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Home Affairs Committee

Tobacco smuggling

First Report of Session 2014–15

Report, together with formal minutes and oral evidence

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Home Affairs Committee

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Key Facts

- *Tackling Tobacco Smuggling—building on our successes: A renewed strategy for HM Revenue and Customs and the UK Border Agency* was published in April 2011. Within the joint strategy, HMRC has overall responsibility for delivery, while Border Force is responsible for the seizure of illicit tobacco at the border.
- HMRC estimates that in 2012–13, duty was not paid on around 9% of cigarettes and around 36% of all hand-rolling tobacco smoked in the UK, with associated revenue losses of approximately £2 billion.
- The National Audit Office’s June 2013 review, *Progress in Tackling Tobacco Smuggling*, concluded that HMRC’s strategy was logical and set out a wide range of complementary measures to tackle the problem, but that HMRC’s approach to deterring and disrupting the distribution of illicit tobacco within the UK was not effectively integrated.
- John Vine CBE QPM, the Independent Chief Inspector of Borders and Immigration scrutinised Border Force freight operations between March and July 2013. He concluded that there had been a breakdown in communication between Border Force and HMRC at an operational level.
- HMRC and Border Force are currently “refreshing” the Joint Tobacco Strategy, taking into account the change in risk and *modus operandi* of smugglings, along with lessons learned from the current strategy.
- In the Government’s 2012 consultation on standardised or ‘plain’ packaging of tobacco products, opinion was almost equally divided on whether standardised packaging would increase the supply of, or demand for, illicit tobacco. HMRC’s assessment is that plain packaging is not going to create any new risks for its operations, but it could well change the profile of the illicit market.
- The revised European Tobacco Products Directive governing the manufacture, presentation and sale of tobacco and related products was adopted in February 2014. It introduces an EU-wide tracking and tracing system for the legal supply chain and visible and invisible security features.

Introduction

1. Tobacco smuggling is a significant threat to UK tax revenues and to public health, yet duty is evaded on nearly one cigarette in ten, and more than a third of all hand-rolling tobacco. This is costing the taxpayer nearly £2 billion per year.¹

2. There are three illicit product categories. First, ‘contraband’ are legally manufactured by the major tobacco companies and smuggled into the UK either from other countries, where they are duty paid in that country, but due to higher UK duty are still worth smuggling into the UK. A typical example of contraband in the UK is French cigarettes in French packs.²

3. Second, ‘illicit whites’ are brands that are legally manufactured by companies, often based in emerging economies, with the intent on exporting illegally to other countries through a smuggling network. The products are then sold illegally without domestic duty being paid.³ Illicit white brands are typically imitation brands that copy the ‘look and feel’ of well-known legal brands.⁴ The most common brand is “Jin Ling”, which is produced in Russia, Ukraine and Moldova, although the provenance of many illicit whites is obscure.⁵

4. Third, ‘counterfeit’ are illegally manufactured copies of well-known existing brands. Although they are often very high quality copies of the pack, they are distinguishable from legal duty free through the lack of identifiable production or security markings, and product quality is often poor.⁶

5. The nature of the threat from tobacco smuggling has evolved since 2000. Then, most large cigarette seizures consisted of genuine UK brands being smuggled from EU countries with lower rates of duty. In 2007, non-UK cigarette brands and illicit whites first began to appear, and by 2012–13 most large seizures were of illicit whites.⁷

6. Tobacco smuggling is associated with organised crime, including the smuggling of controlled drugs, weapons and human beings.⁸ Along with counterfeits, HMRC note that

1 HMRC, Tobacco tax gap estimates 2012–2013

2 Sir Cyril Chantler, *Standardised packaging of tobacco: Report of the independent review undertaken by Sir Cyril Chantler*, 3 April 2014, p. 33

3 European Parliament, answer on behalf of the European Commission, given by Mt Semeta. Cigarette Smuggling, E-9307/2010, 4 January 2011.

