



House of Commons
Committee of Public Accounts

HM Revenue & Customs: Progress in tackling tobacco smuggling

Twenty-third Report of Session 2013–14

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

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Committee of Public Accounts

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

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Contents

Report	<i>Page</i>
Summary	3
Conclusions and recommendations	5
1 Developing the tobacco strategy	8
2 Progress in delivering the tobacco strategy	11
Formal Minutes	13
Witnesses	14
List of printed written evidence	14
List of Reports from the Committee during the current Parliament	15

Summary

We welcome the progress that HM Revenue & Customs (HMRC) has made in tackling tobacco smuggling. The size of the market share for illicit tobacco products in the UK is believed to have reduced significantly between 2000-01 and 2010-11, from 21% to 9% for cigarettes and from 61% to 38% for hand-rolling tobacco. However, these figures are only the best estimate. The expansion of HMRC's network of overseas intelligence officers has been particularly successful, preventing £226 million of lost tax in the last two years for an initial investment of £4.6 million. However, HMRC's proposals to tackle tobacco smuggling in the 2010 Spending Review investment were over-optimistic. Three of the five projects had delivered no benefit by March 2013. HMRC has not made full use of the range of enforcement actions available to it in dealing with those involved in the illicit tobacco trade, or challenge adequately UK tobacco manufacturers that fail to prevent the over-supply of their tobacco products to countries from which they might be smuggled back into the UK.

Conclusions and recommendations

1. Tobacco duties generated £9.9 billion of revenue in 2011-12, but tobacco smuggling represents a significant risk to revenues. It undermines initiatives to reduce smoking and it is linked to the activities of organised criminal gangs. HMRC estimates that duty not paid on tobacco smoked in the UK in 2010-11 resulted in revenue losses of around £1.9 billion. HMRC launched the latest iteration of its tobacco strategy in April 2011. This is a joint strategy with Border Force; HMRC has overall responsibility for delivering the strategy while Border Force is responsible for the seizure of illicit tobacco at the border.¹
2. **HMRC appears to have used some of the funding from the 2010 Spending Review, earmarked for investment in new initiatives to tackle tobacco smuggling, for business-as-usual funding of its tobacco strategy.** HMRC's 2010 Spending Review settlement included £25 million over four years to invest in new initiatives to tackle tobacco smuggling. However HMRC was also required to find efficiency savings so total spending on HMRC's tobacco strategy in 2011-12 rose by only £3 million to £68.9 million and fell to £67.4 million in 2012-13. HMRC claims to have made efficiency savings but admitted, for example, that some of the money it earmarked for new initiatives actually funded six overseas intelligence officers already in post.

Recommendation: *HMRC should be transparent about the extent to which its Spending Review investment is truly additional to the funding required for business-as-usual and where it has been used to make up any shortfall in funding elsewhere.*

3. **By the end of 2012-13, three of the five projects to be funded by investment from the 2010 Spending Review had yielded nothing.** One of the projects, designed to tackle the fact that tobacco supplies far in excess of local demand are sent overseas, and are then available for smuggling back in to the UK, was abandoned because of legal concerns. HMRC and Border Force have been painfully slow in implementing new proposals designed to improve performance. HMRC achieved benefits of £328 million from reduced revenue losses by the end of 2012-13 from the five new initiatives, less than two-thirds of the benefit expected by that time (£527 million). The Committee welcomes innovative approaches to delivering benefits; however, HMRC and Border Force did not subject their plans to proper scrutiny or make a realistic assessment of the benefits achievable and their timing.

Recommendation: *HMRC and Border Force should encourage innovative solutions to tackle problems, but these must be based on clear, well thought through, evidence-based proposals that can be implemented when funding is available.*

4. **We are not convinced that the 2010 Spending Review projects will deliver the £900 million benefit, in terms of revenue loss prevented, that HMRC now**

¹ C&AG's Report, *Progress in tackling tobacco smuggling*, Session 2013-14, HC 226, paras 2, 3, 5

predicts they will achieve by March 2015. There are significant weaknesses with some of the data on which HMRC relies to demonstrate its impact. In particular, there are significant inaccuracies in HMRC's estimates of revenue-loss prevented from criminal investigations work, which limits its usefulness as a performance indicator.

Recommendation: *HMRC should include its data sources, and a clear quantitative analysis, when providing its assessment of the financial impacts achieved by March 2015 from its projects funded by the 2010 Spending Review.*

- 5. HMRC has not yet found the right balance in its use of prosecutions and other enforcement action to deter potential offenders.** Tobacco fraud cost taxpayers £1.9 billion in 2010-11, with 9% of cigarettes and 38% of hand-rolling tobacco sold in the UK estimated to be illicit. Yet there were only 265 prosecutions for tobacco smuggling in 2012-13 and prosecutions for organized crime actually fell from 62 to 51 in the last year. A campaign of targeted enforcement action and associated publicity could have a wider deterrent effect, but HMRC does not know what level of enforcement action is required to deter would-be offenders. HMRC has not yet found the right balance in its enforcement action, which can range from prosecutions of organised criminal gangs to imposing fines or referring offenders to licensing authorities for those involved in local, small-scale operations.

Recommendation: *HMRC and Border Force should develop a clear and coherent rationale for the use of prosecutions and other enforcement action within the UK, based on good evidence of the deterrent effect. They should also publicise prosecutions and other enforcement action more widely to deter potential offenders. HMRC needs better relationships with Local Authority trading standards officers to achieve this.*

- 6. HMRC must do more to work with other agencies to tackle tobacco smuggling in the UK. Joint working of this nature will improve enforcement activity, reduce supply and educate the public about the risks of purchasing illegal products.** A pilot scheme launched in 2009 to tackle tobacco smuggling, by cutting public use of illicit tobacco in the UK and which involved health, trading standards and police services, produced positive results. However, despite this success the scheme has not yet been rolled out across the UK.

Recommendation: *HMRC should implement effective examples of joint-working more quickly across the UK.*

- 7. There is still a significant problem with the over-supply of hand-rolling tobacco, in particular, to high-risk countries.** HMRC is concerned that some UK manufacturers, of hand-rolling tobacco in particular, are greatly over-estimating the size of the legitimate European market for their products and are not co-operating with HMRC to tackle the smuggling of hand-rolling tobacco. HMRC estimated that the supply of some brands of hand-rolling tobacco to some countries exceeded legitimate demand by 240% in 2011. But HMRC has not fined any UK tobacco manufacturer for over-supplying products and failing to control its supply-chain and has issued only one letter of warning. HMRC is focusing on improving cooperation

with manufacturers but it must also become more assertive in using its powers where necessary and consider whether it has the full range of powers and tools at its disposal to take action.

Recommendation: HMRC should apply the supply-chain legislation to its full extent. It needs to identify and seek to correct any shortcomings in the legislation to put a stop to the abuse of exports by tobacco manufacturers. It should consider naming and shaming those manufacturers who fail to co-operate fully with the Department.

1 Developing the tobacco strategy

2. Tobacco smuggling is a significant risk to tobacco duties which generated £9.9 billion of revenue in 2011-12. HMRC estimates that duty was not paid on some 9% of cigarettes and 38% of hand-rolling tobacco smoked in the UK in 2010-11, with associated revenue losses of around £1.2 billion and £0.66 billion respectively. Tobacco smuggling undermines government initiatives to reduce the prevalence of smoking, as it makes smoking more affordable. It can also be linked to organised criminal gangs involved in other crimes, such as drug smuggling and people trafficking.²

3. Since 2000 HMRC has had a strategy to tackle tobacco smuggling which has contributed to a decline in the market share for illicit tobacco products. HMRC estimates that in 2000-01, duty was not paid on 21% of cigarettes, and 61% of hand-rolling tobacco smoked in the UK, with associated revenue losses of £2.7 billion and £0.67 billion respectively.³

4. HMRC launched the latest iteration of its tobacco strategy in April 2011. This is a joint strategy with Border Force; HMRC has overall responsibility for delivery while Border Force is responsible for the seizure of illicit tobacco at the border.⁴ On the basis of a Report by the Comptroller and Auditor General, we took evidence from HMRC and Border Force on their renewed strategy to tackle tobacco fraud.¹

5. As part of the 2010 Spending Review, HMRC allocated an additional £25 million, to be spent between April 2011 and March 2015, to tackle tobacco fraud by organised criminal gangs.⁵ HMRC increased its total spending on tackling tobacco fraud from £66 million in 2010-11 to £68.9 million in 2011-12, including £3.2 million of Spending Review investment. However, HMRC spent only £67.4 million in 2012-13, despite reporting that it had spent £7.7 million of additional Spending Review funds on tackling tobacco fraud in that year.⁶

6. HMRC told us that overall spend on tackling tobacco fraud had reduced because it had made efficiency savings, which had reduced its spending on business-as-usual activity. However, the Department of Health withdrew its funding of six overseas intelligence officers in 2010, leaving HMRC to meet these costs from its budget.⁷ It is unclear how much of the new money is being used for cuts in expenditure elsewhere in the area of tobacco smuggling policy.

7. HMRC planned to use its Spending Review investment to deliver five projects with a total expected benefit of £1.4 billion by March 2015. However, by the end of 2012-13, three of the five projects had delivered no benefits.⁸ One of these unsuccessful Spending Review

2 C&AG's report, para 2, 3

3 C&AG's report, para 1.8

4 C&AG's report, para 5

5 Q 1

6 Qq 5-6, 8; C&AG's report, para 1.20

7 Qq 10-12; C&AG's report, para 2.3

8 C&AG's report, Figure 8

projects was intended to test the effectiveness of manufacturers' activity to prevent the over-supply of tobacco products to high-risk countries, such as Spain, Belgium, the Netherlands and Luxembourg, through test purchases.⁹ However, during the planning stage, HMRC realised that UK officials could not exercise their powers in another country in that way. HMRC has re-scoped the project and now expects the project to deliver much-reduced benefits, down from £465 million to around £100 million.¹⁰

8. HMRC and Border Force also cancelled a proposed project to provide a mobile unit to examine freight consignments at a number of UK ports, after assessing that the project was unlikely to deliver the expected benefits. The Border Force's postal screening facility, designed to examine a greater volume of incoming post without disrupting Royal Mail services, was also two years late coming on-line due to technical and supplier problems.¹¹

9. HMRC and Border Force conceded that their assumptions for these projects had been over-optimistic, but explained that these projects were innovative and that this had made it difficult to estimate the likely benefits.¹² HMRC admitted that the projects were put together quickly and told us it had learnt lessons, both in terms of assessing and challenging potential benefits, and in project testing.¹³ HMRC admitted that it needed to spend longer in the planning phase to ensure projects are well scoped.¹⁴

10. HMRC recognised that it needs to work with a range of bodies to tackle tobacco fraud effectively.¹⁵ HMRC and Border Force said they have a good working relationship, for example they are working together on a further revision of the tobacco strategy.¹⁶ Similarly, overseas intelligence officers work with local law enforcement agencies in foreign jurisdictions to facilitate seizures overseas, and share intelligence with Border Force.¹⁷

11. HMRC also told us that it had worked well with UK tobacco manufacturers to reduce over-supply to Europe. However, it accepted that it had much further to go. In particular, one UK tobacco manufacturer had a poor record of engagement with HMRC: it had not notified HMRC of any firm plans to address HMRC's concerns; it had been very slow in responding to HMRC; and it had provided very little useful information. HMRC told us it had raised its concerns with the tobacco manufacturer, and would monitor its response.¹⁸

12. HMRC considered that it has good working relationships with its European partners, as evidenced by the introduction of lower minimum indicative tobacco limits for personal use.¹⁹ We asked HMRC about its relationship with the European Anti-Fraud Office

9 Qq 60, 96

10 Qq 61-62, 86; C&AG's report, para 1.22

11 Qq 19, 77, 84; C&AG's report, para 2.17

12 Qq 18-20; C&AG's report, Figure 8

13 Q 62

14 Q 83

15 Q 35

16 Q 14

17 Qq 20, 49-50, 56

18 Qq 60-62, 64; Ev 20

19 Q 73

(OLAF). HMRC told us that it works with OLAF at both a strategic and an operational level. However it was considering how best to increase co-operation given that OLAF does not currently have the capacity to instigate criminal investigations within European member states.²⁰

13. HMRC also noted that it had contributed to the recent EU strategy to tackle cigarette smuggling through informal discussions with the European Commission ahead of the strategy's publication. This had included making a number of general observations and specific comments on the strategy in the context of the UK illicit market. The strategy will be negotiated over the coming months and HMRC told us that it would be working closely with the European Commission and member states on the detail of the proposals to ensure that the actions complement and add value to HMRC's UK strategy. HMRC noted that the strategy is subject to Parliamentary scrutiny procedures and that it had prepared an explanatory memorandum to brief Parliament on the European Commission's proposals and their implications.²¹

14. HMRC has started to improve its strategy to tackle tobacco smuggling within the UK, and has seen positive results from a pilot scheme involving health, trading standards and police services, which was the first large-scale attempt to cut public use of illicit tobacco. However, this has not yet been implemented on a wider scale, some four years after the pilot was launched in 2009. HMRC accepted that there is more to do to develop its work in the UK.²²

20 Ev 19

21 Ev 19

22 Qq 36-37; C&AG's report, para 1.26

2 Progress in delivering the tobacco strategy

15. The expansion of HMRC's network of overseas intelligence officers under the 2010 Spending Review has yielded a significant return on investment, preventing an estimated £226 million of lost tax for an initial investment of £4.6 million— a benefit to cost ratio of 49:1.²³

