those small activities, because we all know that if you take an enforcement eye completely off an area,

things can grow, but the major attack on our system is large-scale. One large-scale organised gang may be moving 50 to 90 lorries a week and that is where our attention is. Some of the examples you gave, we do. I will let Mike follow up on those.

Mike Norgrove: Mr Jackson, I think you first mentioned the co-operation between us and other member states and what we learn from them. It is a different problem from tobacco. We have fantastic co-operation with all EU member states, because they have the problem too. Illicit cigarettes coming from the Ukraine or Dubai and so on are just as likely these days to go to Germany or Ireland as they are to the UK. There is a very profitable market outside the UK and there is tremendous co-operation between us. On alcohol, the UK's duty rates compared with German rates, for example, are very high. Germany does not have a problem with beer, because it has an extremely low rate of duty on beer, as does France.

Mr Jackson: What is the closest comparator in Europe?

Mike Norgrove: Ireland and Finland. Ireland is not currently beset with the problem of alcohol fraud in quite the way we are. I think that that is mainly because of the lack of a land boundary except with us. They also do not have the channel. Finland is suffering from this problem too and I have discussed it with my opposite number there. I have also discussed it with the Swedes and the Danes. There is lots of mutual assistance, as they call it, as well as lots of mutual co-operation and exchange of data. There is a tremendous exchange of intelligence these days.

One facet of our armoury that we have not mentioned is our network of fiscal crime liaison officers, who are stationed abroad, in Europe and further afield, who work with local intelligence services, the police, counter-fraud groups, and customs authorities, but the police especially, to try to stop the problem at source. They have been fantastically successful on cigarettes: more than 1 billion cigarettes were seized before they ever got to the UK last year. Increasingly, they have been working on alcohol for us too. That co-operation is there.

The final point that I think you mentioned was about POCA. We use all assets at our disposal. The single feature of the new strategy, insofar as enforcement, investigation and prosecution is concerned, is that it is fully joined-up. We use all our intelligence sources. We use our civil and criminal investigators together. We use all the weapons at our disposal, whether it is the confiscation of assets or the proceeds of crime. Equally, we can use, now that we are a merged department, other measures—Mr Drew was saying how complex some of these cases are and our biggest success recently has taken us seven or eight years to bring to fruition. Kevin Burrage was a massive success in the courts for us earlier this year. Very often, it might be easier for us—we are increasingly doing this—to take people down for direct tax offences or for money laundering, where the threshold of proof and evidence is not quite as high. That is a really profitable avenue for us to exploit.

Q114 Mr Bacon: I wanted to ask about criminal prosecutions as well. I shared Mr Jackson's concern

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that figure 7 shows what appear to be very trivial figures. I am interested to hear what you say on this in defence of your approach. For years on this Committee, I have heard various Government bodies, including, notably, Customs and Excise, and indeed others, defend what appear to be extraordinarily poor records on prosecution and willingness to prosecute. The Report says, opposite figure 7 in paragraph 3.6: “The Department considers that, although criminal investigation remains its default position, this should be used only where the potential disclosure impact can reasonably be minimised.” That makes it sound like your default position is not to prosecute, because of the risk of disclosing how you find out about the bad guys. That is what “potential disclosure” is referring to, isn’t it?

Mike Norgrove: Not the problem that we would have in disclosing, because it is secret or would reveal too much of our weaponry as it were, but the sheer logistical difficulty of revealing every bit of evidence, every bit of paper, and every letter that any trader who is complicit in the crime has ever written to us and what we have said in reply. The millions of transactions that we have to have physical evidence of before we can fulfil our—

Q115 Mr Bacon: So it is an evidential problem.

Mike Norgrove: Yes.

Q116 Mr Bacon: So in fact this sentence says two things that are completely contradictory. It says that you consider that your default position is one thing, but to all intents and purposes your default position is actually another thing, isn’t it?

Lin Homer: I think that we are always prepared to prosecute in those cases where we think the impact is right.

Q117 Mr Bacon: I am really asking about your default position and what you consider it to be. This describes it as being “to prosecute”. I am saying that actually—Mr Norgrove sort of helped to sustain my point by what he just said about the weight of evidence and the difficulty of assembling it all—your default position is not what you consider it to be, namely, criminal prosecution, but not criminal prosecution, isn’t it?

Lin Homer: I agree with you. I do not think that I would have written the sentence in that way. As I tried to say earlier, I think—

Q118 Mr Bacon: Did you not clear the Report with the NAO?

Lin Homer: It was just before I arrived.

Q119 Mr Bacon: Good defence. Who was in charge before you? I know that you had one or two other things on your mind. If you had sat down late at night with a glass of wine, I am sure that you would have gone through all of this.