4 Ibid.

5 World Customs Organisation, *Illicit Trade Report 2012* (Brussels, 2013), p. 20

6 Sir Cyril Chantler, *Standardised packaging of tobacco: Report of the independent review undertaken by Sir Cyril Chantler*, 3 April 2014, p. 33

7 HMRC, *Tackling Tobacco Smuggling—building on our successes, A renewed strategy for HM Revenue and Customs and the UK Border Agency* (2011), para 3.3. See also NAO, *Progress in Tackling Tobacco Smuggling*, June 2013, Figure 5, p. 18

8 HMRC, *Tackling Tobacco Smuggling—building on our successes, A renewed strategy for HM Revenue and Customs and the UK Border Agency* (2011), p. 1

illicit whites “represent the most significant threat to legitimate trade and tobacco revenues in the UK from large scale organised criminality”.⁹

7. Illicit tobacco products have public health implications, both because they make smoking more affordable and because many of them are made from unregulated materials. According to the HMRC, unregulated distribution networks associated with smuggling make tobacco more accessible to children and young people, and perpetuate health inequalities between different social groups.¹⁰

8. Written evidence was submitted by 31 respondents to the Home Affairs Committee’s inquiry into tobacco smuggling. On 5 November 2013, the Committee took evidence from Paul Williams, Head of Corporate Affairs UK, Japan Tobacco International, and Steve Payne, Anti-Illicit Trade, Government Relations & Communications, Japan Tobacco International. On 11 March 2014, Sir Charles Montgomery, Director General, Border Force, and Jim Harra, Director General, Business Tax, HM Revenue & Customs appeared before the Committee.

The strategy to tackle tobacco smuggling

9. In response to the changing nature of tobacco smuggling, *Tackling Tobacco Smuggling—building on our successes: A renewed strategy for HM Revenue and Customs and the UK Border Agency*, was published in April 2011. The renewed Strategy sought “to combine policy and legislative changes, enforcement, and collaborative working with stakeholders to address the source, supply and demand for illicit tobacco in the UK”.¹¹ Within the joint strategy, HMRC has overall responsibility for delivery, while Border Force is responsible for the seizure of illicit tobacco at the border.

10. According to the National Audit Office, HMRC’s reported performance against its targets since the introduction of the new strategy is “mixed”, as while HMRC met most of its objectives in 2011–12, none were met in 2012–13 although performance improved in most cases from the previous year.¹²

9 HMRC, *Tackling Tobacco Smuggling—building on our successes, A renewed strategy for HM Revenue and Customs and the UK Border Agency* (2011), para 3.7. Raquel and Jin Ling are well established illicit white brands in the UK. HMRC seized 47 million Jin Ling cigarettes in the UK in 2010–11 – a quarter of all seizures of illicit whites in that year.

10 HMRC, *Tackling Tobacco Smuggling—building on our successes, A renewed strategy for HM Revenue and Customs and the UK Border Agency* (2011), para 1.2

11 HMRC, *Tackling Tobacco Smuggling—building on our successes, A renewed strategy for HM Revenue and Customs and the UK Border Agency* (2011)

12 National Audit Office, NAO analysis of HM Revenue & Customs performance data, NAO (2013), p. 24

Table 1: HMRC's reported performance against objectives¹³

Objective/measure		2011-12		2012-13	
		Target	Achievement	Target	Achievement
Seizures: Seize greater volumes of illicit product to undermine the economics of the fraud	Cigarettes (millions)	1,700	1,732	1,928	1,858
	Hand-rolling tobacco (tonnes)	400	572	614	483
Supply: Reduce the availability of genuine tobacco products for fraud	Cigarettes (millions)	Less than 1,857	1,046	Less than 1,027	1,042
	Hand-rolling tobacco (tonnes)	Less than 3,306	2,789	Less than 2,455	2,743
Criminal investigations: Increase the impact of targeting and disrupting the criminal gangs behind the fraud	Revenue loss prevented (millions)	No target	£313	£421	£378
Deterrents: Punish and deter those involved in the fraud	Assessments and penalties (millions)	£20	£8.2	£30	£17.7

11. Director General, Business Tax, HM Revenue & Customs Jim Harra stated that it was “right” that they had “stretching targets” and were “driven by them to perform even better.” He concluded that changes in the profile of smuggling were making it “increasingly challenging” for them to make seizures. There has been a move away from use of the postal channel and the use of large consignments through containers, as consignments are fragmented into smaller values.¹⁴

12. In October 2013, HMRC published updated tobacco ‘tax gap’ estimates. The ‘tax gap’ is the difference between tax that is actually collected and the tax that is ‘theoretically due’, which is the tax that would be paid if all individuals and companies complied with both the letter of the law and HMRC’s interpretation of the intention of Parliament in setting law.¹⁵

13. The mid-point tax-gap estimate shows an increase in the level of the illicit cigarette market in 2012–13, with an illicit market share of 9% and associated revenue losses of £1.1 billion.