16. HMRC recognised that there was scope for increasing the profile of enforcement action to increase the impact on deterrence.²⁴ It had strengthened the enforcement and compliance aspects of its strategy by introducing civil assessments and penalties. These enable HMRC to impose financial sanctions, in addition to the value of lost revenue on those caught smuggling tobacco, and to increase the volume of criminal prosecutions which target smaller players.²⁵ However, HMRC noted that it had to weigh the higher cost of prosecuting people, against the use of civil penalties and assessments in deciding the best course of action to take in combating tobacco fraud.²⁶

17. Although prosecutions for small scale offences involving tobacco increased from 105 in 2011-12 to 214 in 2012-13, prosecutions for organised crime fell from 62 to 51 over the same period, making a total of 265 prosecutions for tobacco fraud in 2012-13.²⁷ The total number of convictions for tobacco fraud has been static year-on-year.²⁸ HMRC had processed only 1% of potential cases for assessments and penalties successfully in 2011-12, rising to 28% in 2012-13.²⁹ HMRC acknowledged the need to enhance its work to tackle tobacco smuggling in the UK by rolling out campaigns supported by more sophisticated intelligence and by working closely with the police and with trading standards.³⁰

18. In addition to serving as a deterrent, prosecutions can also reveal valuable intelligence about organised crime networks which can then be used to improve the effectiveness of the other strands of the strategy, for example, by informing the targeting of overseas activities.³¹ UK tobacco manufacturers have had a responsibility not to facilitate smuggling since the introduction of supply chain legislation in 2006, which was designed to minimise the over-supply of tobacco products to overseas markets. HMRC works with the tobacco manufacturers and can impose sanctions on manufacturers in cases where they fail to meet

23 Q 51; C&AG's report, Figure 8

24 Qq 28-29

25 Qq 27, 119

26 Q 58

27 Q 31; C&AG's report, Figure 13

28 Q 33; C&AG's report, para 2.41

29 Q 31

30 Qq 27, 33

31 Q 57

their obligations.³² HMRC considered that this work had contributed to a 64% reduction in the over-supply of cigarettes to high-risk countries between 2008 and 2012.³³

19. No UK tobacco manufacturers have been prosecuted under supply-chain legislation and HMRC has issued only one letter of warning.³⁴ However, HMRC told us that it still had concerns about the over-supply of tobacco products, particularly of hand-rolling tobacco, to high-risk markets overseas.³⁵ HMRC explained that one of the challenges it faces in applying the legislation is that it only comes into effect if the manufacturers do not co-operate.³⁶

20. Over the first two years of the 2010 Spending Review, HMRC has secured a total return in terms of reduced revenue losses of £328 million on an initial investment of £11 million; less than two-thirds of the expected benefit.³⁷ It told us that it currently expects to deliver around £900 million of the initial target of £1.4 billion, a return on investment of around 30:1, which is considerably above the average across HMRC of around 11:1.³⁸

21. HMRC uses a basket of measures to assess the impact of its work to tackle tobacco smuggling.³⁹ At present, tax gap data used to monitor long-term trends is subject to an 18-month time lag. However from autumn 2013, HMRC plans to publish new data with a time-lag of six months.⁴⁰ The availability of more up-to-date and timely data on the tax gap should enable HMRC to adapt more quickly to changing conditions.⁴¹ However, there are significant inaccuracies in HMRC's estimates of the impact of its criminal investigations.⁴²

33 Qq 63, 113

34 Q 91

35 Qq 43, 60, 92, 95-97

36 Qq 63, 98; Ev 20\

37 Q 85; C&AG's report, para 12

38 Qq 81, 83, 86, 90

39 Q 47

40 Q 44

41 Qq 38, 47-48

42 C&AG's report, para 15

Formal Minutes

Wednesday 4 September 2013

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon
Guto Bebb
Jackie Doyle-Price
Chris Heaton-Harris

Meg Hillier
Fiona Mactaggart
Nick Smith
Justin Tomlinson

Draft Report (*HM Revenue & Customs: Progress in tackling tobacco smuggling*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 21 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Twenty-third 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 9 September at 2.30 pm]

Witnesses

Monday 24 June 2013

Page

Lin Homer, Chief Executive and Permanent Secretary, **Jennie Granger**, Director General, Enforcement and Compliance, HM Revenue & Customs, **Sir Charles Montgomery**, Director General and **Kevin Franklin**, Director, National Customs Operations, Border Force

Ev 1

List of printed written evidence

- 1 HM Revenue and Customs
- 2 HM Treasury

Ev 18:19:20

Ev 18

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 2013–14

First Report	Ministry of Defence: Equipment Plan 2012-2022 and Major Projects Report 2012	HC 53
Second Report	Early Action: landscape review	HC 133
Third Report	Department for Communities and Local Government: Financial sustainability of local authorities	HC 134
Fourth Report	HM Revenue & Customs: tax credits error and fraud	HC 135
Fifth Report	Department for Work and Pensions: Responding to change in jobcentres	HC 136
Sixth Report	Cabinet Office: Improving government procurement and the impact of government's ICT savings initiative	HC 137
Seventh Report	Charity Commission: the Cup Trust and tax avoidance	HC 138
Eighth Report	Regulating Consumer Credit	HC 165
Ninth Report	Tax Avoidance – Google	HC 112
Tenth Report	Serious Fraud Office – redundancy and severance arrangements	HC 360
Eleventh Report	Department of Health: managing hospital consultants	HC 358
Twelfth Report	Department for Education: Capital funding for new school places	HC 359
Thirteenth Report	Civil Service Reform	HC 473
Fourteenth Report	Integration across government and Whole-Place Community Budgets	HC 472
Fifteenth Report	The provision of the out-of-hours GP service in Cornwall	HC 471
Sixteenth Report	FiRe Control	HC 110
Seventeenth Report	Administering the Equitable Life Payment Scheme	HC 111
Eighteenth Report	Carrier Strike: the 2012 reversion decision	HC 113

Oral evidence

Taken before the Committee of Public Accounts on Monday 24 June 2013

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon
Guto Bebb
Jackie Doyle-Price
Chris Heaton-Harris
Meg Hillier

Mr Stewart Jackson
Fiona Mactaggart
Nick Smith
Justin Tomlinson

Amyas Morse, Comptroller and Auditor General, National Audit Office, **Gabrielle Cohen**, Assistant Auditor General, NAO, **Paul Keane**, Director, NAO, and **Marius Gallaher**, Alternate Treasury Officer of Accounts, were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Progress in tackling tobacco smuggling (HC 226)

Examination of Witnesses

Witnesses: **Lin Homer**, Permanent Secretary, HM Revenue and Customs, **Sir Charles Montgomery**, Director General, Border Force, **Jennie Granger**, Director General, Enforcement and Compliance, HMRC, and **Kevin Franklin**, Director, National Customs Operations, Border Force, gave evidence.

Q1 Chair: Welcome. We thought we would announce a smoking ban at the start of this session, with only duty paid tobacco being eligible. Thank you all for coming. Clearly, there has been real progress over the last decade on this whole area, and we welcome that. If we focus a bit on the latest strategy and the impact on that, it is in the context of really understanding that this is one of the areas where intervention by HMRC and Border Force is a good thing.

Just to be clear on the budget, you were given in the Spending Review, out of the £900 million extra money for tax avoidance, £25 million extra to tackle tobacco smuggling. I was therefore surprised to see the PQs answered recently, and I wondered whether you could explain them, Lin. Both were answered by Sajid Javid. One suggested that the money allocated to the tobacco smuggling strategy—this was in answer to a question from Catherine McKinnell—was, in 2011–12, just under £68.918 million and then in 2012–13 it went down. Answers to another two PQs from Stephen Williams took a slightly different take on the expenditure on the same issue. You said that in 2011–12, the total of HMRC activity was £36.881 million and in 2012–13 it was £35.734 million. I could not understand how reduced expenditure fitted with the CSR commitment to increase spending in this area.

Lin Homer: It may be that I cannot answer all that level of detail relating to those PQs. Very broadly, the position is that we have had an overall strategy for dealing with tobacco, and the £69 million is the amount that we have been spending overall on tobacco strategy. Within the SR10 provision, an additional investment was placed alongside what I suppose you might term that “business as usual”

investment. So in addition to the moneys we were spending each year on tobacco, there was a particular additional amount—part of the £917 million investment overall—that was additional money to push the tobacco strategy further forwards. As a consequence of that, we had an ability to add some further projects to the work that we had done.

I am afraid I do not recognise the £38 million figure, and it may well be that that is—

Q2 Chair: Hang on a minute. Let me just take you back to the £69 million figure, the 2011–12 figure. The answer to Catherine McKinnell suggested that in 2012–13 it went down from £69 million to £67.641 million. If you had been given £25 million extra, I would have expected to see that. I understand the strategy—I have read the Report—but I could not tally that with the figures on expenditure. Why are you spending less? The figures suggest you are employing fewer people, or something like that.

Lin Homer: Yes. The £69 million is the figure I do recognise. That is the annual “business as usual” expenditure. The £25 million is a spending review total, so that is a multi-year—¹

Q3 Chair: I understand that, but the 2012–13 expenditure on this area should therefore have gone up.

Lin Homer: And it will have slightly, because the—

¹ Note by witness: HMRC total expenditure on tobacco was £68.918m in 2011–12 and £67.641m in 2012–13. This includes administration and policy, as well as enforcement. Spending Review investment in tobacco enforcement work included in this figure was £3.24m in 2011–12 and 7.71m in 2012–13.

Q4 Chair: It has not. It has gone down.

Lin Homer: No. That is the annual “business as usual” spend, but the SR10 money, which is an extra £25 million, was due to go up over that period.

Q5 Chair: Can I just read it to you? “Expenditure information for the Tackling Tobacco Smuggling strategy”—this is the answer you gave to the parliamentary question—“is not recorded separately... expenditure on all activity across the tobacco regime is recorded and reported retrospectively...the following information is available in relation to expenditure on the tobacco regime in the first two years of the current spending review period”. I would have expected £25 million extra to mean that in 2011–12 you were at £69 million and in 2012–13 you should have gone up to—I don’t know what—£72 million or £74 million, or something like that, but you did not; you went down.

Jennie Granger: Chair, if I could add to that answer. Like the other parts of the Department, we all had to make efficiency savings as part of the SR10 review and then there was reinvestment, if you remember, of the £917 million over four years. What you are seeing reflected here is that the “business as usual” element went down slightly as part of those efficiency savings, but—

Q6 Chair: Sorry to interrupt. It is not your fault, but it is something that I would like clarity on. I will go on to mention another aspect of it. All your business as usual is to stop smuggling. That is business as usual. You were then given an extra £25 million to stop more smuggling, and then suddenly you hear, “Well, actually, we had to cut business as usual”, and then there is this magical £25 million, so actually it is not new money. There was a cut in the budget on tobacco smuggling and we should come clean on that.

Jennie Granger: Just to complete that answer, there has been reinvestment, so how those figures have travelled in 2011–12 is, £65.7 million was business as usual and £3.2 million was SR10. The SR10 £25 million is split over four years and it escalates over the four years. So that is how you get to the £69 million. In 2012–13, the SR10 figure increases again. It is now at £7.7 million and the “business as usual” figure is £59 million, and that is what makes the £67.64 million figure.

Q7 Chair: Yes, but business as usual is money you would have spent in past years.

Jennie Granger: Yes.

Q8 Chair: To tackle tobacco smuggling. So the reality—I have no doubt you have had fantastic efficiency savings and are using the money much more effectively—for us and for the public out there is that you are spending less in 2013 than you were spending in 2011–12. It might have come from a different budget, but you are spending less.

Lin Homer: The position on tobacco is £67.64 million this year and £68.90 million in the year before. In overall terms, within HMRC writ large, as you know, for the SR10 period we had broadly the same level of efficiency cut as everybody else. We had something

like £1 billion put back in. In very broad terms, enforcement and compliance, which is the area Jennie is responsible for, is increasing. We are taking more of our efficiencies from both back office and the more administrative bit of the business. The focus on enforcement is going up in terms of both cash and the numbers of people. This area is about that.

Q9 Chair: Except I would argue that, in relation to back office, all your work in this area is enforcement. Back office supports the front line. It would have been better to be honest and say, “Okay, we are taking cuts. We are getting a little bit back, but the reality is that we are spending less.”

Lin Homer: I see your point. I think this is an area of spend that has been incredibly well protected, and I do not think it is unreasonable to ask us to make efficiencies.

Q10 Chair: It hasn’t been cut as much as anything else. The only other budget point I want to make is that the Report also says that part of the expenditure was to take over the funding of some Department of Health posts. Again, that is not new expenditure, and I do not know how we account for that. Presumably it shows up as a saving in the Department of Health budget. Our interest is across Government and the whole of taxpayers’ money. Is that not true?

Lin Homer: I am not sure.

Q11 Chair: The Report says that you took over the funding.

Lin Homer: But I am not sure on the accounting. It may have been a straight machinery of government change. Can you refer to the paragraph?

Paul Keane: It is in paragraph 2.3, which is on the fiscal crime liaison officers. You are funding six posts that were previously funded by the Department of Health.