Lin Homer: I do not think that it is something that we would have argued with Amyas about, because the main point that is made in this paragraph is clear. You are challenging us about whether we should prosecute more. Our position, I think, is that we accept that we

should prosecute and we do prosecute. What I tried to say earlier is that we think that we have to have a whole range of responses and it is not prosecuting every case.

Q120 Mr Bacon: They do look like trivial figures—16 defendants involved in five cases. There is a barrister sitting behind you, who was a witness earlier, who I am sure would love to have more prosecutions. To be fair to you, can you give some indication of what that represents? Is it much larger than it looks? How many lorries are represented by those five cases?

Lin Homer: Yes. I think that you heard from Mr Drew, who I am sure likes the work and would argue for much more, that they are long cases. Operation Rust was a seven to eight-year investigation. It stopped a £50 million⁷ business in its tracks, and there were 33 years’ worth of sentences—?

Mike Norgrove: Thirty five.

Lin Homer: Thirty five years’ worth of sentences were handed out.

Q121 Mr Bacon: Figure 7 says, “Convictions—Cases” on the third line. Is that just one of those five?

Lin Homer: No, that is not even there, because this is further back than that.

Q122 Mr Bacon: So those five cases—

Lin Homer: Can be very substantial.

Q123 Mr Bacon: I know that they can be, but what I am saying is, what are they? You talked about an average criminal gang doing 50 to 90 lorries a week—28,000 divided by 90 gives 300 criminal gangs and 28,000 divided by 50 gives 560 criminal gangs. With those five cases in that line and the 16 defendants, how many criminal gangs are we talking about that have been brought down?

Lin Homer: We think that each prosecution not only takes out the people we have got, but interrupts the supply chain. However, we would say that they are pretty canny entrepreneurs—

Q124 Mr Bacon: But how many gangs? I am taking it that the reason that it says, “Convictions—Cases” and, “Convictions—Defendants” is because there will be several defendants involved in one case. Can the NAO confirm that that is right?

Lin Homer: Yes.

Q125 Mr Bacon: If you take the five cases that involved more than one defendant in each one, in each of those five cases, what was the value of what was brought down in terms of the number of shipments and lorries per week and so on? I am saying that they are trivial numbers; this is also what Mr Jackson was saying as well. It could be that we are quite wrong because what that is really representing is 450 lorries a week in five cases. I don’t know; that is what I am asking.

Lin Homer: Could I offer you a note that breaks down figure 7 into a bit more detail?

Mr Bacon: Yes, sure.

⁷ Value of fraud is estimated to be worth £50 million per year in unpaid excise duty and VAT.

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Q126 Chair: It sounds a bit odd. If we had the police sitting in front of us talking about another matter and they were to say, “It is very difficult to collect the evidence, and therefore we do not do it”, it sounds odd.

Lin Homer: I don’t think that’s what we are saying.

Mike Norgrove: Sorry, if it is me who is being interpreted that way, let me correct any impression that I gave.

When a crime has been committed—alcohol fraud is no different from any other in this department—our first consideration is whether we can prosecute. In that sense, that is where the default position came from. How difficult that is of course leads us to look for lots of other instruments as well. The case that Lin referred to, involving 35 years for the six defendants, is enormously significant for us. It was called Operation Rust. The principal defendant was Kevin Burrage, who had been in this game for many years. The fact that we brought that home, despite the complexity, was really significant for us. It reflected a new technique on our part, which Simon has not yet been involved in, which is to narrow considerably the focus of the prosecution. Rather than looking across the piece and trying to convict across 1,000 transactions, we would break that into small chunks and convince the jury, as we tried, on any of those, any of which would warrant a custodial sentence. That is what we did on that occasion. So if our disclosure obligations happened not to work on any of them, let’s move on to the next one. That was very effective this time. That is just a month or two old.

Q127 Mr Bacon: It is surprising. Al Capone was done on that basis 100 years ago. Why have you only just woken up to this?

Lin Homer: Well, that is a different point. That is something we also do. Operation Rust was a prosecution for criminal activities involved with smuggling, but you are absolutely right. What we are getting better at is taking down a business for other irregularities—VAT, for instance. This is my point about our trying to use the whole toolkit. We could break that down and give you more detail.

Q128 Mr Jackson: I do not want to belabour the point, but in the early evidence we had, I specifically asked Mr Drew, who is an expert in this area of law, whether the evidential test was too high or about right. He did not, as far as I remember, say that it was. Yet you seem to say that it is high in terms of volume. Would the inference from that be that perhaps the CPS needs to look at its guidelines for this particular area of criminal activity?

Mike Norgrove: This has been a subject of a recent review by His Honour Judge Goss QC.

Q129 Chair: And?