13 National Audit Office, NAO analysis of HM Revenue & Customs performance data, NAO (2013)

14 Q108 (Jim Harra)

15 HMRC, Measuring tax gaps 2013 edition

Table 2: Cigarettes (illicit market and revenue losses)¹⁶

	2008–09	2009–10	2010–11	2011–12	2012–13
Illicit market shares (%)					
Upper estimate	15	15	13	12	13
Mid-point estimate	12	11	9	7	9
Lower estimate	9	8	5	2	4
Associated revenue losses (£ million)¹⁷	1,800	1,800	1,500	1,500	1,800
Upper estimate	1,400	1,300	1,000	900	1,100
Mid-point estimate	1,000	900	500	200	500
Lower estimate					

14. The mid-point estimate of the illicit hand rolling tobacco market shows an illicit market share of 36%, around the same level as in 2010–11 and 2011–12. The associated revenue losses for hand rolling tobacco is estimated to be around £900 million, an increase compared with previous years explained by the higher duty rates and prices in 2012–13, together with a slight increase in the illicit volumes consumed.¹⁸

Table 3: Hand rolling tobacco (illicit market and revenue losses)¹⁹

	2008–09	2009–10	2010–11	2011–12	2012–13
Illicit market shares (%)					
Upper estimate	55	48	44	41	42
Mid-point estimate	50	42	38	35	36
Lower estimate	46	37	32	30	31
Associated revenue losses (£ million)²⁰	900	800	800	900	1,100
Upper estimate	800	700	700	700	900
Mid-point estimate	700	600	500	600	700
Lower estimate					

Arrests, prosecutions and convictions

15. Criminal investigations are a key part of HMRC's approach to tackling the organised criminal gangs behind large-scale tobacco smuggling. HMRC has legal powers to seize cash suspected of being the proceeds of crime and refer cases for prosecution. HMRC targets the cases that it believes will have the biggest impact, based on intelligence on organised criminal gangs. The aim is to make tobacco smuggling into the UK less attractive and factors such as profit margins, the ease and cost of operating in a country, the likelihood of being caught and the severity of the sentences play a key part in determining smuggling routes.²¹

16 HMRC, Tobacco tax gap estimates 2012–13

17 Includes duty and VAT, based on the Weighted Average Price (WAP) of all UK duty paid cigarettes.

18 HMRC, Tobacco tax gap estimates 2012–13

19 Figures are independently rounded to the nearest 1 percent, £100 million or 100 tonnes.

20 Includes duty and VAT, based on the Weighted Average Price (WAP) of all UK duty paid cigarettes.

21 National Audit Office, NAO analysis of HM Revenue & Customs performance data, NAO (2013), para 2.28

16. Total spending on the Government’s tobacco strategy in 2011–2012 rose by £3 million to £68.9 million.²² This resulted in the seizure of 1.7 billion cigarettes and 572 tonnes of hand-rolling tobacco.²³ Despite this, in 2012, a total of 1 billion illegal cigarettes were smoked in the UK, an increase of 49% since 2011.²⁴ It is a matter of grave concern that, despite an increase in the resources devoted to anti-smuggling operations, 49% more illicit cigarettes managed to slip through the net in 2012 than in 2011, although this figure stabilised in 2013. In 2012–13, seizure rates of cigarettes rose slightly to 1.8bn, but the seizure of hand-rolling tobacco declined to 483 tonnes. The HMRC’s tobacco tax gap estimates rose slightly in 2012–13, to 9 percent for cigarettes and 36 percent for hand-rolling tobacco. **We are worried that not enough is being done by the Government and its appropriate agencies to combat the problem of tobacco smuggling at source. We urge the members of HMRC and Border Force set up firm relationships with their counterparts in countries such as Malaysia. This will ensure that intelligence and best practice is shared.**

17. While there have been some high profile successes,²⁵ over the last three years the numbers of prosecutions and convictions for organised crime cases involving tobacco have fallen. We do not believe that these numbers are decreasing due to the reduction in this type of crime and are deeply concerned that these figures may indicate a reduction in enforcement action.