Lin Homer: Yes, but I am afraid that, in terms of that position—

Q12 Chair: Well the Treasury know. When we look at cuts across Government, it is slightly irritating, after being sold a story about increased expenditure on tobacco smuggling, which we all welcome, to find that, actually, it isn’t an increase because they have taken their cut and you have got a bit of dosh back but it isn’t quite as much as there was. And then we find that they are spending money that was spent before anyway but under the Department of Health budget. I know it is not a huge amount, but there needs to be a bit of honesty about where our tax money is going.

Marius Gallaher: We will have to give you a note on that.

Chair: You will have to give us a note?

Marius Gallaher: Yes, because I don’t know the answer to the question.

Chair: Okay. The note should say whether there was a cut in the Department of Health budget.

Marius Gallaher: I know where you are coming from. Yes.

24 June 2013 HM Revenue and Customs and Border Force

Q13 Chair: That is the finance one, but even within the moneys that you have, which I think we now accept are better than elsewhere in Government but not as good as perhaps some Ministers would have believed them to be, may I ask about the work between the two agencies? Especially as you are back in the Home Office.

Sir Charles Montgomery: Border Force has been in the Home Office for some time. The residual part of the Border Agency has just been brought back into the Home Office, too.

Q14 Chair: How do you work together?

Sir Charles Montgomery: Are you asking me?

Chair: You are both going to tell us wonderfully, and then I think we are going to ask you a few questions on strategy.

Sir Charles Montgomery: I will have a go. As someone coming into this, three months in, I genuinely believe there is a good relationship between the two areas. The relationship has got significantly closer in the time I have been in post, with the arrival of HMRC sitting on my main board and taking its position on the Border Systems Programme board, for example. So I am now finding HMRC to be an integral part of my business. Kevin Franklin, who looks after my intelligence area, likewise works extremely closely with HMRC. Looking forward, I know that both of us are working together on revising a tobacco strategy, for example, although it is not the only area on which we are working. So, three months in, do I have hard deliverables that demonstrate that greater co-operation? No. Do I see good working practices between us? Yes. Do I see honesty and transparency? I do.

Q15 Chair: I have to say that the stats—I know you are three months in, but you are here accounting for the past record of the department—are not that encouraging.

Sir Charles Montgomery: In terms of what?

Chair: Seizures. Which is the best stat on seizures?

Paul Keane: Perhaps figure 10 on page 28.

Q16 Chair: Here we are: “Border”. That is for 2012–13, or the year just completed. You are holding back the collective performance.

Sir Charles Montgomery: Yes.

Q17 Chair: In fact, 2012–13 does not look like a brilliant year.

Sir Charles Montgomery: We certainly did not hit any of the overall border targets on either HRT or tobacco. I would offer three reasons at this stage why I would say that was the case. The first is that we had a particularly successful year the year before, especially on HRT and especially at Coventry. What we have detected in the 12 months past is that the criminal routes have changed and we are having to adapt our modus operandi to identify the new routes of criminality. That is the first reason—

Q18 Chair: What does that mean in plain English?

Sir Charles Montgomery: The criminals are changing their behaviour. Inevitably, we have disrupted their

supply route through the Coventry hub, and they are now using alternative routes. Our judgment is that they are now using more routes and smaller packages at any one time, which means that although, as you rightly say, we did not hit our targets, it is worth while reflecting that in HRT, for example, although the volume that we took was lower, the number of seizures was significantly greater. I think what we can see there is a change in what I described as the behaviour of the criminals.

The second reason why I think our performance at the border was reduced—I do not have hard evidence yet, but that will be part of our strategy work—is that our take out of country has increased significantly. Border Force are part of that, because we provide a lot of the intelligence for it. Seizures overseas have increased significantly. There is an assumption, at least in my mind, that if you take more and disrupt further out of country, less should come across the border in the first place.

The final reason—I want to be perfectly honest about all these things—is that two of our initiatives in SR10, the mobile freight capability and the scanning facility at Coventry, failed to deliver as we had anticipated.

Q19 Chair: Why?

Sir Charles Montgomery: There were different reasons for each of them. The first one, the mobile scanning capability, had to be cancelled at the concept phase, because frankly, we did not believe that it would deliver on the ground. Rather than spending money on a concept that we did not believe was going to deliver, we terminated the project, I think rightly, but assumptions had already been made, and they were over-optimistic.

On the second one, the Coventry scanner, we had significant issues, both technological and with the contractor at Coventry, in getting the new installation in place, which delayed it quite significantly. It is on stream now, and it is delivering, but it is delivering late. The effect on our operation last year was marked, because we had no benefit from the system at all.

Q20 Chair: To put it on the record, we support innovation—surprise, surprise. People say we do not, but we do. However, we expect proper planning, and it looks to us like you made all sorts of predictions and went ahead without having thought things through.

Sir Charles Montgomery: Things were thought through. The assumptions have proved to be, and were, overly optimistic. We will learn from that.

Amyas Morse: The scale of that is quite considerable, isn't it?

Sir Charles Montgomery: Yes.

Amyas Morse: In terms of millions of cigarettes, to have seized 455 million and had a target of 610 million, that is a pretty big difference.

Paul Keane: That is in 2011–12. We have the 2011–12 comparatives, and it looks as if the target for cigarette seizures in 2011–12 was 610 million sticks. Actual seizures were 455 million.

Sir Charles Montgomery: Our take in terms of cigarettes increased in 2012–13, set against 2011–12.

Paul Keane: Okay, but it looks as if the target was missed in 2011–12 as well.

Sir Charles Montgomery: It was.

Amyas Morse: So, it tells us there is a more endemic planning issue, isn't there? It is not just one year's bad luck, is it? That would not be a fair conclusion to draw.

Lin Homer: Chair, you asked me about the joint working as well. The thing to say is that, from our perspective, we are seeking to stop illicit tobacco gaining market share in the UK, and that does need us to work together. We have been increasingly going upstream—Jennie could tell you about that—and it has been a success story, but inevitably it means that the seizures we make overseas and at the border are proxies for what hits the street. I think figure 7 actually shows continued improvement against cigarettes and hand-rolling tobacco, in terms of seizures, in 2010–11, 2011–12 and 2012–13, but that is when you combine our efforts. It is important to remember that it is not a competition between us; it is about the net result of our work together, and quite a lot of what we do upstream and overseas is fed by intelligence we get from the border. So this is a joint piece of work, and we would rather catch it upstream than let it go through in order to let Charles hit his targets.

Q21 Chair: I accept that, but on figure 7, I can't see the improvement.

Lin Homer: If you look at "Achievement"—just take the top line—the achievement in 2010 was 1,727.

Q22 Chair: Yes, that's the only one; everything else is down.

Lin Homer: Then it was 1,732 and 1,858. On hand-rolling tobacco, Charles has just made the point that we had a huge win at Coventry in 2011–12, but if you accept a degree of blip around that, what you are seeing in both cases is less of the illicit product hitting the market. You have to bear in mind that we are also seeing a significant reduction in the numbers of people smoking, so we are taking more out of a market that is diminishing. We have more to do—I would accept the challenges in this Report—but I think there is a tale of a successful strategy here. I just wanted to make the point that for us, the joint work between Jennie and Charles is what matters.

Q23 Chair: I accept that. I'm sorry, but I have to come back to you. I accept that you got slightly better on the first one. You say there is a blip on the second. But if you then look down—given that this is a protected area of investment, even though we have established that actually there is not more money, you would expect to see more progress.

Lin Homer: You are right to challenge us to do more. As I say, we would accept the challenges in this Report. I think we can do more, but you have to have the overall target of reducing the supply that reaches the country. That is what matters to us, not where you seize it. The fact is that we have reduced the supply of available cigarettes, so we are seeing fewer cigarettes hit the market. Admittedly, things were flat between 2011–12 and 2012–13, but we have made a

significant dent in the number of illicit cigarettes reaching the country during a period when consumption has been going down. There is a story of success there, but there is much more we can do. That is how I would sum things up at this point.

Q24 Jackie Doyle-Price: I declare an interest, in that I am an unpaid adviser to port police forces, which Sir Charles will be more familiar with than anyone else. I really want to give you, Sir Charles, the opportunity to explain to the Committee just what tackling the import of illicit cigarettes means day to day, because I have seen your operation at Tilbury and I think that your staff are real unsung heroes in all this, because it's not a very nice job—some of the things that they have to do.

Sir Charles Montgomery: Thank you very much indeed. What does tobacco interception feel like at the border? Well, first, some of it is prompted by intelligence, and therefore we can target appropriately. Actually, a great deal of it is not; a great deal is detected through the instincts and judgment of the officers on the front line, whether that is in airports, at rail heads or in the seaports. Intercepting it requires a very fair balance of savvy, shrewdness, judgment and in some pretty unpleasant working conditions. All right, it's not so unpleasant at Dover when you're searching cars, but it does require great savvy to deal with some of the very clever ways in which this smuggling is now taking place. It does require working in some really unpleasant working environments—some of the ship ports, for example, that we see. So it's a case of intelligence-led, non-intelligence-led and, right across the environments, slightly different skills and challenges in each. But I have to say that, from what I have seen of my people on the front line doing this work, it is one of the areas where I think Border Force has a lot to show the rest of the world.

Q25 Jackie Doyle-Price: I think you are right. What interests me as well about the operation at Tilbury—and it was interesting that you were talking about how working co-operation has improved over recent years—is that the guys doing that always viewed themselves as customs officers, so being moved into Border Force perhaps wasn't very comfortable for them. How do you think morale is in the force now?

Sir Charles Montgomery: There is rather more to morale than just the issue of immigration versus customs. As far as the bringing together of the Border Force is concerned, it required bringing together two organisations with very significant histories and heritage, and very different cultures, into a single force. I would always say that any significant change in culture is generally done over a generation rather than overnight—you have to get yourself ready for the long haul. That cultural change certainly has not been effected yet.

However, there are benefits for me in this too. Most people that I meet on the front line now—certainly the younger ones, who see it immediately—see the more flexible deployment that having people who are trained across both disciplines brings to the force. It really does: it allows me, for example, to deploy a

24 June 2013 HM Revenue and Customs and Border Force

force of 7,500 people much more flexibly across primary control, which many confuse with what was old immigration,—and secondary control, which many people confuse with old customs. It allows that flexibility to operate between the two. A fair number of people I have talked to genuinely enjoy that flexibility of employment and therefore that element would be on the morale-enhancer scale.

Q26 Jackie Doyle-Price: From HMRC's perspective, would you reflect that there has perhaps been a weakness from conflating what happens at borders as one activity—maximising your tax take is rather different from protecting the borders and dealing with immigration?

Lin Homer: I think there has been a lot of opportunity. I totally agree with Charles about the time it takes to change a culture—I think we had a similar challenge in HMRC, where the revenue culture and the customs culture have lots of similarities but lots of differences. At the ports, what it enables is a much more adaptable use of the resources you have: we did genuinely have, at the point of merger, two teams of staff that just did not really work together. I have seen first hand the ability to turn that combined force, as a very strong focus, to an emerging risk or a new way of tackling something. I think you are right that some of the newer officers are showing that adaptability, because that is the way they have been trained. For some of our longer-term officers, their background will always be very important to them, but their corporate knowledge of the tradition and profession of customs is hugely important.

Q27 Jackie Doyle-Price: My reading of the Report is that there is a really good story to be told about what is happening at the borders and what we are doing to try to stop things coming in; but, ultimately, it is a difficult job and a lot does get through. What is missing for me, really, is what should happen at the other end. There is a lack of priority in terms of enforcement. We need to get that deterrence to stop people engaging in this activity.

On that note, it is heartening that, on Friday, my local paper reported a big seizure. That chap has got five years for evading £925,000, but those sorts of stories are all too infrequent, and the reality is that your chaps with holdalls behind the back of a pub—and everyone knows they can go and get their packet of cigarettes for £2 from them—are still proliferating in the market. What more can be undertaken to tackle that market?

Lin Homer: Should I ask Jennie to talk about the approach to prosecutions and penalties inland? All I would say is that there is some very important overseas work as well, and all three stages are important; but I think the Report correctly focuses on what we need to do inland to disrupt, and we have a variety of tools there, haven't we, Jennie?

Jennie Granger: As Lin said, all three stages are important. Certainly, the more we can disrupt close to the source, the better. As Sir Charles mentioned, we are now seeing adaptations to smuggling, particularly by the organised criminal gangs. That is not just small but more frequent loads; we are also starting to see

the importation of raw tobacco, with manufacturing here in the UK. They continually adapt.

We have started to ramp up our inland strategy in a more sophisticated way over the past couple of years. You can see the beginning of assessments and penalties mentioned in this Report in figure 7. That allows us for the first time to go further than confiscation; we can also issue assessments and penalties. We have started to do that for the very low level of this. We have also started to increase what we call volume crime, which is focused on the smaller players, because a lot of our organised crime resources and prosecution—they are bound up in the 2010–11 figures—were actually at fairly low levels of the organised crime groups.

There is a three-pronged strategy, and we will be doing it in campaigns, where we are rolling out all those, both at the border and inland, but in a campaign way. It will be backed by more sophisticated intelligence than we have had in the past, both from exercises we have been running with Border Force, to understand the new patterns of importation, but it has also involved working with law enforcement colleagues. We have been mapping organised crime gangs from the common pool of knowledge to be able to detect and prioritise for those.