Mike Norgrove: He has encouraged prosecutors to find new ways of fulfilling their disclosure. He recognised the complexity and the difficulty—the height of the bar—but the improvements that he has recommended are principally for the prosecution. We also suffer from failure to honour the obligations on the defence side—a very late submission of

evidence, for example. But the judge’s recommendations are aimed at us to help us improve the way we marshal our evidence for these cases. I think Rust—the one I just mentioned—is a good model for the future.

Q130 Ian Swales: I am delighted to say that I have a plant in my constituency that makes 400 million litres of alcohol a year. But fortunately, it is for road transport, so it should not cause you a problem.

I was thinking about Mr Drew’s evidence. He was saying that some of the big-scale things are not about moving branded products at all, but industrial alcohol movements, which is the relevance to my plant. I did a bit of research before the meeting and I note that some of your high-profile cases have been fake vodka factories and things like that. What more needs to be done about those industrial movements of alcohol, either generated in this country or coming in overseas? Is the system tight enough to know what those products will be used for, and is more regulation, monitoring or whatever needed in that alcohol world?

Lin Homer: Mike is more of an expert in industrial alcohol than I am.

Mike Norgrove: You are right, Mr Swales. This is still a significant problem, insofar as the spirits duty gap is still a concern—as long as it is not zero, it always will be. One of our principal concerns has been the smuggling or manufacturing in this country of industrial alcohol, which is then used in illicit production plants anywhere in the country. Over the last two years, we have taken out 11 such production plants. The most high-profile case, you will remember, was last July, where five Lithuanian workers were killed in a production plant in Boston.

Mr Jackson: They were from Peterborough.

Mike Norgrove: The gang was from Peterborough, but I think the incident happened in Boston. So, it is a particularly tough nut to crack, because that was alcohol that could well have come from this country. Increasingly, we are seeing—sorry, not increasingly. One phenomenon we are spotting is that some alcohol, from eastern Europe, which is trying to make the whole journey through Europe to the UK is 100% ethanol industrial alcohol. UKBA and UK Border Force, as they are now, have done well in seizing that, but of course, some occasionally gets through. That is the material that these illicit workers are using in production plants, which is so dangerous, both to themselves in the production and in the consumption.

Chair: Fiona.

Fiona Mactaggart: I am sorry, Chair. I want to ask a question but I also wanted to say something to the Committee. In the last few hours, owing to an error in the administration of my blind trust, I have discovered that within that trust, there are shares in a distillery. I probably should have declared that at the beginning of this meeting, so I am declaring it now.

Q131 Chair: I will sweep it up. There are two or three issues we have not touched on that I think we should have covered. First, you set a target to cut the illicit trade on spirits by 50%. You were successful in that—a year late, but you managed it. You then got

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rid of the target, and as I understand the report—tell me if I am wrong—the illicit share of the spirits market has now increased by 2% or 3%. It is on page 12, paragraph 1.14. Have I read that right?

Mike Norgrove: An extra per cent.

Q132 Chair: What does that say to you?

Lin Homer: I am not sure that we think a difference between 2% and 3% is a trend.

Chair: It has gone up by 2% to 3%.

Lin Homer: It has gone from 2% to 3%.

Q133 Chair: It is £130 million.

Paul Keane: Yes, figure 2. It has gone up from £80 million, which was 2%, in 2008–09, to 3%, or £130 million in 2009–10.

Lin Homer: We would want to keep our eye on this. The trend in spirits over five or six years has gone hugely downwards. It is not that we are unconcerned, but we just want to watch and see whether that is a blip—

Q134 Chair: I just wonder whether you are dropping targets, because you now haven't got them, have you? Have you any targets on this?

Lin Homer: As an operational business—again, when Mike Eland was here, you talked at some length to him about tasking. We absolutely continue to task. We have very specific targets with UK Border Force that are set through an annual process, so I don't think it is to do with that. However, with all these things, we think we need to follow a trend over time and be prepared to move back in if the system needs another push.

Q135 Chair: Okay, thanks for that. The other thing I picked up was this drawback scheme that we have not talked about, which seems to be a problem. As I understand it, although you have got rid of the scheme—tell me if I have got this wrong—the value of claims has gone up.

Lin Homer: We have changed the scheme, and we thought the value of claims would go down, but it did not—it went up. So, we have been looking at what more we need to do.

Q136 Chair: Why?

Lin Homer: I will ask Mike to comment, but may I say that not all drawback is evidence of fraud. There is a legitimate right to draw back tax if you are moving from duty paid to duty suspended. We think that about £25 million of fraud is perpetrated with some involvement of drawback. That might be a sort of shift in business patterns of some people who now operate both sides of the European border, but it is an area that we need to watch and understand.

Q137 Chair: Do you understand it?

Mike Norgrove: We have a good understanding of what is happening. One of the big increases in drawback has been the perfectly legitimate change in a business model. One of our major supermarket chains has begun the practice, for its own commercial reasons, of paying duty up front, exporting to a nearby European member state perfectly legitimately for

export elsewhere into Europe and the rest of the world, and then asking for that duty back. That was partly the cause of a 30% rise between 2009–10 and 2010–11⁸. That is perfectly legitimate, and we are not worried about that sort of increase.

