

Based on a pack price of £7.98 for 20 premium cigarettes (March 2013)

Tobacco taxation

- It has been the policy of successive Governments to maintain a high level of tax on tobacco products in order to reduce tobacco consumption and the prevalence of smoking
- The tax, both excise and VAT continues to be a major source of revenue for the Government, contributing over £12 billion in 2012/13
- This is according to the Treasury equivalent to more than 2 pence on the basic rate of income tax
- The revenue derived from tobacco is the same as for all alcohol products (wine, beer, spirits, cider) combined
- On a typical pack of 20 premium cigarettes the total tax burden (Specific excise + Ad Valorem excise + VAT) of £6.17 accounts for 77% of the recommended retail price (RRP) of £7.98
- On some of the least expensive brands the total tax burden accounts for up to 90% of the RRP
- Cigarettes and handrolling tobacco are subject to far less taxation in other EU member states, with a typical pack of 20 premium cigarettes costing £3.94 in Spain and £2.89 in Poland, whereas hand rolling tobacco costs around £16.70 for a 50gr pouch in the UK compared to £5.44 in Belgium

The duty escalator

- In 1993 the Government introduced a 3% above inflation 'duty escalator' on tobacco products, rising to 5% from 1997
- The intention was to drive down consumption and bolster Government revenues
- Whilst the duty escalator was in place (1993-2000) cigarette taxation increased by 85%
- Although built in to Treasury policy the duty escalator on hand rolling tobacco was not imposed during the mid-late 1990s due to the rapid acceleration in smuggling

Tobacco Taxation Briefing

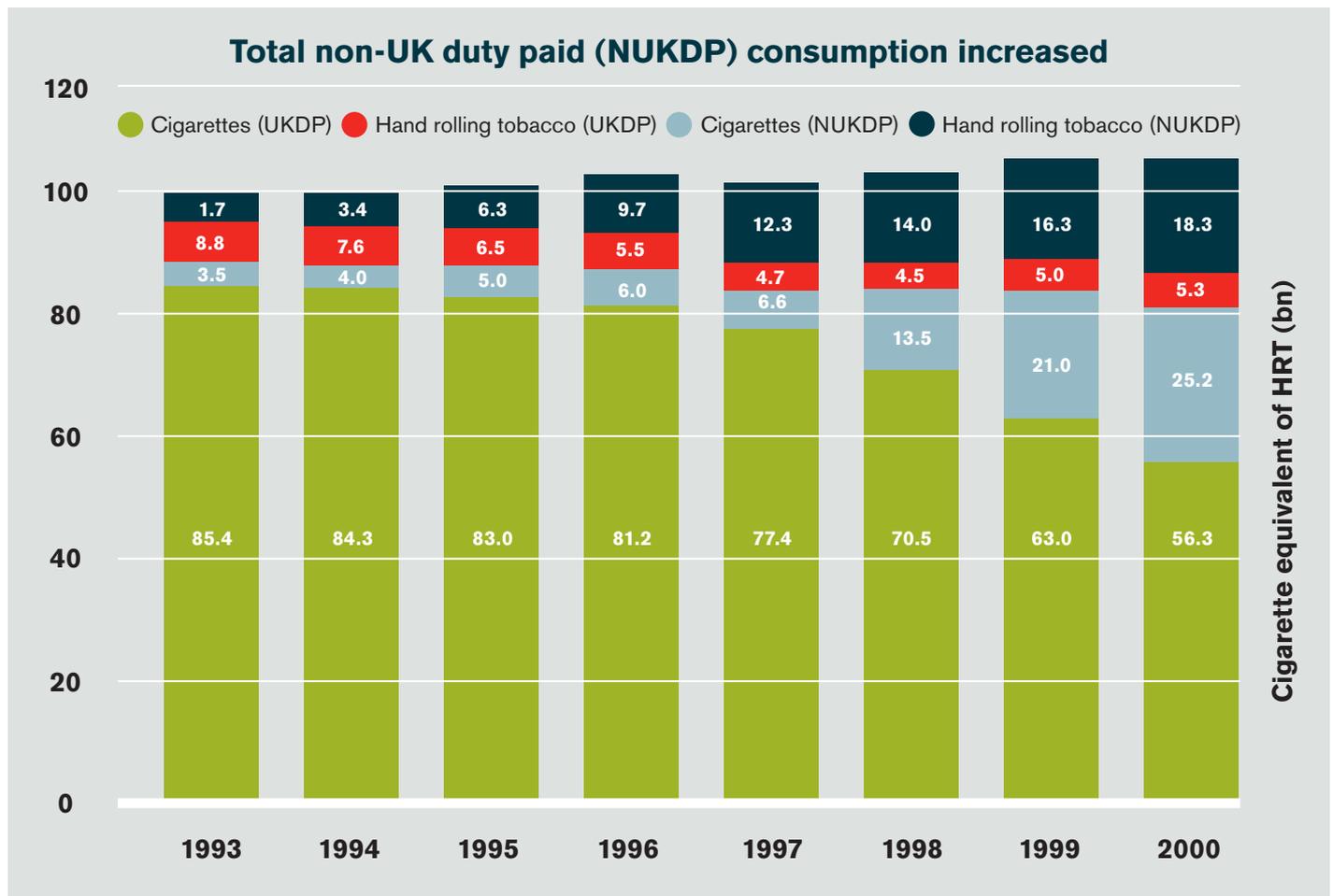
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The impact of the duty escalator on revenue and consumption