Lin Homer: Just to give you some figures, because you talked about prosecutions, if you put the volume crime prosecutions and the organised crime prosecutions—that is your man behind the pub with the small outlet, alongside the bigger criminals—over the two years of 2011–12 and 2012–13 together, there were more than 400 prosecutions, nearly 2,000 assessments and well over 1,000 penalties. It is a mixture of big prosecutions, small prosecutions, penalties and assessments. We need to increase that more—we would accept that.

Q28 Jackie Doyle-Price: We need to increase the profile of it. For white van man who gets on the ferry at Dover and fills up the back of his boot, the penalties are not there to disincentivise them. They can make a lot of money.

Lin Homer: Or at least they do not think there are.

Q29 Chair: Looking at figure 13, it suggests that in 2012–13, all that stuff is down.

Lin Homer: Figure 13 does not include the volume crime prosecutions; that is the big organised criminals. You have rightly told us, on other occasions in front of you, that we have to do, as Jackie said, some of the small criminals as well. If you put those two figures together, it gives you some of the coverage that we need, and then we need to ensure that people know that we will do that.

Q30 Chair: Okay. If you put it together—you haven't done that in this table, but remember that you agreed the Report—again, in 2012–13, you ought to be seeing the impact of the strategy coming a little bit to fruition now.

Paul Keane: Paragraph 2.41 brings together both volume and organised crime.

Q31 Chair: That doesn't look too brilliant. HMRC processed only 1% of potential cases successfully in 2011–12, but even in 2012–13 only 28%. That doesn't look very good.

Jennie Granger: That is the assessment and penalties. The volume crime prosecutions are a separate set of figures. Just on the volume crime prosecutions, we have been progressively increasing those. We did 105 in 2011–12 and 214 in 2012–13.

Q32 Chair: Where do they show in your figures?

Paul Keane: In the penultimate sentence of paragraph 2.41, it states: "The total number of convictions for tobacco fraud, including organised crime—"

Q33 Chair: The total number of convictions for tobacco fraud is static between the two years—156 in 2011–12 and 159 in 2012–13.

Lin Homer: I think that the challenge made to us of the need to enhance our inland work is a challenge well made—something that Jennie and Charles have already agreed that we should seek to have another uplift. Our volume crime approach is relatively new. I think you will remember that, on another occasion, I rather cavalierly volunteered to multiply one performance figure by 10—I think we are on target to do that, by the way—but in this area, you have been seeing quite a quick ramping up, from 150 to 240. We have got to lift that again next year. We accept that. I think that that is a point well made.

Q34 Jackie Doyle-Price: How effective is your relationship working with trading standards officers across local authorities? Obviously they are a crucial ingredient.

Jennie Granger: It is certainly good, but we think we can do better, working with local law enforcement and trading standards.

Q35 Jackie Doyle-Price: My experience of trading standards is that they are not really interested in this. They are more interested in prosecuting a retailer for selling cigarettes to under-age kids than tackling dodgy supply. From a public health perspective, we have quick wins both in terms of getting more money into the Exchequer and for public health, if we tackle that.

Jennie Granger: We think there is a range of people we need to work with. Trading Standards is one, and certainly, to an extent, local authorities, and DWP. From some of our work at the border recently, we referred a number of admitted couriers to DWP to look at benefits. We think there is a whole range of things we should be doing to disrupt this. What we want to do is take a targeted approach—to target on the high-risk regions. We are hoping that will interest Trading Standards as well—not just doing one at a time, but a very intense approach.

Q36 Jackie Doyle-Price: You have the template, haven't you, in case example 1 on page 21? If that has been a success, why has it not just been rolled out? The wheel is invented, so let's use it.

Lin Homer: I think that is right. You have to have the good case study before you can persuade others to

follow. It is fair to suggest that now we have a good case study, we should get more people involved. The habit of working, using all the powers we have—

Q37 Jackie Doyle-Price: This was launched in 2009, so you have had four years to get it rolled out.

Lin Homer: Yes, but you have to have a successful pilot. I think that is right. I have accepted the point that is made in the Report. There is more to do inland. There are some very good examples, but there is a need to keep up the pressure. The phrase you used was that you have got to make the risks seem sufficiently high on the people who are selling the small amounts and, bluntly, on the people who are buying. We were talking as we waited to come in. One of the illicit brands is among Britain's top-10 smoked brands. People need to understand that, and the risks they face. I think that is a fair criticism that we would accept going forward.

Q38 Meg Hillier: This crosses over with inland. What is your relationship like with the Garda in the Republic of Ireland? Have there been any particular issues there that impact on the illicit market in the UK, and your ability to tackle it?

Lin Homer: Generally, our relationship with Ireland is very good. You understand the common travel area better than many, Ms Hillier. I do not think we believe we have any difficulty in working that border. I have to say that I am not aware that it is one of the riskiest for us. As Charles said, we have to work within an environment where the level of profitability in the trade is such that the criminals will not be easily harried out of it. We see a rate of adaptation by the criminal gangs that requires us to match it if not better it. That will continue. This is not an area where you can anticipate that you will entirely drive the business out of profit.

We have to react as speedily as they do. Both Jennie and Charles mentioned the recent tendency. Because both the overseas fiscal officers and the officers at the ports have got very good at large seizures, what they are doing now is cascading—what in the business is called little and often. They take large amounts but push them through a number of small distributors, and we have to find ways to match that. Bluntly, if we do, they will change their mode of operation again. The level of profitability will keep them and us on our toes, I have no doubt.

Q39 Guto Bebb: On the level of profitability, I have an open question. If you look at figure 1, which is a map of Europe, do you ever feel despondent about your ability to deal with the issue? The profitability levels are so significant that it is difficult to see how you could ever curb smuggling to the UK totally. Have you any quick comments on that?

Lin Homer: No, I do not, because—this is an interesting fact—Lithuania, which has one of the cheapest cigarette prices, has the second biggest share of illicit cigarettes. Twenty-seven percent of its trade is illicit and, goodness only knows, you only have to pay £1.72 to buy it legally. It is not all about relative price. Wherever there is a difference in price, this trade will exist, so the reality is that we have got to

24 June 2013 HM Revenue and Customs and Border Force

work very collaboratively within Europe and with the rest of the world.

Q40 Chair: Is it not true that Italy and Spain are down to 1% illicit?

Lin Homer: It may be, and that is my point: it is not all about the absolute rate. Criminals will be as habit forming as others, and we have to disrupt those habits to make them regard the UK as a harder place to crack.

Q41 Guto Bebb: To take you back to the original figures, the Chair applauded the fact that there looks to be a good news story: the percentage of the cigarette market that is illicit has gone from 21% to 9%, according to the figures. On hand-rolling tobacco, it has gone from 61% to 38%. Indeed, it looks as though there was an improvement towards 2011 in that respect, but is there any evidence to show that the legal market for UK tobacco products increased from 2008 onwards? Some of the figures I have seen would indicate that the legal market increased at that point.

Lin Homer: I am not sure. My understanding is that there is an overall downwards trend. Therefore, I think their share of the market has increased, but I thought that absolute consumption was going down at such a rate that the absolute amount probably had not increased.

Q42 Guto Bebb: It would be interesting to look into those figures, because the figures I have seen indicate that the market grew by about £2 billion in the period of 2008–09.

Lin Homer: As profit or as sticks?

Guto Bebb: In terms of the legal UK market, £2 billion.

Chair: Turnover figure?

Guto Bebb: Yes. The reason I am asking that question is because firstly, if there has been growth in the size of the market, a percentage reduction is not quite as impressive as it looks. I would like to analyse that issue.

Secondly, there is an argument that fewer people have come back from abroad with a car boot full of cigarettes because they have not been going abroad. If that is the case, is there any evidence that we are moving away from somebody putting a few thousand cigarettes in their car to a situation where we have more organised crime involvement? That is the question I am coming to.

Chair: There are two questions in that.

Lin Homer: Absolutely, Chair. I think that the market overall is reducing, but I will be happy to write to you if I am wrong. Whether individual companies are either taking a bigger market share or putting their prices up and therefore being more profitable, I am less sighted on, I am afraid. But I think that figure 2 is an accurate representation of the illicit market share reducing. The overall consumption of tobacco is reducing at a rate that means that the legal share is not going up, but it is not going down as much as it would if that were not the case.

Q43 Chair: Figure 3 is a bit different, isn't it?

Lin Homer: Yes.

Jennie Granger: In relation to that, there has been a clear and very strong trend down in terms of cigarettes. HRT has been a little bit bumpier, and that may be what you are thinking about, because HRT in tonnes terms did go up in 2006. It had been at 9,000 tonnes in 2001, it went up in 2005–06 and it went up a little bit in 2010–11. That is one of the reasons why we have particular concern about genuine HRT being over-supplied to near European markets—

Q44 Chair: I am sorry to interrupt you on this, but, on figure 3, I know that it is industry figures, but it is up. That is the other thing.

Lin Homer: If I can try to finish the first question, I think that the cigarette production, as we understand it, has gone down in terms of sticks. So 44 million sticks of cigarettes in 2011–12, and 40 million in 2012–13 were home produced and about 4 million and 3 million imported. Overall, it is down—I think I am right in that.

On the second question, which we did not answer, organised criminals have always been at the heart of this and I think that they always will be. What they are getting cleverer at, which we have to tackle, is an ability to use a much more distributed network of people to support them. And, of course, the further away from being the caught they are, the bigger the risks they will impose on the small people.

On figure 3, an earlier recommendation made by the Committee was that it was simply not acceptable for our data to be so late, and this autumn we will be publishing two years in one. Our figures will now be six months old, not 18 months old. I think that that was a sensible thing to encourage us to do. So by the autumn we will have our own data to put alongside that. Obviously, we would want to track that. All I would say is that it is very early for us to assume whether the illicit share is going up again, but we should, in the autumn, have two years of data to finish off our lines on that.

Q45 Chair: Have you any view on where it is going? Is this right or wrong?

Lin Homer: We do not know. The trend is clearly downwards. There is some challenge to the way the industry picks up their stats, because they are predominantly city focused. They are predominantly done by measuring empty packets, which does not necessarily give the whole picture. They also, slightly oddly, count imported non-duty paid, although of course in their debate about how much they should manufacture, they accept that it is a legal trade to bring it back in, so there is something about what they define as illicit. They define it as licit when they export it, but then count it in their count, so you could see a growth in the amount people are bringing back for their own consumption or you could see a growth in the illicit market, and I do not think we will know until the autumn.

Q46 Guto Bebb: Just to clarify the question on organised crime, the question I specifically asked was: Do you think there is any evidence of an increase? I accept entirely that there will always be an involvement, but has there been a drop in private

smuggling for own use? To be specific, has there been any increase in organised crime involvement in your view?

Jennie Granger: I am not sure how it compares with 10 years ago, but we are certainly very concerned about organised crime's role in this: both the sophisticated large groups and also the smaller groups. So quite small operations, but some of them are transnational, and that has certainly been a trend in the last five or six years that can be measured all the way up the supply chain. Some of them do not operate only in tobacco; they will switch. The more we protect, the more they will switch to other things. As Lin said, it is an area that is difficult, and it is important that we continue to adapt as they adapt to the strategies we try.

To give you an idea, we have identified about 76 organised crime groups that are tobacco related, which HMRC is tracking and investigating.

Q47 Guto Bebb: On the differential, you have already touched upon one of my questions in relation to the fact that your figures seem to be 18 months behind the industry's figures, and you have explained why there are some differentials, but do you feel that your work has been affected in any way by the fact that your information flow seems to be out of date? Are you actually using that internally?

Lin Homer: Generally speaking, it is sensible for us to take trends over longer periods. Whether it is against us or for us, there is always a danger in looking at year on year movement, although I have to say the more up to date your figures can be, the more you can adapt quickly. This is not dissimilar to some of our challenges in the tax credit fraud and error position, where our data has traditionally been 18 months old. It is very reliable when you get it, and the methodology is very accurate, but you have lost quite a lot of time to react to it, so I think we are looking forward to its being more timely.

Jennie Granger: Absolutely. Importantly, the tax gap analysis gives us trend information at the time. As detailed in the Report, there is a whole range of measures that are also intended to give us information on how well they are targeting activities at the tactical level, so the revenue loss prevented figures and how close to source are important to understand how well seizure is working to disrupt, for example. The conviction rates and penalties as a deterrent effect, and the success rates we are getting in terms of how many prosecutions lead to convictions, are two examples of how effective our criminal investigations are. There is a basket of measures that are measuring at the tactical level all the time, and closer to real time. For us, the tax gap measurement is very important for understanding the trend and informing refreshers of the strategy, which is exactly what we are doing at the moment. Clearly, that will be very important information, as well as all the other intelligence we can gather in, to decide what we need to do next to respond.

Q48 Guto Bebb: So in short, there is a possibility that you can be more reactive if those figures are published at a more up-to-date level.

Jennie Granger: Yes, that is certainly the case, but you also have to have a bit of time for strategies to get traction as well. So there is always a balance between year-on-year analysis, but getting it closer to the end of the year is definitely very useful.

Q49 Guto Bebb: On the areas of investment—or not investment, depending on whether we now take the Chair's view—that you undertook, in terms of trying to identify how you could deal with some of the issues, the great success story seems to be the fiscal crime liaison officers used in many parts of Europe. Could you briefly explain how that actually works and where the best partnerships have been in place?

Lin Homer: These are the FCLOs—

Q50 Chair: Are they yours or yours?

Lin Homer: They get fed with information by Charles's—

Sir Charles Montgomery: We provide intelligence.