The more worrying increase is when it is happening with small and medium enterprises because we have less reassurance about whether they are doing it for legitimate purposes or not. That increase has recently been 9%. Of that, 5.5%—more than half the increase—has been to do with duty rises and inflation. But that bit is not worrying, so we are down to a tiny percentage, probably 3% or 4%, where it has gone up. We are not quite sure why. We think that it is probably fraud, and that is a target for our effort. But, as Lin says, it is a tiny percentage of the overall alcohol fraud problem.

Q138 Chair: The final thing that we have not really talked about is fiscal marks.

Lin Homer: The consultation is out. We believe that it is something along with the other things in the paper that should be looked at very seriously. We know the brewing industry is concerned, and we want to encourage it to respond to our consultation and tell us why. I do not believe we think that it is an undue regulatory burden. We all know that the both alcohol and non-alcohol cans—

Q139 Chair: Do you challenge their 1p a can—£50 million, we worked it out as?

Lin Homer: I think that we do.

Q140 Chair: You think that you do?

Lin Homer: I think that the costs are something that we should talk to you about, but it is something that most of the people who put drinks in can and change the flashes on those cans almost at will for promotional reasons can cope with, with relative ease. They will need to plan their businesses better because taking a mark off might be a challenge for the beer industry, but that is something that we would want to talk to them about during the consultation period.

Q141 Mr Bacon: Can I talk to you about that? As part of your consultation, are you just sending out some questions and asking people to comment? Or are you guys yourselves going into big bottling and canning plants for beer, and seeing how labelling is done? My understanding from talking to food labellers is that it has now reached a very high level of sophistication; it is driven by a lot of computing and software and, as you say, can be changed extremely easily. I would be very surprised if the same were not true if you were trying to can or bottle 5 billion units of beer a year. Are you going in to check that the mark can be done relatively easily from the point of view of putting it on?

Lin Homer: Yes. We think that it might be 0.36p, but one also needs to remember that, within the consultation, we are proposing arrangements for small breweries that could be different. It is worth saying that the smuggling of beer that has not had duty paid is largely lager-type beers. Someone mentioned

⁸ Claims rose from £84.7m to £110.3m

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Guinness, but there is little evidence that that is happening.

Q142 Mr Bacon: That was me.

Lin Homer: Shall I mention another local product?

Q143 Mr Bacon: No, unfortunately Guinness is not made locally. Not yet anyway—

Lin Homer: I was thinking about Adnams—

Q144 Mr Bacon: Although funnily enough the Earl of Iveagh lives in Mr Hancock's constituency—right by the dualling of the A11—so there is a Suffolk if not a Norfolk connection.

On the subject of beer, we have a lot of microbreweries. You can go to any shop in East Anglia—I am sure the same is true in other parts of the country—where you will find locally produced beers. There has been an explosion of that in recent years. They are more expensive—you might pay £2.60 a bottle or even more. They are a novelty, they are a feature, there is a big market for them, tourists like them, they make great presents, and you do not want to do anything to damage that market. You are deeply conscious of that, are you?

Lin Homer: We are deeply conscious of that. We are also deeply conscious that those products should not end up in the smuggled market.

Q145 Mr Bacon: But if you went down the fiscal marks route, would they still need fiscal marks?

Lin Homer: We think that there can be provisions for exclusions and, again, those are questions being asked in the consultation.

Q146 Mr Bacon: Good. On the subject of taking marks off, you said that the businesses will just need to plan better. This is one area in which I have a lot of sympathy with business. I realise that they are big businesses. They spend a lot of money on planning and marketing and thinking about their businesses, so it is not as though they are not doing planning. The statement by Government, "Oh well, they'll just need to plan better", is one that automatically makes people's nostrils flare if they know anything about small business, or business of any kind. It is easy for Government to say that, but businesses have enough things to think about as it is.

The business of taking a mark off is wholly different. One can accept that putting it on is very easy—it can be done in a computerised fashion as part of a lot of other stuff. Taking it off—precisely because it is an integral part of the thing; it is not affixed, as I think Mr Norgrove said—is a wholly different question. One might think it is virtually impossible. You might have to put something else on over it. Is that a possibility?

Lin Homer: Yes. I don't think I said, "Oh well." I mentioned it because it is absolutely an area in which we think we should be in discussion with the industry. We have mentioned several times that we think there are legitimate reasons for paying tax, expecting to sell the products in the UK and then moving. We think that is exactly the area that we should be talking to

the industry about. How would one resolve that? What costs would it put on? We can see that.

To be clear, we think that the issue of smuggled beer is largely about the mass producers of the very recognisable UK brands. We should be talking with big business about that. It is not about asking every micro-brewer to deal with that problem.