- Between 1993-2000 the level of non-UK duty paid (NUKDP*) cigarette consumption increased from 3.5 billion sticks to 25 billion sticks, as smokers took advantage of cheaper smuggled and crossborder shopped tobacco products. Therefore by 2000, around 1 in 3 cigarettes consumed was not UK tax paid and at the same time around 80% of hand rolling tobacco also avoided UK duty
- The acceleration in smuggling led to a surge in associated criminality and combined with crossborder shopping undermined legitimate UK businesses, whilst depriving HM Treasury of billions in revenue (up to £5 billion in 2000/01)
- HM Treasury forecast that tobacco excise revenues would reach £8.9 billion in 1998/99, although actual revenues for that year were £8.3 billion, representing a shortfall of £600 million

- The shortfall in revenue can be attributed to the decline in duty paid consumption and the substantial increase in tobacco smuggling and crossborder shopping
- In 1999, Chancellor Gordon Brown commissioned smuggling Tsar Gordon Taylor to look at the issue of tobacco fraud. The report, which was only made public in 2012¹ stated: "The principal cause of the smuggling, of course, is the high level of duty in the UK." Many of the recommendations contained in the report formed the basis of the Tackling Tobacco Smuggling Strategy, which was launched in 2000.

***NUKDP comprises illicit/smuggled tobacco products and legitimately purchased crossborder shopped products, *none of which pays UK taxes**



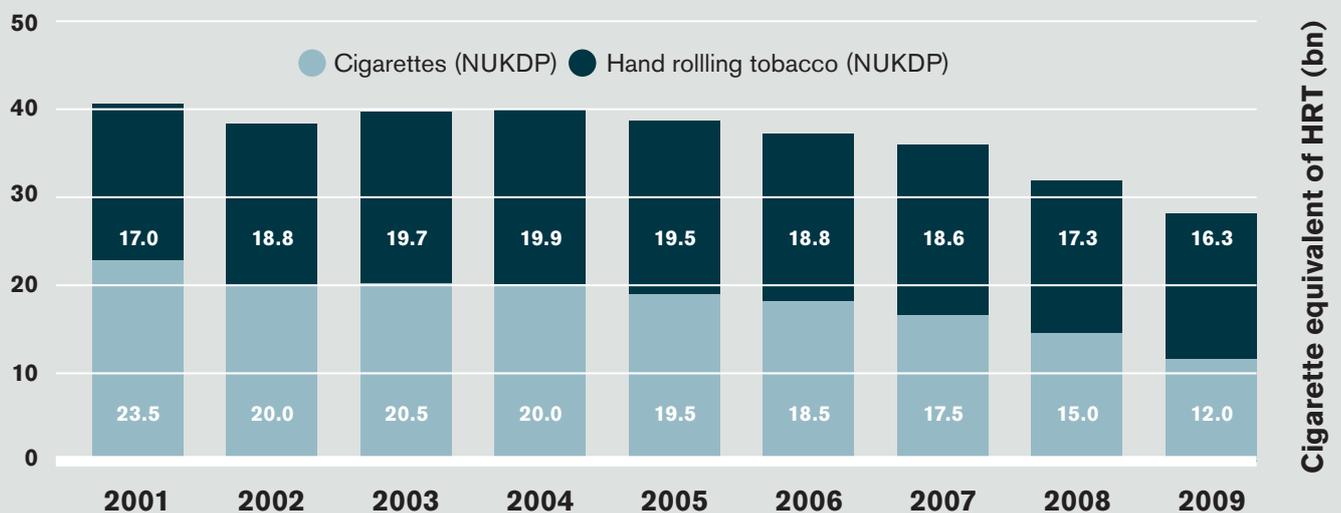
Stepping off the duty escalator

- ➔ In response to the high levels of illicit tobacco entering the UK, the Government elected to increase tobacco duties by inflation only in 2001, effectively stepping off the duty escalator, a policy that continued through to 2009
- ➔ This inflation only tax policy combined with the launch of the Tackling Tobacco Smuggling Strategy led to a gradual restoration of order in the tobacco market