Jennie Granger: There are 29 fiscal crime liaison officers and between them, they cover 70 countries. Obviously, they are based in some and work in other regions. They really are unsung heroes. They are working with countries and building relationships, often in circumstances where we have to really try and establish what the common interest is to have an interest in seizing tobacco bound for the UK. They work out of high commissions and embassies. They are fed by intelligence from ourselves and Border Force colleagues, and indeed, are alongside Border Force colleagues in some cases. Their role is to work with the local law enforcement agencies and feed intelligence to them to facilitate seizures, and bring back intelligence to us on what is happening. We also have some of them placed at key places in Europe to work with law enforcement agencies as well. They really are terrific. We are very impressed with it.

Q51 Guto Bebb: In terms of being unsung heroes, we should make it clear that for a £4.6 million investment, they have stopped £226 million of lost tax, which is a return of £49 for every £1 invested. We should make that point clearly, because it is very impressive. Out of interest, one issue that has been touched on is the fact that consumer research has identified a couple of brands that consumers will talk about as their favourite—"My favourite cigarette is Jin Ling", or "It is Richman". My understanding is that some of those products come from the Russian enclave in Kaliningrad—I hope I have pronounced that properly. Have you any relationship with the Russian authorities, in terms of the fiscal crime liaison officers?

Chair: No, is being said.

Lin Homer: It would be fair to say that our relationships with all countries have their ups and downs, so even when we have them, we do not always keep them long term. To add to what Jennie said, our overseas officers—both Charles's and Jennie's—really work with only their professional skill at their behest, so they have to persuade the countries we are working alongside to use that country's laws. It is an extraordinary role and the success rate is very impressive.

24 June 2013 HM Revenue and Customs and Border Force

Jennie Granger: I do have an answer. Do you remember the 70 countries that they cover? The Lithuanian-based FCLO works with our Russian colleagues.

Q52 Chair: Is working with the Russian colleagues—

Jennie Granger: Does work, yes.

Q53 Guto Bebb: We can look forward to some success. I was wondering—they clearly do such a great job—to what extent and what sort of research has been undertaken to identify high-risk countries to work with. Obviously, if we can identify the countries from which the biggest amount of cigarettes are coming into the country, that would be beneficial.

Lin Homer: Yes.

Q54 Guto Bebb: So some research has been undertaken initially.

Lin Homer: Two thirds of the seizures now occur overseas, so that is some indication that the pattern of working is successful.

Q55 Chair: Do these guys sit in the embassy? I am trying to envisage it.

Lin Homer: No, they often sit in a port. They will often walk the port and be in the container ports.

Q56 Chair: Is it sensible to have them organised in that way? You have a little group of 29 trying to hack their own territory.

Lin Homer: They are trying to work co-operatively, first of all, with the country that they are in, and secondly, often with similar officials from other countries. So there is a network of overseas liaison officers that support each other. It is kind of front-line intelligence work really. Our experience is that it is quite tricky, but it is very successful.

Q57 Guto Bebb: This team seems to be working extremely well, but in your view, Sir Charles, are there any improvements that could be made—it is already a success story—in terms of identifying how it could be improved even further?

Sir Charles Montgomery: You have already touched on the area that I would want to improve, which is more prosecutions at the end of it, not just simply because of its benefit in terms of deterrence, but because those prosecutions tend to reveal intelligence about the criminal networks which themselves allow us to then cue, among others, the FCLOs to target their efforts overseas. That is an area we are already working on.

Q58 Chair: Why haven't there been that many?

Lin Homer: As we discussed earlier, there is a growth in prosecutions. We have this discussion with you on occasions. We have to balance out the more costly task of prosecuting people against the use of civil penalties and assessments. One area that we have perhaps not exploited as much as we could is some of the work Jennie's people have been undertaking on campaigns and taskforces. You can't prosecute every small-scale smuggler who crosses the border, but you

can occasionally have a focus of attention in an area that will make people feel the risk has changed.

Q59 Chair: I understand that this is all the stuff being manufactured abroad and then brought in. There is a project, and one of the five strands of your 2011 strategy was the supply chain control project, which was presumably focused on trying to get at this stuff and do more prosecutions, but it has completely failed because of legal problems. I didn't understand that.

Lin Homer: This was not aimed at prosecutions. It was aimed at working with the manufacturers and applying penalties to manufacturers if we could show that they were not managing their supply chain.

Chair: We will come back to manufacturers.

Q60 Guto Bebb: On manufacturers, one area of concern has always been the Benelux countries because they are close by and it is easy to go there and come back. To what extent have you been able to work with the industry in terms of reducing over-supply to countries such as Belgium and the Netherlands because my understanding is that there has been a reduction in supply to those countries from British companies? How has that relationship worked, and can it go any further?

Jennie Granger: Absolutely, it can. First, over the last two years we have been able to reduce by 20% what we believe is over-supply to some of the high-risk countries. Benelux is one of the areas we are particularly concerned about. The project in SR10 was aimed at gathering evidence to establish over-supply in those areas. It couldn't go ahead in its current form for legal reasons.

Q61 Chair: Why?

Jennie Granger: The actual idea was very clever. It was about test purchasing, but we cannot exercise our powers in another country in that way, so what we have done is to rescope that. We are still doing that project in practice in field right now and it has gathered some good evidence. We are working with those advisers and also with French customs who were also gathering evidence from their seizures. That has gone back to one of the tobacco manufacturers to analyse and test their supply chain.

Q62 Guto Bebb: To follow up that interesting point, is it therefore the case that when you planned this operation you thought you could do the test purchasing, but subsequently received legal advice that you could not?

Jennie Granger: It wasn't legal advice. When it went into tactical planning, the SR10 projects were put together very fast and obviously there were lessons to be learned both in the statement of benefits and in testing projects. We acknowledge that, but when we went into tactical planning we quickly realised that that was not going to be possible, but what we have done is to rescope it. It won't achieve the same benefits, but we think it will achieve around £100 million. We are being cautious because we have learned our lesson on that, but it is already producing good evidence and we have already packaged that for

tobacco manufacturer to check their supply chain controls.

Q63 Chris Heaton-Harris: My line of questioning was not contained within the report. I was a Member of the European Parliament for 10 years, and was in charge of the budget of the European Anti-Fraud Office—OLAF—as a rapporteur for a number of those years. OLAF’s big success has supposedly always been in tackling cigarette smuggling. The Report does not talk about OLAF, and you have not mentioned anything about your co-operation with OLAF and the things you do., but that seems to be exactly the sort of thing that you would escalate up to that European level to try to have them step in at that point. Can you tell me something about your relationship with OLAF?

Lin Homer: I cannot, I am afraid, but you are absolutely right and will know from your experience that you need to get the necessary bits of Europe talking to each other. It has certainly been the case that the legislative proposal that we put forward has run into difficulties.

I just wanted to—

Chris Heaton-Harris: Before you leave that subject—

Lin Homer: I just wanted to answer the previous question. Despite the fact that the specific ability to test purchase ran aground, the co-operative work that we have done with manufacturers through that has been very successful. There has been a 64% reduction in the over-supply to the high-risk countries that Mr Bebb mentioned. One of the challenges in utilising the legislation we have put in place is that it comes into effect if the manufacturers do not respond. In most of the areas that we have needed to work in, the response from the manufacturers has been very good. That has required us to work with European partners, and I am sure there will be working arrangements.

Q64 Chris Heaton-Harris: You will be pleased to know that the European Commission has a new strategy and a whole bunch of tough measures to combat the issue, about which I will ask you in a second. The European Commission’s “Representation in United Kingdom” website states: “The European Commission is already playing a significant role in combating cigarette smuggling in the UK through” OLAF”. It continues: “It also provides intelligence and helps coordinate criminal investigations.” It does not really sound like that from the answers that you are giving.

Lin Homer: There is nothing that a European body can do if our legislation is not effective. We did not design our legislation well enough. We have to accept that.

Q65 Chris Heaton-Harris: So it is our fault.

Lin Homer: We put into effect a piece of legislation that did not have the effect that we thought it would. I do not think that we are coming here and suggesting that we lack co-operation with our partners. Working with multiple partners is sometimes complex, but my experience of both Customs and Border Force has

been that we have had extremely good working relationships with European partners.

Q66 Chris Heaton-Harris: But this is one easy way of getting to what will soon be 27 other partners in one hit. In fact, they have a relationship with the Russian Federation and other countries and a pretty average track record of dealing with the companies themselves. I am just really surprised. The Report mentions integrating policy downwards, but your issue seems to be dealing with—you have 29 fiscal crime liaison officers working no doubt in some of the countries of the European Union. I can remember OLAF’s budget being a darn sight bigger than yours to tackle this particular problem. In fact, I was going to ask you a horrible question. How did you spend the £3.5 million you got from the Hercule II programme?

Lin Homer: I do not know the answer to that, but we will give you a note.

Q67 Chair: Does Jennie know the answer?

Jennie Granger: No.

Chair: What was that programme?

Q68 Chris Heaton-Harris: The Hercule II programme. It “co-finances initiatives aimed at protecting the EU’s financial interests”—the VAT part of the transaction. “Under the programme the UK has received around €3.5 million (£3m) for training and the purchase of technical equipment to fight against cigarette smuggling.”

Lin Homer: We have joint work going on with Europe all the time.

Q69 Chair: Does the Treasury know where that money went?

Marius Gallaher: I do not know the answer to that either.

Q70 Chris Heaton-Harris: I know that it is going on, so it is not that it is not going on; I am just slightly surprised that none of you here seem to know about it.

Lin Homer: I think the Report focuses on the things that we have not done well, not the things that we have—

Q71 Chris Heaton-Harris: Fair enough, but Mr Bebb raised a particular point about when something should have been escalated up—I hate saying that because I am a Eurosceptic and do not want them doing too much of this stuff—and should have gone to someone who is organised at that level. I would have liked to have thought that you would have been able to say, “We tried the European Anti-Fraud Office as well” and so on. I hate asking for notes, because I know that they involve a great deal of work for your officials.

Lin Homer: I am very happy to give you a note.

Q72 Chris Heaton-Harris: I am actually genuinely interested in the money that we receive, the co-operation that we have and the things that we ask them for.

Lin Homer: I did not mean to suggest that all of the Report was negative because it says some very

24 June 2013 HM Revenue and Customs and Border Force

positive things about us. But there is a legitimate criticism of us and the legislative fix we put in place to try to control the supply chain mechanisms better by undertaking test purchases. I was trying to illustrate the fact that despite that, despite our arrangement not proving as useful and easy to use, we have made significant progress in that area. It has largely been high co-operation with partners including European partners and the manufacturers. To some degree we have overcome the challenge that we created for ourselves in the legislative fix we gave ourselves.

Q73 Chris Heaton-Harris: The European Commission published on 7 June this year a new strategy to combat cigarette smuggling. What input did we have into that?

Lin Homer: We will have been involved significantly in that. For instance, one of the things we have achieved through negotiation with Europe, not entirely to their liking, is that we have put in place a lower indicative level of personal use tobacco—

Chair: Lin, answer the question.

Lin Homer: Well, that is—

Chair: If you don't know, it is better to say, "I don't know."

Q74 Chris Heaton-Harris: It is a bit of an unfair question because it is not in any of the papers. The point I am trying to get at, which I hope I have emphasised, is that there is something else. There is another dimension that goes on as well.

Chair: There is a load of money in this

Lin Homer: Yes.

Q75 Chris Heaton-Harris: I just wanted to know how much the four of you would know about it.

Lin Homer: Not loads when we have come to talk about this Report. But an example of the joint work we have done, and it has been really important to us in the smuggling, is that there is now a specific limit guidance on what is expected to be allowed to be brought back for personal use. Our input into that debate was to produce a much lower level than was desired by the rest of Europe. So that is a good example of co-operation within the sphere. There is a pressure for freedom of movement, of course, but there is an acceptance that there is an indicative limit of the number of cigarettes and the amount of HRT. If people go above that we are allowed to take a firmer line. That is something we agreed with Europe relatively recently and put in place. There is good co-operation. I don't think anything in the Report says there is not. I am happy to give you a note and I don't have all the facts of our European-wide co-operation at my fingertips. There was a European meeting about three weeks ago that I didn't manage to get to, despite being invited, and I am feeling rather guilty about now. But knowing my luck, I was probably attending a PAC meeting at the time.

Mr Bacon: That is no excuse.

Q76 Chris Heaton-Harris: The second part of this document is about your strategy. It has to link into what is going on upstream in the European markets, essentially where most of this stuff comes from. No

question, but just the point that the European Commission has just said that it is going to stub out cigarette smuggling with its brand new policies. If you could put in your note what our response to that is, it would be great.

Lin Homer: Yes, happily, and I have no doubt you will expect to see that reflected in our own review of strategy, which Charles and Jennie have referred to.

Q77 Fiona Mactaggart: I was just interested, Jennie, in your remark that the SR10 projects were developed very fast. It seems to me that that might be at the heart of some of the weaknesses of this in that you estimated that you were going to prevent the loss of £1.4 billion by £25 million investment. I am feeling anxious that too much of that was a bit, "Lick your finger, stick it in the air and hope". That might say something about the spending review process as well about your processes. I wondered whether you thought it was something to do with the spending review process as well as your processes.