Q147 Mr Bacon: Finally, one quick question about fiscal stamps on spirits. I remember when that was introduced. I got involved in a debate on it and made lots of powerful speeches about why it would never work, about how the labels—the fiscal marks—would end up being traded in the secondary market in Kiev within three weeks of being produced and about beautiful fakes being produced and everything else. But it appears that, for all my purple prose, it has worked reasonably well. I know it has resulted in a drop in fraud in the spirits area. Can you characterise the extent of that? What remains to be done? To what extent hasn't it worked? To what extent, even if only 10%, was I right, because I always like to be a little bit right.

Lin Homer: I think you weren't very right.

Mr Bacon: You are not the first person to say that to me, believe it or not.

Lin Homer: I would have liked to finish at that point. If you go back to the table that shows the gap on spirits, in figure 2, you will see that during that period we believe the illicit market share has gone down from 8% to 2% or 3%, so we think it has been very successful. You are absolutely right. There was deep anxiety. One of the reasons we feel confident—not that we would just leave the industry in it—that we could work through these issues is that we have had that experience.

Q148 Chair: Very finally, what is the impact of all this illicit trade on the legitimate market? Do you know?

Lin Homer: The impact on the legitimate retail and wholesale market is something to be concerned about.

Q149 Chair: Do you know anything? Have you analysed that at all?

Lin Homer: It is difficult to, because you cannot see where it is going, but if you are a small retailer and you are buying your beer with 50p tax paid on it, you are getting a lot less profit than if you are buying it with less tax than that. We suspect that it is the criminal gangs who are making most of the profit.

Q150 Chair: That's not really answering the question. What is the impact on the legitimate market?

Lin Homer: It gives them a level playing field.

Q151 Chair: One of our previous witnesses suggested that it was causing huge damage, but you have done no work. James Bielby suggested that there is huge damage from the illicit trade on his legitimate business.

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Lin Homer: The industry thinks that up to £605 million of trade is lost⁹.

Q152 Chair: The industry does, and the beer people disagree with you.

Lin Homer: The brewers are not as convinced about some of our proposals as the wholesalers and the retailers.

Q153 Mr Bacon: The wholesalers are making the point that sales by their members—and they represent a significant chunk of the market—were very significantly declining at a time when beer sales were going up. That is fairly concrete prima facie evidence that there is a big problem, isn't it?

Lin Homer: That's right.

Chair: Good. Thanks very much indeed.

⁹ The Federation of Wholesale Distributors, thinks that up to £605million is lost from the trade of the members HMRC estimates that its central estimates of fraud would equate to a loss of approximately £1.2 b worth of legitimate sales across the entire trade sector.

Written evidence from the British Beer and Pub Association

FOLLOW-UP TO ORAL EVIDENCE GIVEN TO THE PUBLIC ACCOUNTS COMMITTEE

Following the oral evidence provided this week we would like to submit the attached paper that explains in more detail the key points made in my evidence session and the alternative partnership approach we have proposed to HMRC to complement and build on the current strategy. In addition we would also just like to clarify a few points discussed during the oral evidence session and respond to some of the assertions made which we have concerns about.

The Profitability from Brewing in the UK

The industry is facing unprecedented challenges from rapidly rising costs, particularly excise duty, and sharply declining sales. The latest accounts submitted to Companies House by the four major brewers for 2010, who account for around 75% of the UK beer market, showed a profit of just £45 million on turnover of £5.47 billion (or 0.8%). This equates to 1p a pint and clearly would not be sustainable if these companies were not part of larger international businesses making greater returns elsewhere. However, it is increasingly difficult for these companies to justify investment in large-scale brewing in the UK. This lack of profitability for major brewers is replicated in many smaller brewers, who, in turn, may only be sustained by other business interests, including pubs and property.

Costs of Implementing Fiscal Marks and Supply Chain Legislation

There is perhaps a misperception that the costs of implementation of fiscal marks for UK brewers largely relate to the marking of the product. Under the consultation proposals, whilst this would be a significant cost, larger costs would relate to reduced packaging line efficiency, greater warehousing/storage requirements and transport costs of holding separate stock for the UK only and then stock that can be sold elsewhere in Europe, (or indeed other export markets). The loss of flexibility in relation to matching stock levels to demand that can be highly seasonal and can fluctuate significantly and at short notice, will inevitably lead to greater wastage and loss of business. Unlike spirits, beer has a limited shelf-life. Ian Swales raised the subject of specific bottles for Enterprise Inns. I can confirm that certain pack types or stock-keeping units are produced for the on-trade, but it is not company specific. In relation to supply-chain legislation, the proposed requirement to track and trace individual bottles or cans to a particular customer is simply not feasible without huge cost and wholesale changes to business operations. The tobacco industry have been developing track and trace technology and solutions at a global level for a number of years and are still not able to track and trace to individual pack level.