Tax revenues stabilised



Total non-UK duty paid (NUKDP) consumption fell

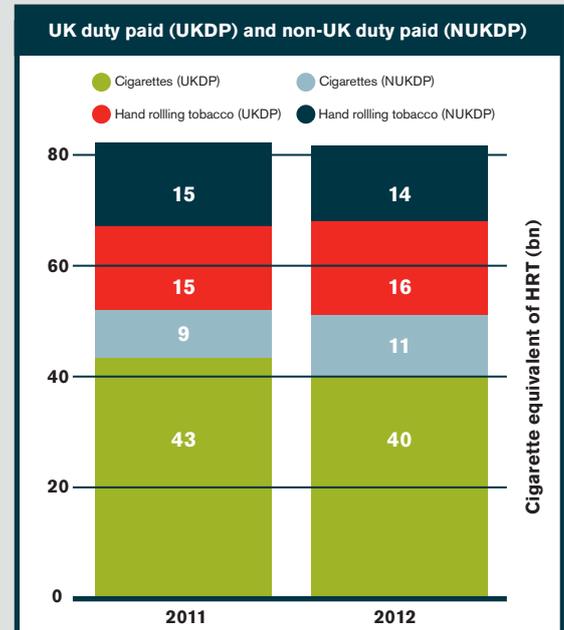
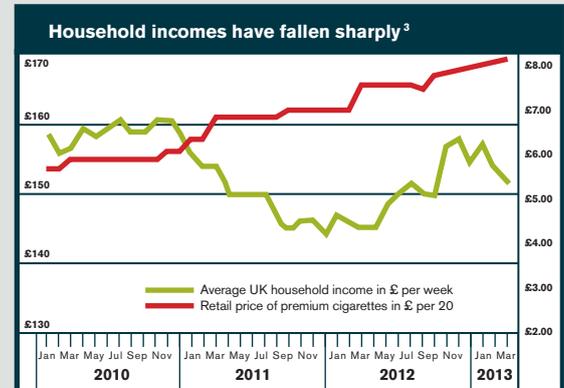


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The economic crisis

- In response to dramatic falls in Government income, a number of measures were taken to bolster the economy
- When the VAT rate was cut in December 2008, tobacco duties were increased to offset the lower VAT, although when VAT returned to 17.5% in January 2010, there was no compensatory reduction in tobacco duties. VAT was raised to 20% in January 2011
- The duty escalator on tobacco products was re-introduced in March 2010 at 1% above inflation, rising to 2% from 2011/12
- At the 2012 Budget, tobacco duties were increased by 5% above inflation with immediate effect
- Research conducted by Oxford Economics² shows that the duty increase announced at the 2012 Budget would not deliver the additional tax revenues forecast by HM Treasury, and subsequent figures released by the Office for Budget Responsibility in March 2013 revealed a revised forecast for tobacco duty revenue for 2012/13, down by £200 million
- At the 2013 Budget, tobacco duties were increased by 2% above inflation, adding 26 pence on to a pack of 20 premium cigarettes and 25gr pouch of hand rolling tobacco
- Empty pack surveys conducted in 2012 showed non-UK duty paid cigarette consumption at 21%, up from 17% in 2011
- The decline in duty paid cigarette consumption in 2012 has been offset by the increase in non-UK duty paid
- An increase in illicit tobacco undermines the joint cooperation that exists between the tobacco industry and enforcement agencies such as HMRC, UKBA and Trading Standards in addressing this serious criminal issue, which deprives HM Treasury of billions in lost tax revenues, brings criminality into the local community and makes it easier for children to access tobacco products



Looking ahead

- The re-introduction of the duty escalator, increases in VAT, combined with difficult economic circumstances have created conditions where consumers increasingly move to illicit products, in turn undermining duty paid sales and Government revenues
- The Government should reflect on the decisions taken and the impact that they are having, before committing to further above inflation tax increases which are in the long run proven to be counterproductive

The Tobacco Manufacturers' Association (TMA) is the trade association for tobacco companies that operate in the United Kingdom. Our members are British American Tobacco UK Ltd, Gallaher Ltd (a member of the JTI Group of companies) & Imperial Tobacco Ltd. The TMA's prime function is to represent the views of its members when communicating with Government, authorities and others on issues of shared interest and concern.

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