Jennie Granger: First, on the spending review more generally, as you know, HMRC got a £919 million investment—[*Interruption.*] Sorry, £917 million, which encompasses many projects. Some are under and some are over in a particular year, but we are on target to achieve all that. So, although particular projects have not exceeded or have had to be cut back, overall we are keeping our promise to achieve the extra yield. The thing that these three projects have in common is that they are all innovative. One of the challenges for us when we are estimating benefits from an innovative project is that we do not have the history. Usually, for other compliance projects, we know the pattern over a number of years, so we can reasonably predict the outcome.

Q78 Fiona Mactaggart: I understand that, but you discovered that in law you could not do something that you had planned to do.

Jennie Granger: Yes.

Q79 Fiona Mactaggart: So it sounds to me like you had to whip things up rather fast and not very reflectively. If my impression has some accuracy to it, what does that tell us about the spending review process itself?

Jennie Granger: As I mentioned, we are on target to achieve or overachieve commitments on the spending review. I think that the planning process—

Q80 Chair: What do you mean, you are on track to achieve your commitments? Not the £1.4 billion.

Jennie Granger: The spending review has a lot more projects than this; this is a very small part of it. Overall, there is a £919 million investment—

Q81 Chair: I understand all that. However, on this one—we are only dealing with this bit today—the Report is absolutely clear that you are not going to achieve the £1.4 billion.

Lin Homer: We will achieve about £900 million against that £1.4 billion, we think.

Q82 Chair: Well, what have you achieved to date?

Lin Homer: About £328 million to the end of last year.

Q83 Chair: I just don't believe your £900 million.

Lin Homer: Well, you will have us back and we will talk about that in due course. I think that Fiona's point is well made. One of the things that we have to learn is to spend longer on the scoping in order to be more confident about delivery. I would say that since the beginning of this major investment programme—the beginning of SR10—quite a lot of work has been done to ensure that benefits are challenged both internally within HMRC and also on the big projects, through the role of the Major Projects Authority. I think that Lord Brown has just published a report that similarly says, "Spend longer on the scoping stage of a project, do not announce it so soon and be more sure that you know what you are doing." That would be fair. Two of the biggest projects of these five have delivered, and have over-delivered, so it is a mixed picture, rather than one in which none of them were well scoped, but your criticisms are well made.

Q84 Fiona Mactaggart: What I am trying to get at is this. One of the accusations sometimes levelled against this Committee is that we are against innovation. What I think I am hearing here is that innovation has higher risks when it is kind of rushed; when there is a bit of, "Oh look, there is some money that we could get our hands on if we invent some good projects here." I am not blaming HMRC and I am not saying that I know that that is what has happened, but it seems that one of the conclusions it might be interesting for us to come to from the Report is about how Departments should plan for innovation when it comes to the comprehensive spending review. There is a terrible risk to rush at an offer of possible money, if you bring money in, which is dangerous if it is not going to work. Thank goodness, two out of five have worked, but it may be reasonable for us to conclude that Departments need to take more care about innovative projects—for example, to ensure that they do not make pledges that they cannot actually deliver, which is what happened in one proposal here, although not in all of them, I accept.

Lin Homer: Yes, that is right. However, I think that some of those elements of procedure were in place. If you look at the mobile freight, which Charles referred to, it was announced, but it was put through a procedure to look at the scope and to consider it, and it was not started. So the system actually worked. In a way, it might have been better never to have announced it, but we did not start it and then decide that it did not work. That is slightly different to the supply chain one, where we thought we had come up with a clever wheeze, which was actually not as clever as we thought. You have to be careful not to apply the same rule. In the mobile freight one, the system worked, we assessed the project properly together, and we did not proceed with it because it would not have given us what we thought it would. I think you would say to us that it is better to stop a project at that stage than to keep going because we said we would, and pour money into something that will not deliver.

Q85 Chair: Can we go back to the figures? You said that in the first two years you got £300 million.

Lin Homer: £328 million has been delivered so far.

Q86 Chair: You are assuming in the next two years you will get another £600 million.

Lin Homer: Yes. Very broadly, the five projects were meant to deliver about £500 million on the FCLOs. That is on target and slightly over-delivering; we think all that will come in. We over-optimistically thought that the supply chain would be £500 million; we are only going to get £100 million, and that is where most of the loss will be. On criminal investigation, we thought that for a cost of £15 million we would get £250 million back; we expect to get that. We did not spend anything on mobile, and we won't get anything for it. We have spent about £500,000 on post, and we expect to get about £30 million back, but that has been slower than we expected. We have three different problems. On that one, we were probably optimistic about the pace at which we could bring the project on. Overall, four out of five of those projects will deliver returns, and they will deliver about 30:1 on the investment.

Q87 Chair: At the moment, you are predicting that by the end of this spending review period—by March 2015—you will have achieved an overall figure of—

Lin Homer: About £900 million, we think.

Q88 Chair: I am a bit sceptical about that. We shall wait and see.

Lin Homer: I'm sure that has booked me a meeting for April.

Q89 Guto Bebb: Can I go back to the issue of the returns very quickly? I talked about the fact that the crime liaison officers were a return of 49:1. I mentioned that figure to a former Treasury Minister. Out of interest, is there a target for return on investment for initiatives that you bring forward?

Lin Homer: I saw in a recent transcript that the Chairman quoted figures for the rate we get to the House of Lords on our behalf. I think it is 9:1 on average.

Q90 Guto Bebb: That is half what the Treasury Minister said to me.

Lin Homer: I am slightly sceptical about saying that there should be a certain level. If we go back to the low-level prosecutions we were talking about earlier, which Charles would like us to do more of, we get very low rates of return on something on that. However, to get the whole coverage we sometimes have to do things that have lower rates of return. My view—and we are trying to answer your questions better on this—is that we should know roughly the target of investment we are going for, and we should make a judgment. Overall, the country needs us to go for high return, but we should allow ourselves some space to do the smaller things with smaller returns where they have a deterrent or disruptive effect. I think Jennie's average is 11:1 over the whole of this investment. That covers 60 here and four there.

24 June 2013 HM Revenue and Customs and Border Force

Jennie Granger: In that context, this set of projects overall is already achieving 30:1. One of the ways to manage that risk while we plan better is to have a basket of projects that we can manage across.

Q91 Chair: Can I go back to the issue of the suppliers? I accept that we are in a better position than in 2002, but if you look at figure 11 and figure 12, it is creeping up. Figure 12 shows that hand-rolling tobacco is going up a lot. You have done no prosecutions of tobacco manufacturers, have you? There has not been one prosecution.

Lin Homer: No. We have given one warning. The way we have put the proposals into effect brings deterrents in if manufacturers don't work co-operatively with us. Although it has taken a lot of combined effort from various people, the reality is that over this period the manufacturers have worked with us. The interesting thing about figure 11 is that the genuine UK brands did show a significant reduction. We are beginning to see a little bit of creeping up on that, but we are seeing non-UK brands and counterfeit, the growth areas—

Q92 Chair: If you look at figure 12, it is worse.

Lin Homer: Hand-rolling tobacco is a much bigger challenge than cigarettes; I accept that. Two things are happening. Let me go back to Mr Bebb's question about manufacture. In a period when consumption is going down, hand-rolling tobacco has almost doubled—3,400 tonnes to 6,200 tonnes. Within that, it is even more difficult to counteract both counterfeit and the circular movement of something that has been imported and then comes back in. Hand-rolling tobacco is a real challenge.

Q93 Chair: And this demonstrates that it is the percentage of the market. You are saying that it is a bigger market because people smoke more cheaply. As a percentage of the market, the cigarette manufacturers are perhaps beginning to show the naughtiness that they showed at the beginning of the century. The Chancellor, who was a member of this Committee in 2002 when it interviewed the senior management of Imperial Tobacco, said to them, "I am afraid I am forced into the conclusion that you have lied to this Committee"—that sounds like me—"I am forced to the conclusion that you knew, when you were exporting cigarettes to these countries, particularly the ones I have focused on but there are others too, like Montenegro, these cigarettes were going to be or likely to be smuggled back into this country." I am worried that, particularly on the hand-rolling tobacco, the market is going up and the percentage coming from the big manufacturers is going up as a proportion.

Lin Homer: That is a growth industry, and therefore, yes, it is a big market. I think we have to continue working with them.

Q94 Chair: And prosecuting them occasionally?

Lin Homer: It has to be the end of the chain, but we should not be frightened of prosecuting them if that is what it takes. What we have to do is get more of a shared view about what the legitimate market size is.

My view is that some of the manufacturers are judging a legitimate market to include a sizable amount of hand-rolling tobacco that is exported to Europe, but will come back in with returning British holidaymakers. The level of their estimate about how much will legitimately be brought back in by returning British tourists is the area that we have to talk to them about.

Q95 Chair: And there is 240% in one country—I cannot remember which one. Am I right?

Paul Keane: Yes. HMRC's stats from 2011 said that for some categories of hand-rolling tobacco, it thought that the legitimate market—

Q96 Chair: Oh, it is at the bottom of that. Which countries are those?

Lin Homer: The high-risk countries for us are Benelux and Spain in terms of exports and coming back, and that is because a lot of British tourists go there.

Chair: That is back to working with Europe.

Q97 Guto Bebb: Just to clarify, in figures 11 and 12, we can see there has been an uptake in the genuine UK brands of hand-rolling tobacco, but in terms of the figures I can see here, 97% of cigarettes for the past three years have been either illicit or non-UK brands.

Lin Homer: Yes.

Q98 Guto Bebb: So it is important to keep the issue in context in terms of revenue loss. Primarily, we are looking at either illicit or non-UK brands coming into the country.

Lin Homer: Absolutely. Therefore, in those areas the work we have done with manufacturers has been good. Just going back to the Chair's point about our relationship with them, I think we have seen manufacturers of cigarettes work more closely with us to get the level of supply nearer to what it should be, and I do not think we have succeeded with hand-rolling tobacco.

Q99 Guto Bebb: This was the line of questioning that I wanted to finish with. You mentioned that the work you have done with the tobacco manufacturers in Europe has been quite positive. As a result of this meeting, I had two briefings from small business organisations, such as the Association of Convenience Stores and so forth, and their concern is that while that relationship is working at a high level in terms of trying to stop stuff coming into the country, there seems to be a reluctance to work with each other, whether it is trading standards working with HMRC or trading standards working with the industry in terms of dealing with issues in the UK. Trading standards especially was highlighted as an area where there has been a significant level of cuts, and yet there is a reluctance to work on this in a co-operative manner. Is that the case?

Jennie Granger: We certainly would not say "unco-operative", but we do believe, as we said earlier, that if we take a campaigning approach to this, for trading standards, local authorities and others there will be a

strong interest in doing this, because it will allow us to target a particular area and make sure that we get the best cases for everyone. We are keen to work with them in relation to this. Also with local authorities and DWP, where we identified people who are also abusing the benefits systems. Anything we can do that helps disrupt the hot spots will be important, but we must do it on a targeted basis.

One of the things that challenges all of us is that, if you dispel that activity and do a little bit everywhere it is difficult to be able to have an impact, but it is also extremely resource intensive. We think this more strategic process will be quite attractive to everyone. We are certainly happy and keen to be working with them.

Q100 Guto Bebb: Specifically, the issue that was raised with me is that some of the expertise that can be brought to bear on this issue has been developed by the industry. The Association of Convenience Stores, for example, is saying that in many cases local authorities will refuse to engage with the industry, even though it might have the expertise that trading standards does not have. In view of the fact that you are saying that your relationship with the industry, in terms of dealing with issues in Europe, has been positive, should that issue be addressed, especially in view of the lack of resources available to trading standards?

Lin Homer: I am happy for us to take away the challenge that asks us whether can we use our existing working relationships to improve a broader multi-agency response. I do not think we have ourselves perceived a difficulty in working with trading standards, but inevitably in this field there are some conflicts of interest, because it is generally recognised that smoking is bad for people, and there will be lots of local authorities spending a great deal of time trying to stop people smoking at all. Therefore they may feel, at a local level, that they have to find the way in.

The case study captured in the Report—I have forgotten which page it is on, but Paul will remind me—

Paul Keane: Page 21.

Lin Homer: In that case study we have aligned local working, primed working and health working, so that the overall message to the community is, “These people are cheating us of tax and they are damaging your health, and we are all working collectively.” I think Fiona Mactaggart put it to us that if we started that in 2009, let us do more of that. I would have thought that is an area we should go to, and it would partly help resolve those conflicts.

Q101 Mr Bacon: On non-UK brands, in figure 11—I am talking about cigarettes at the moment, rather than hand-rolling tobacco—the green section showing non-UK brands is obviously the predominant one in the bar chart. When we speak of non-UK brands, these are global companies. Are they brands that are produced by manufacturers based overseas? Is that how you classify them?

Lin Homer: Yes. The counterfeit will be things masquerading as.

Q102 Mr Bacon: They could be masquerading as anything.

Lin Homer: Yes. The green—

Mr Bacon: Pale green.

Lin Homer: Yes. The pale green will be those which are competing—Jin Ling was the one that was mentioned; they may be produced in any part of the world, imported into a part of Europe and then, potentially, moved across borders. Those will be a much wider range than—if I can put it that way—the big, recognisable multinationals.

Q103 Mr Bacon: How many different brands are we talking about in total?

Lin Homer: Gosh. I would say hundreds.

Q104 Mr Bacon: Is that right? I am not going to ask you to send me a list if it is many hundreds. Is it a manageable amount? I want to understand this in more—

Lin Homer: There are four big manufacturers based in the UK, two of whom manufacture here and two of whom only import; those are the big four you would all recognise.