Have Fiscal Marks Significantly Reduced Spirits Fraud?

We do not believe that this assertion, made several times during the session, can be substantiated from the data available. The assertion is based on figures quoted from the spirits tax gap calculation for 2003–04 (12%) and 2009–10 (3%) in terms of the central estimate (Figure 2 in NAO report). This ignores two crucial points: tax stamps were not introduced until 2006 and in the last full year prior to this (2004–05) the central estimate had already fallen to 3% (ie, the same as in 2009–10). Indeed, following the introduction of fiscal marks, the central estimate then increased to 9% in 2006/7 and 8% in 2007–08 before falling to the current level. The second point is that because of the margin of error around the methodology and the central estimates, all the data actually shows is that the tax gap in 2009–10 was somewhere between 0% and 11% (lower and upper confidence intervals). When considering the relative scale of fraud between beer and spirits it is also worth highlighting that if the same methodologies were applied, the tax gaps would be very different. The beer estimate assumes a significant increase in the level of under-reporting of consumption in recent years whilst no such increase is assumed in the spirits methodology. Applying the same assumption (as would seem logical), would mean either the spirits tax gap increases, or the beer tax gap decreases. The final point is that latest

seizure data (perhaps the only tangible indication of the scale of fraud) shows that despite tax stamps being introduced in 2006 there is still more illicit spirits seized than illicit beer in revenue terms.

Dispatches to the EU: In his evidence, Mike Norgrove (HMRC) stated that 450 million hectolitres of UK-produced beer is dispatched to the near continent annually and that the 450 million figure was the brewing industry's own figures, This is not the case, This figure is calculated by HMRC from brewers' duty returns of all exported beer plus returns from third-party excise warehouses of beer dispatched to the EU, The actual data provided directly by the major brewers to HMRC showed that they dispatched 134 million litres to the EU in bottles and cans in 2010, It is also worth noting that not all beer dispatched from the UK will have been produced here, as beer will be imported into the UK (often in bulk for packaging) and subsequently exported elsewhere (for example Ireland).

Industry estimate of beer tax gap: Mike Norgrove also stated that the brewing industry's own estimate of beer fraud was 6–8%, This is the industry estimate of the absolute upper-bound if all duty-in-suspense beer sold to UK and EU wholesalers was subsequently diverted into illicit supply chains (which is clearly not the case) plus assuming another 30% for smuggled imported beer. The actual industry estimate is somewhere between this figure and the absolute lower-bound of 0.3% which is the amount seized, This then gives a mid-point of 3–4% (ie, less than the HMRC lower-bound estimate), As promised in our evidence, we will shortly be sending you the independent assessment of the HMRC beer tax gap estimates currently being compiled by KPMG.

Use of EMCS: Our understanding, contrary to the impression given to the Committee, is that whilst limited intelligence can currently be gained from EMCS, the risk module required to properly interrogate unusual trading patterns, abnormal journey times and so forth is currently still being developed and so this capability is still some way off implementation.

Declining Beer Sales through Wholesalers

Whilst there is no doubt that legitimate wholesale businesses are particularly impacted by alcohol duty fraud, it is also important to note that perhaps the most significant impact on sales in this sector in recent years has been the growing share of the off-trade (take home market), taken by the major supermarkets; both through their larger outlets and more recently through the move into the convenience sector. According to Nielsen data, the share of the multiple grocers (supermarkets), increased from 56% in 2004 to 76% in 2010 with a corresponding fall in the independent off-licence share from 44% to 24% at a time when overall beer sales did not increase. This shift is consistent with beer prices in supermarkets being consistently lower than in independent off-licences over this period.

In conclusion, and as I said to the Committee, the BBPA is committed to working with HMRC to tackle fraud. We are however, very concerned that supply chain legislation and fiscal marks are disproportionate in terms of regulation to the size of the problem.

Brewing is a great British industry which needs support if it is to continue to flourish. There is much more that could be done by HMRC, though EMCS and in partnership with the industry before such over burdensome and costly measures should be contemplated.

I hope this is helpful but if the Committee would like any further information please do let us know.

2 May 2012

Written evidence from Federation of Wholesale Distributors

FOLLOW UP: RENEWED ALCOHOL STRATEGY—PROGRESS REPORT

Thank you for the opportunity to contribute to your inquiry into the NAO's progress report on HMRCs renewed alcohol strategy. Members of the FWD regard tackling alcohol fraud as a critical issue for the sector, so we were grateful that the Committee has been able to examine the issue.

Following the evidence session last week I wanted to write and reiterate a number of points.

As I said, the FWD believes that alcohol duty fraud is a serious problem that is harming legitimate businesses of all sizes in the wholesale and retail sectors. These businesses are operating on wafer-thin margins, and are losing significant trade to illegitimate competitors who are profiting from organised crime.

I particularly want to emphasise that the view that the scale of the problem is not sufficient to justify legislative action does not seem, to our members, to be credible. Their day to day experiences show that alcohol duty fraud is a very substantial problem.

To provide just one example, last week I was contacted by a member who operates a wholesale depot in your own constituency. The member reported that over a period of weeks, they had experienced a decline in beer sales of 80%. They understand that this correlates with a new company in the area. Some of our members' customers have reported that the new company is offering beers such as Fosters, Kronenbourg and Stella Artois

at prices that we do not believe are credible if duty has been paid. They also provide an additional service offering invoices for £1 extra.

They know that this new business operates at twilight hours, with queues extending onto the roadside.

This is just one example of many. All of our members can report similar incidents of new businesses “popping up” in their area offering product at prices that are not credible if they have paid duty. And their own legitimate sales drop hugely for a period. HMRC enforcement activity can be effective in the short term. As one member told us recently, “It’s like turning a tap off when illicit stock dries up—when they get it right in terms of enforcement activity-our sales go up almost overnight. Sales of Carling will go from 200 to 2,000, almost overnight”. However, the scale of the problem across the country means that enforcement activity is not in our view, an adequate solution. We agree with HMRC that there is now a need to tackle the problem “at source”.

We believe that all parties need to take responsibility for tackling the issue. This is why we have proposed registration of wholesalers, which might be seen as a regulatory burden on our industry, but is something we think that will be worthwhile as it will help to tackle illegitimate wholesalers. In addition, we believe that the introduction of fiscal marks, will have a positive impact as they have had on spirits.

We would also dispute the BBPA’s estimates of the costs and impact of fiscal marks. Far from costing a penny a pint, as brewing lobby group BBPA claim, these need be no more expensive to produce than the existing plethora of “skus” or format with their price marks, competitions or football-themed special editions. The suppliers already manufacture, store, and distribute bespoke variants for different routes to market. HMRC’s proposal would simply require them to add one more, the unmarked can or bottle for export.

Finally, there was some discussion in the session of the impact of fiscal marks on smaller beer producers, and those producing craft beers in particular. I want to emphasise that duty fraud in general affects a relatively small number of beers broadly speaking the high volume lager brands, and super-strength lagers. HMRC’s proposal is to specifically exclude all draught beer, all heel’ lower than 2,8%ABV, and all small brewery beer (defined at 200,000 hectolitres per annum), The measure will effectively target those beers which are subject to fraud, without affecting smaller brands.

Thank you again for inviting FWD to give evidence. If I can provide any further information please don’t hesitate to contact me. I have copied this letter to the Clerk of the Committee.

3 May 2012

Written evidence from the Chief Executive and Permanent Secretary, HMRC

INFORMATION REQUESTED AT PAC HEARING ON 24 APRIL, 2012. HMRC RENEWED ALCOHOL STRATEGY: A PROGRESS REPORT

Please find attached the response we promised to provide you at the hearing on 24 April, 2012.

If you require any further information please do not hesitate to contact me.

Q125 Mr Bacon: If you take the five cases that involved more than one defendant in each one, in each of those five cases, what was the value of what was brought down in terms of the number of shipments and lorries per week and so on? I am saying that they are trivial numbers; this is also what Mr Jackson was saying as well. It could be that we are quite wrong because what that is really representing is 450 lorries a week in five cases. I don’t know; that is what I am asking.

Lin Homer: Could I offer you a note that breaks down figure 7 into a bit more detail?

For information:

Figure 7

PROSECUTIONS CASES INVOLVING ALCOHOL

| | 2006–07 | 2007–08 | 2008–09 | 2009–10 |
|--|---------|---------|---------|---------|
| Cases Referred—Cases | 7 | 6 | 8 | 1 |
| Complete Prosecutions—Cases ¹ | 7 | 3 | 8 | 12 |
| Convictions—Cases ¹ | 6 | 3 | 6 | 5 |
| Convictions—Defendants | 15 | 4 | 12 | 16 |

NOTES:

This table includes prosecutions where there is at least one charge relating to evasion of excise duty payable on alcohol.

¹ A case is regarded as completed when an outcome is given for all defendants involved (excludes absconders). Source: Crown Prosecution Service (CPS).

The data for 2010–11 is not held in a comparable format due to changes in the CPS' database systems.

Response:

| <i>Year</i> | <i>2008–09</i> | <i>2009–10</i> | <i>2010–11</i> |
|------------------------------|----------------|----------------|----------------|
| Revenue Loss Prevented (RLP) | 52,350,000 | 1,385,450 | 67,463,453.43 |
| Tax at Risk | 69,150,000 | 8,300,000 | 68,711,277.93 |

The table shows the revenue loss prevented and tax at risk from alcohol cases based on the date of intervention for three financial years. The date of intervention is taken as the point at which a financial quantification is recorded. This is because it may be a number of years before the case actually reaches the courts (see below for examples), and the mere fact of an intervention could be enough to stem the loss to the Exchequer.