Q105 Mr Bacon: Can you remind us who those are?

Lin Homer: Imperial Tobacco, Japan Tobacco—I do not know if it is Incorporated, or Industries—BAT and Philip Morris.

Q106 Mr Bacon: Of those four, Imperial, Japan Tobacco, BAT—the old British American Tobacco, as was—and Philip Morris, which counts in the dark green? Or none of them.

Lin Homer: They all count in the dark green.

Q107 Mr Bacon: They all count in the dark green. Okay.

Lin Homer: Yes. But they will also be importing—

Mr Bacon: Other brands.

Lin Homer: No. They will all be importing to other parts of Europe for that market in ways that might arrive here.

Q108 Mr Bacon: In other words, non-UK brands.

Lin Homer: Yes.

Q109 Mr Bacon: So they might feature in the pale green as well.

Lin Homer: Yes.

Q110 Mr Bacon: Earlier, you mentioned UK legitimate product that goes overseas and makes its way back here, so to speak. I take it you are talking about stuff that leaves bonded warehouses and goes overseas without the duty being paid because it is intended for the overseas market.

Lin Homer: It is destined. Yes. Exactly the same as alcohol.

Q111 Mr Bacon: And it creeps its way back. Do you do what was being done years ago by Customs and Excise? It was called “letting loads run”. Miss Granger is nodding.

24 June 2013 HM Revenue and Customs and Border Force

Lin Homer: To catch a big criminal, we will not intercept absolutely everything we find, yes.

Q112 Mr Bacon: It got out of hand a few years ago under Customs and Excise, didn't it? In one bonded warehouse, £340 million-worth of tobacco ended up going abroad. What controls do you have on it now?

Lin Homer: Do you mean in terms of its going overseas?

Q113 Mr Bacon: Yes. I am talking about the amount that is allowed to run before you intercept.

Lin Homer: Sorry, I am still not sure I know what you mean. There is a legitimate amount of tobacco that leaves the country for sale overseas. That is exactly the same as the conversation we had with you on alcohol. The supply chain precautions we put in place allow us to bear down more on the manufacturer and make them prove to our satisfaction that it is a legitimate market. That is an area of work where I was saying that on cigarettes we think we have had a significant impact—a 64% reduction in the supply of legitimate tobacco to high-risk countries, where we think it was being exported only to come back in. In addition, there is legitimate supply that then gets smuggled back in, rather than brought back in for personal use. We work with manufacturers on that. I thought you were asking whether we sometimes watch some of that coming back in and do not intercept it at the first point.

Mr Bacon: Yes.

Lin Homer: Of course.

Q114 Mr Bacon: Or even when it is leaving the country, but does not actually leave the country; it goes down the M20 towards the ports, turns left and disappears before it has even left the UK, which is what was happening. That is also letting loads run, isn't it?

Lin Homer: Yes. We have a range of projects. Track and trace is one of those where we have increasingly worked with manufacturers to improve the traceability of their product at every stage. I will not say that it is perfect, but it is an area where the work we have done with the manufacturers has moved us forward.

Q115 Mr Bacon: I have one quick, final question, because I know the Chair wants to bring in someone else. When one of your predecessors gave evidence many years ago, Imperial Tobacco was pointed out as an example of one of the manufacturers that was not co-operating while the others were, and as a result, we had the chief executive of Imperial Tobacco in. Do you think that there is a comparable situation now, in which you see much more co-operation from most of the manufacturers than from others, or are they all being equally co-operative?

Lin Homer: I think we would say that there is more work to be done with some than others, but I take a different view to my predecessor: I do not think it is for me to name names of those taxpayers to you. We have this debate quite regularly.

Q116 Mr Bacon: In fact, we ended up doing it in private session with Mr Broadbent, who I think was

the chairman of Customs and Excise at the time, because he was initially unwilling to do it in public, but it subsequently came out that it was done. The degree is really the degree of the lack of co-operation; if the difference between the behaviour of most of the manufacturers and some of them is sufficiently marked, it might be something that the Committee should look at further. On the other hand, if they are all more or less co-operating, maybe not.

Q117 Chair: Perhaps you could send us a private note, Lin.

Lin Homer: We should be prepared to move into the regime we have given ourselves, if we feel that one of them is not responding as well.

Q118 Chair: Would you be prepared to send us a private note on it?

Lin Homer: I would be prepared to give you a briefing note on our experience. It may still not name names as you would like, but—

Chair: This is not covered by legislation like taxpayer confidentiality. Chris has a question, and I want to raise a final issue with you.

Q119 Chris Heaton-Harris: I have a final, very quick question. You were talking earlier about what you do when you find these people smuggling cigarettes. You talked about prosecutions, civil penalties and then assessments. I wondered what an assessment was.

Jennie Granger: An assessment is an “assessment for duty” and a penalty can be assessed on top of that assessment, if there has been wrongdoing, so there is a behavioural penalty as well that can be assessed. It has filled a gap for us because for very low-level amounts coming across the border, in the past the only option was confiscation. When Border Force carries out a seizure, we are now having it referred to some of our normal investigators, as opposed to our criminal investigators, to look at assessment and penalty provision. It is intended to discourage small smuggling.

Q120 Chris Heaton-Harris: What would be a typical assessment?

Jennie Granger: Sorry, but I do not have that information.

Lin Homer: You would get the duty that is due anyway, and then a penalty.

Q121 Chris Heaton-Harris: So you confiscate and charge the duty—

Lin Homer: And a penalty.

Jennie Granger: The penalty can be up to 100% of the duty, although obviously we do not do 100% in every case.

Q122 Chris Heaton-Harris: You said something about behavioural, too.

Jennie Granger: That is the penalty. It is for deliberate intention to smuggle.²

Q123 Mr Bacon: What do you do with the stuff you confiscate? Do you destroy it?

Chair: I hope so.

Lin Homer: We used to.

Q124 Mr Bacon: Wouldn't you make more money if you sold it?

Lin Homer: That would not be universally regarded as a good thing.

Q125 Chair: No, because the Department of Health would have to spend lots of money looking after ill people.

Lin, I am sorry to do this to you, but since we last met Mr Hartnett has joined Deloitte for, I understand, one day a week. The Committee has a right to ask some of these questions, but we will see how far you can go. Was Deloitte the preferred facilitator of Mr Hartnett when he was head of tax in HMRC?

Lin Homer: I don't entirely understand.

Chair: When they were trying to reach agreement with the large companies, there was a facilitator and the suggestion is that Deloitte was the preferred facilitator of Mr Hartnett when he was head of tax, certainly in one or two deals that some members of the Committee have raised with you before.

Lin Homer: No. We have a separation—

Q126 Chair: Now you do, but I am asking about the past. When agreements were reached in the past, particularly with the large companies, was Deloitte the preferred facilitator?

Lin Homer: Not to my knowledge, and I do not see any evidence to suggest that they were playing either a preferred or a significant role in our large disputes.

Q127 Mr Bacon: Really?

Lin Homer: Yes.

Q128 Mr Bacon: Vodafone went for a meeting with HMRC, and when they got there they found Mr Cruickshank from Deloitte was in the room. As a result of that meeting, Vodafone hired him as their adviser—so Mr Cruickshank from Deloitte ended up working for Vodafone as an adviser, and Vodafone became, as it were, Mr Cruickshank's client. That happened because of an encounter that first took place when Vodafone walked into an HMRC office for a meeting and Mr Cruickshank was there. Don't you think that was significant?

Lin Homer: You know that I am not at liberty to discuss individual arrangements, but I am confident from what I have seen that Deloitte were not playing either a preferred or a significant role in our business, as with all of the big four, with which we have dealings all of the time.

Q129 Nick Smith: Do you know how many times Mr Cruickshank and Mr Hartnett met officially in, say, the three years before Mr Hartnett's departure?

Lin Homer: No. I think he has answered a number of those questions, and you have seen evidence of his meetings with external companies. We still publish that, and I could not add anything to what we have put into the public domain.

Q130 Chair: There are various things. You may not have this on the top of your brain, but it would be useful if you could send us a note on it. On the tax settlements in excess of £50 million entered into by HMRC before you arrived, and between 2006 and 2011, when Mr Hartnett departed, could you tell us how often advice from Deloitte was part of the mix in reaching those settlements?

Lin Homer: I am happy to seek to give you a note, as far as I can, of any large settlements where we had an adviser involved. Obviously what you will understand, and I do not know whether we can entirely separate it, is that in many of those big cases one of the big four will be in the room. The question is whether they are in the room as an adviser. You had a hearing recently where you had one of the big four sitting next to the chief executive of a multinational. Most of the big companies will use a tax adviser, and many of them will use the big four. I would say that one of the big four will be in the room for many of those discussions. That is a slightly different question from whether—

Q131 Chair: So can you tell us how often—

Lin Homer: Not off the top of my head, but I am happy to write to you on that.

Q132 Fiona Mactaggart: There was an answer to a parliamentary question by David Davies, who some years ago had your role, which said that Mr Cruickshank and Mr Hartnett met 48 times in the last three years.

Lin Homer: I think it has been answered in the public domain, yes.

Nick Smith: I am trying to work out exactly how often they have met. It is 48 times.

Q133 Chair: What I would like the answer to—tell me if you cannot give it—is how often in those five years to 2006, in all the settlements over £50 million, Deloitte was present, supporting either you or the company negotiating with you.

Lin Homer: I will look at what I can give you. We may not have as rich a set of information as you would like. I do not know whether we always record—

Q134 Chair: I am not asking you to identify particular companies; it is just the—

Lin Homer: But I do not know whether we always record the adviser when we are in the room with a company. My point is that they will often be there, but I am happy to try to give you advice about the number of times we took them into the room.

² Note by witness: Excise civil penalties become applicable when a person "handles" goods subject to unpaid excise duty. There is no requirement to prove a deliberate intention to smuggle. However, behaviour can be taken into account in calculating the amount of a penalty.

24 June 2013 HM Revenue and Customs and Border Force

Q135 Mr Bacon: But presumably you know which advisers you paid and how much money you paid them.

Lin Homer: Not off the top of my head.

Q136 Mr Bacon: No, but you will be able to provide a record.

Lin Homer: Yes.

Q137 Mr Bacon: I know that HMRC's record keeping is not always what it should be. We found that out when HMRC did not take a note of Mr Hartnett's meeting with Goldman Sachs. They relied on Goldman Sachs's note. What I am saying is that even if you do not know in which particular meeting an adviser was present—which surprises me, frankly—presumably you do know how much money you spent on each adviser being paid by you to advise HMRC. You do know that?

Lin Homer: I have said that I will give you a note on that. I do not know it off the top of my head—

Q138 Mr Bacon: I am not suggesting that you know it off the top of your head. I am suggesting that you have records that show how much money you as HMRC spent on receiving advice from each of your advisers.

Lin Homer: Yes.

Q139 Mr Bacon: And they, as advisers, would be able to tell you when they were present giving you advice.

Lin Homer: And I have said I will give you a note. We are straining to agree, Mr Bacon.

Q140 Mr Bacon: Good. It is wonderful when we are in violent agreement. What I am really getting at, and I think the Chair was alluding to this as well, is that what is really of interest are those occasions when you were buying advice from a firm such as Deloitte and the same firm was also selling its advice to a large taxpayer such as Vodafone, to take one example. That is what we want to understand.

Lin Homer: I understand that. I will endeavour to give you some information on that if I can. The point I was making is that I am not sure—I will ask—whether we always record the adviser who is sitting in a room with a company. It may be that we did—

Q141 Mr Bacon: No, particularly if you were turning out to be the marriage broker who introduced the adviser to the company—

Lin Homer: That is an assertion which I do not accept, Mr Bacon. You have made that assertion. I have no evidence to support it.

Q142 Chair: You have no evidence that it is not true.

Lin Homer: No, but I am not prepared to have it said as fact.

Q143 Chair: Can I ask a more specific question? While I am grateful that you are going to provide the information in relation to HMRC, I would also be interested, if you have it—I accept that you might not, and I am not asking for information in relation to

particular companies—to know how often Deloitte was also present supporting companies. You will clearly know how often they were present supporting HMRC, but it would also be interesting to know, if you have it recorded, how often they were present supporting particular companies.

Lin Homer: I am happy to see what depth of information we can give you.

Q144 Chair: Can I then check two other things? This is where we have more detail. The NAO looked at 27 cases for the 2010–11 accounts, which is where we started getting involved, before your time. Do we know how often in those cases Deloitte was there supporting either HMRC or particular companies?

Paul Keane: I am not sure that I have that information.

Q145 Chair: Will you?

Lin Homer: I will check. It is the same—

Q146 Chair: Can you both check?

Lin Homer: Yes.

Q147 Chair: Again, without naming a company, can we know how often Deloitte was present supporting either yourselves or a company? The same goes for the five settlements that we looked at in detail. Do we know how often Deloitte was the adviser in those five settlements?

Lin Homer: Not off the top of my head.

Q148 Chair: Again, in these latter two cases, both the NAO and you may have some information that might help the Committee. It would be really helpful and would possibly save us having a hearing if you could provide that information to us in writing. I am sorry to raise that matter at the end, but it is the first occasion we have had.

Q149 Chris Heaton-Harris: Would there have been any occasion when you used the same big four accountants as the company that was in the room negotiating with you?