The significant time lag between intervention and a trial starting with some cases can give a distorted picture of Criminal Investigation (CI) activity. For example, the intervention on Operation Rust was in 2008–09 so the £50 million RLP and tax at risk falls within that financial year, as intervention is taken as the data point. However the trial was actually in the financial year 2011–12. Another example of a serious organised crime case in that year was Operation Domic. This concerned counterfeit, rather than diverted or smuggled alcohol. The tax loss was approximately £14 million over an 18-month period and was incredibly well organised. However, there were also cases across the spectrum of criminality, such as Operation Platform, which was a relatively modest wine smuggle accounting for £11,000 tax loss, and Operation Buckeye with revenue loss prevented of £900,000 and dealt with an alcohol wholesaler.

Similarly, in 2009–10 two further examples, Operations Installbox and Bighorn, tackled organised criminality and accounted for over £4 million revenue loss prevented. These concerned the diversion of alcohol into warehouses and wholesalers who also traded in legitimate alcohol. Rather than just deal with them criminally, civil processes and receivership were used to stop the companies trading. This was also the case with Operation Arcade, in which intervention was made in early 2010, with no prosecutions, but the fraud was stopped before it could take hold in the UK. It started off with a request from the Dutch authorities for border seizures. They suspected that the companies involved in Holland were diverting alcohol to the UK rather than consigning it to the stated countries on the mainland. However, the consignments were smuggled into the UK (described as food and groupage).

Operation Baygood involved counterfeit vodka production, with about £2 million revenue at stake, also took place in this year although the trial was in late 2011. Both principals were found guilty and sentenced to seven years imprisonment each, with their lower level co-conspirators receiving just under four years total imprisonment terms.

The figures for 2010–11 include £62 million RLP for a large organised crime case (Operation Centrum, December 2010) although a trial is unlikely to take place until later this financial year at the very earliest. However, the scope of CI activity throughout this year also encompasses the full range of criminality, and includes an unlicensed retailer selling non-duty paid excise goods with a small revenue loss of £4,000 (Operation Fastlane).

The complexity of these large cases is such that, on occasion, they do not reach the courts due to issues such as disclosure. Operation Tangelo 2 is a good example where the loss to the Exchequer was over £10 million from alcohol diversion. This case did not proceed to trial in 2010 because of an inability of HMRC to satisfy the courts that all material deemed by the courts as “relevant” could be located, scheduled and revealed to the defence, wherever in the department it was located, arising from over 500 separate transactions throughout Europe over a two-year period. The lessons learned from this case have already been put into practice with great success, such as in Op Rust, with guilty verdicts and sentences of imprisonment of 35 years against the principals.

Another good example of impact in 2010–11 is Operation Coltsfoot, which did not result in an HMRC prosecution at all after the arrest phase. This is because HMRC uncovered a large and very sophisticated counterfeit clothing production facility during searches, one of the largest ever seen by Trading Standards, with the capacity to produce designer clothing worth well over £100,000. The operation also led to the seizure of approximately 34Kgs Class C drugs by the police and about £15,000 cash, with two arrests. Latterly, the principal target was arrested and charged with possession with intent to supply Class B and Class C drugs. As he was out on licence for previous counterfeit offences he was immediately remanded in custody. Although the revenue aspects of this case are not as great as other alcohol cases listed, it is a good example of multi-agency working where the partner who can achieve the quickest and greatest impact is allocated the lead role. It also demonstrates the different illicit commodities traded by the gangs we are dealing with.

It is not possible to make a like-for-like comparison for years prior to 2008–09. This is because Revenue Loss Prevented (RLP) as a calculating methodology was only introduced in that year. As such, cases in previous years were quantified in simple number terms as per the table below (which was produced in the NAO report).

 RCPO CASES INVOLVING ALCOHOL

| | <i>Cases</i> | <i>Cases Referred¹ Defendants</i> | <i>Completed Prosecutions Cases²</i> | <i>Defendants</i> | <i>Cases²</i> | <i>Convictions Defendants</i> |
|---------|--------------|--|---|-------------------|--------------------------|-----------------------------------|
| 2007–08 | 6 | 11 | 3 | 4 | 3 | 4 |
| 2006–07 | 7 | 13 | 7 | 22 | 6 | 15 |

Prosecutions in which there is at least one charge relating to the evasion of excise duty payable on alcohol.

¹ Includes both prosecutions and advices.

² A case is regarded as completed when an outcome is given for all defendants involved (excludes absconders).

No data is available for the period 2005–06.

14 May 2012