Lin Homer: I am not a tax expert. I don't sit in those settlements myself. I am not aware of how frequently we use advisers to advise us in those circumstances. I am aware, because I sign off some of the expenditure, that there are occasions when we use particular deep experts for an area of law, but I will have to ask the wider question about whether, when and why we would sit a big four adviser alongside us to negotiate. The answer may be never—I don't know. I have agreed to look and to give you what information I have, but I do not have that knowledge personally. And although you may think otherwise, I try to come here to be helpful and to tell the truth.

Q150 Mr Bacon: May I come back on this issue of a marriage broker? One of the things you said was that you were not prepared to have it said as fact that this occurred. What I actually said was, "If you were acting as a marriage broker," and the point I wanted to make was that it ought to be ascertainable—probably from things such as e-mail records, to which

24 June 2013 HM Revenue and Customs and Border Force

the NAO would have statutory access if it chose to go and look at them—the extent to which this might have occurred and the extent to which, for example, Mr Cruickshank or perhaps other advisers, were in a room, first, and that potential taxpaying companies were there afterwards. That ought to be find-outable, shouldn't it?

Lin Homer: Absolutely. There is a question about the scale of information that we can find, and readily. I do not think that this is an area where the NAO will have to insist; if we have information that helps me to answer your query, I will be happy to do it. I just do not have it at my fingertips and I think it is unwise to speculate when I don't know whether we ever do it, whether we sometimes do it or whether we regularly do it—

Q151 Mr Bacon: I was not asking you to have all the information at your fingertips; I was asking you to go back and root around in the shed.

Lin Homer: I am very happy to; I will give you as full detail—it is late this year, but it occurs to me that we are about to publish our tax assurance report. You know that we have established a role separation—that is in relation to Edward Troup's role—and it occurs to me that this may be something that we should report on in the future. We haven't in this first six months—I don't think—but it may well be that it is something that we could add. One of the questions that we were going to ask you in sharing the first six months with you was, "What do you think of that and what else would you add?" If this is a valuable piece of information for the Committee and for Parliament, we could seek to make that a regular part of the reporting.

Chair: That would be very helpful, I think. Thank you very much indeed for that session.

Written evidence from HM Revenue and Customs

At the end of yesterday's hearing you asked a series of questions about the role of particular advisers in discussions between HMRC and taxpayers.

To ensure quick clarification on one of your main questions, I am writing to confirm that it is not HMRC's practice to engage the Big Four accountancy firms to act for us in any cases with a taxpayer. A trawl of senior officials involved in large disputes today has confirmed that none has any recollection of any case where any of the Big Four were engaged for tax advice to HMRC.

I will write again in due course in response to the other points on which I promised follow up notes during the hearing. With regard to the Committee's questions about how often particular advisers were engaged by taxpayers to support them, I hope to be able to write again soon with information relating to the 27 cases that were selected for review by the National Audit Office. However, it would take very considerable time and effort to try to gather similar information for all settlements over £50 million across the whole period the Committee is interested in, and I therefore plan to limit our further work to the 27 cases.

Lin Homer
Chief Executive

27 June 2013

Written evidence from HM Treasury

Q12 Chair: Will the Treasury know? When we look at cuts across Government, it is slightly irritating, after being sold a story about increased expenditure on tobacco smuggling, which we all welcome, to find that, actually, it isn't an increase because they have taken their cut and you have got a bit of dosh back but it isn't quite as much as there was. And then we find that they are spending money that was spent before anyway but under the Department of Health budget. I know it is not a huge amount, but there needs to be a bit of honesty about where our tax money is going.

Marius Gallaher: We will have to give you a note on that.

Chair: You will have to give us a note?

Marius Gallaher: Yes, because I don't know the answer to the question.

Chair: Okay. The note should say whether there was a cut in the Department of Health budget.

Marius Gallaher: I know where you are coming from. Yes.

TREASURY RESPONSE

For the financial year 2010–11, the Department of Health contributed £0.5 million to the expansion of HM Revenue and Customs' fiscal crime liaison officer (FCLo) network. This amount funded an additional six posts

and associated costs for the network. However, Ministers subsequently decided that funding for the whole of the expanded programme should be funded from HMRC's budget from 2011–12 onwards.

Due to HMRC's reinvestment programme, announced at the 2010 Spending Review, the net effect has been to maintain funding for the FCLO network, through a larger contribution from within HMRC's total budget. The Department of Health's budget has not been changed as a result.

Written evidence from HM Revenue and Customs

Q63 Chris Heaton-Harris: *Can you tell me something about your relationship with OLAF?*

HMRC engages with OLAF at both an operational and a strategic level. However, OLAF do not currently have competence to initiate their own criminal investigations within Member States. This defines the possible avenues of cooperation with OLAF.

At an operational level, HMRC already has established strong relationships with Law Enforcement agencies in other Member States, EUROPOL and OLAF, through its network of Fiscal Crime Liaison Officers (FCLOs), who primarily work on a bi-lateral basis. The NAO has recognised the effectiveness of this approach in their report, which is delivering real results for the UK

HMRC also recognises the role that OLAF has played in tackling cigarette smuggling, notably on the over-supply of genuine product, and cooperates with them on matters of mutual interest in this sphere.

HMRC has access and influence in most of the key priority countries where we assess we need support in our own investigations. The NAO report reflects this and we are considering further investment to strengthen the network and its flexibility to respond ever more effectively to shifts and changes in the threat. Our preferred partners overseas are those customs authorities with criminal justice powers, police agencies, other law enforcement and intelligence agencies. Many of these agencies have no co-operation with OLAF overseas.

Q66 Chris Heaton-Harris: *How did you spend the £3.5 million you got from the Hercule II programme?*

Both HMRC and UK Border Force have accessed grants under the Hercule II programme, which have been for a combination of technical assistance and training, however the amounts are small. This money has funded the provision of scanners at key postal hubs for Border Force and the training has taken the form of joint overseas operations targeting containers of illicit cigarettes. This has served to both exchange best practice with overseas authorities and strengthen key relationships.

Just under 94% of the €3.5 million awarded to the UK under Hercules II was spent on contracts concluded directly between the Commission and companies or institutions located in the UK for the provision of IT-support. The IT-support consists of (access to) databases that contain relevant information, for example on ship movements or company data. The information in these databases is made available to national and regional authorities in the Member States. Neither HMRC nor Border Force were directly engaged in these programmes. Over the last two years, HMRC has been awarded only €11,000 under Hercule II.

Q73 Chris Heaton-Harris: *The European Commission published on 7 June this year a new strategy to combat cigarette smuggling. What input did we have into that?*

The EU strategy for tackling cigarette smuggling, covers a range of measures to further tackle the illicit tobacco trade. HMRC had informal discussions with the Commission ahead of publication as part of our regular engagement with OLAF and made a number of general observations and specific comments on the strategy, in the context of the UK illicit market.

The strategy will be negotiated over the coming months and we will be working closely with the EU Commission and member states on the detail of these proposals to ensure that the actions complement and add value to our UK strategy.

The proposed strategy emphasises the importance of signing and implementing the Illicit Trade Protocol to the Framework Convention on Tobacco Control. HMRC has been heavily involved in the negotiations to develop an effective Protocol. The UK supports the Protocol and we are working towards the UK signing it later in 2013. Many of its requirements, such as registration of tobacco manufacturers, have been in place in the UK for many years and we are working towards full implementation of the other requirements.

The strategy is subject to Parliamentary scrutiny procedures and we have prepared an Explanatory Memorandum to brief Parliament on the Commission's proposals and their implications.

Q115 Mr Bacon: *Do you think that there is a comparable situation now, in which you see much more co-operation from most of the manufacturers than from others, or are they all being equally co-operative?*

Our approach to the largest businesses is to invest in direct engagement with them so that we have in-depth knowledge of their business model, business and tax issues, appetite for risk in tax planning, and internal governance. Our Customer Relationship Managers (CRMs) are experienced tax professionals, trained to the

highest levels of tax compliance, who lead teams of our most highly skilled specialists to man mark these complex and high-risk customers.

In addition, for the tobacco companies, we have appointed a dedicated Tobacco Supply Chain Manager.

Of the four main UK-based tobacco companies, (for the purpose of this paper referred to as: “W”, “X”, “Y” and “Z”):

- Our supply chain activity is targeted primarily towards UK-sensitive brands of hand-rolling tobacco where we can have the biggest impact. “W” doesn’t sell any HRT in the UK and has a relatively small share of the UK cigarette market. HMRC engagement on SC controls has therefore been limited to a small number of occasions, where cooperation has been good.
- Of the remaining three, two (“X” and “Y”) have well organised Anti-Illicit teams containing senior company personnel with whom HMRC are engaged. “Z” similarly has an organised Anti-Illicit Team but it has a poorer recent record of engagement with HMRC. We have raised our concerns about this with senior personnel, and are closely monitoring their response.
- A key component in supporting an effective supply chain policy and responding constructively to HMRC challenges about tobacco seizures is “Track & Trace” technology. “X” has had a system in place for some years. “Y” plans to bring in their system in July 2013, as a result of HMRC pressure. “Z” has not notified us of any firm implementation plans to address specific UK concerns, though it has a legally binding commitment to introduce track and trace technology in the EU Cooperation Agreement.
- HMRC notifies the tobacco companies of all seizures of their product above specified quantities (=>50kg hand-rolling tobacco and => 100,000 cigarette sticks). Responses vary. “X” is proactive and promptly provides investigative reports. “Y”’s responses have improved in recent months but there is still considerable room for improvement. “Z” is very slow in responding and provides very little useful information. We have raised this issue at senior level in the company.
- In 2010, following evidence provided by an HMRC investigation, all three companies reduced hand-rolling tobacco supplies to Luxembourg. “X” continues to curtail supplies when there is clear evidence to support action. “Y” and “Z” do not reduce supplies unless there is specific evidence of outlets involved in selling excess quantities. “Y” maintains it is not legally allowed to reduce supplies because of EU competition laws.
- Under the supply chain legislation all the tobacco companies are required to have an effective “supply chain policy”. These are currently being audited by specialists in our Large Business Service to establish whether statutory obligations are being met.
- Under the SC legislation tobacco manufacturers are required to consider the level of legitimate demand for their products in each market supplied. On request, “X” and “Y” have provided assessments of legitimate demand for UK-sensitive brands of hand-rolling tobacco supplied to specified high-risk markets of Belgium and Luxembourg. Our analysts have assessed the industry estimates and do not consider them to be realistic. “Z” has not yet provided HMRC with a BeLux market assessment for their hand-rolling tobacco product.

8 July 2013

Written evidence from HM Revenue and Customs

At the hearing on 24 June the Committee asked us about the involvement of Deloitte LLP in the resolution of large tax disputes. In particular, you asked about tax settlements in excess of £50 million during the period from 2006 to the date of Mr Hartnett’s retirement, about the 27 settlements that were reviewed by the National Audit Office in their 2011 report on tax disputes and about the five cases that Sir Andrew Park reviewed for NAO’s report of June 2012.

As I explained in my letter of 25 June, it is not HMRC’s practice to engage the Big Four accountancy firms to act for us in any cases with a taxpayer. A trawl of senior officials involved in large disputes has confirmed that none has any recollection of any case where any of the Big Four were engaged for tax advice to HMRC. The following information therefore refers to situations in which Deloitte or other advisers have acted for the taxpayer in connection with the resolution of disputes.

We do not advise any large companies on what advisor they should use. For much of the day-to-day dealings that the largest corporates have with HMRC, they use in-house tax teams. It is our experience that they use other professional advisers (accountants and solicitors) on tax matters in a flexible way, bringing in different firms to advise on particular aspects of their tax affairs (such as payroll or VAT, for example) or to advise them on particularly complex issues, both at the planning stage and to help them resolve disputes.

These advisers may be present or take a leading role in discussions with HMRC, or they may simply advise the company ‘behind the scenes’ without us being aware of it or having any direct interaction with them. There is therefore no single model. I would also emphasise the fact that most contact and discussion, whether with

in-house teams or independent professional firms, is handled by our Customer Relationship Managers (CRMs) and their tax specialists.

To enable us to manage our work, case teams record on our systems the advisers who are currently authorised to deal with HMRC and keep contemporaneous notes in our files of who was involved in particular discussions. However, we have not needed to maintain a central historical record of all agents who have been authorised to act over the period you have asked about. To get that information we would have to ask our CRMs to go back through individual case papers to establish who was acting for the taxpayer at the time in relation to a particular issue.

You asked for information regarding Deloitte's involvement in settlements over £50 million. Between 2006 and March 2012, 125 issues with value greater than £50 million were resolved in our Large Business Service (Mr Hartnett retired in July 2012). For the reasons I have already explained, the information you requested is not available as it would take very considerable time and effort to try to gather information for all of these issues across the whole period the Committee is interested in.

For the 27 settlements that NAO reviewed in their report on tax disputes of July 2011, we asked CRMs to report whether any professional firm (eg accountancy or law firm) acted on behalf of or advised the customer at the time of settlement. They report that Deloitte acted as advisers to the taxpayer in 8 cases, either alone or in conjunction with other professional advisers.

I cannot give you any more details about the five cases that Sir Andrew Park reviewed, which are included in the 27 mentioned above. In situations like this where small numbers are involved, we are not able to disclose the actual number where this would potentially disclose information in breach of our legal obligation to protect the confidentiality of information relating to HMRC's customers.

Lin Homer
Chief Executive

4 July 2013