Table 4: Tobacco arrests and prosecutions²⁶

	2010–11	2011–12	2012–13
Arrests²⁷	143	115	156
Prosecutions			
Organised crime cases	133	62	51
Volume crime cases	81	105	214
Total	214	167	265
Convictions			
Organised crime cases	78	52	37
Volume crime cases	82	104	122
Total	100	156	159

18. Civil penalties were also “substantially” below target in both 2011–12 and 2012–13.²⁸

22 National Audit Office, NAO analysis of HM Revenue & Customs performance data, NAO (2013), para 1.20

23 National Audit Office, NAO analysis of HM Revenue & Customs performance data, NAO (2013), para 4

24 Duncan Robinson, Smokers turning more to illicit tobacco, Financial Times, 17 April 2013. KPMG, Project Star 2012 Results, 16 April 2013, p. 28.

25 For example see on 7 March 2013, Border Force reported that officers had seized 30 million counterfeit cigarettes in Southampton, which were being smuggled from China. If the haul had not been intercepted it would have cost the Treasury approximately £8,064,000 in lost revenue.

26 Submission by Border Force, HMRC and National Crime Agency

27 There is no direct correlation between arrest and prosecution numbers as many cases are progressed using information and summons rather than arrest.

28 National Audit Office, NAO analysis of HM Revenue & Customs performance data, NAO (2013), para 2.40

19. John Vine CBE QPM, the Independent Chief Inspector of Borders and Immigration, scrutinised Border Force freight operations between March and July 2013. His November 2013 report concluded that while “Border Force staff employed in freight operations were committed, knowledgeable and experienced in countering threats from freight imports”, and “Border Force enjoyed a broadly positive relationship with port authorities”, there was a “breakdown in communication between Border Force and HMRC at an operational level.”²⁹

20. A protocol on the referrals from Border Force to HMRC for criminal investigation has recently been established.³⁰ These operating protocols have been updated to articulate referral and information exchange processes for front-line officers. The updated guidance has been issued to front-line staff.³¹ A joint debriefing unit has also been established at Dover, focusing on smuggling on “roll-on, roll-off” ferries.³²

21. The Committee welcomes recent steps by HMRC and Border Force to develop more rigorous communication between the two organisations, in particular, the establishment of a new protocol on referrals from Border Force to HMRC for criminal investigation.

22. HMRC and Border Force must continue to strengthen the lines of communication between the two organisations, to ensure that relevant and up-to-date information is passed between teams. In particular, it is vital that referrals be made to HMRC in all cases of seizures where it appears that there might be scope for sanctions to be imposed. HMRC and Border Force should create a platform where effective examples of joint-working with local police forces and partner agencies such as Trading Standards across the UK can be accessed for training and in order to share good practice. Without sharing information, raising prosecution and arrest rates for tobacco smuggling will be more difficult, if not impossible.

Sanctions

23. Tobacco smuggling ranges from individuals abusing cross-border shopping rules to organised, trans-national criminal gangs smuggling shipping containers of illicit product around the globe. HMRC and Border Force state that they have a “comprehensive and effective range of sanctions available to deter people involved in all aspects of tobacco fraud and tailored to fit the seriousness of the offence.”³³

24. HMRC guidance states that tobacco companies are obliged to keep their supply chain policy under regular review, and where weaknesses in their supply chain controls are identified, they should take all reasonable steps to strengthen controls and include any new

29 Independent Chief Inspector of Borders and Immigration, An Inspection of Border Force Freight Operations March 2013-July 2013, pp. 4-5

30 Q 90 (Jim Harra)

31 Border Force response to the recommendations of the Independent Chief Inspector of Borders and Immigration: An inspection of Border Force freight operations, p. 1

32 Q 90 (Jim Harra)

33 Submission by Border Force, HMRC and National Crime Agency

measures in their supply chain policy, where necessary.³⁴ Tobacco manufacturers face penalties of up to £5m for facilitating smuggling.³⁵

25. Although supplies of UK tobacco products to high-risk markets have reduced by 20% over the last two years,³⁶ HMRC is still concerned about the problem of oversupply of branded cigarettes overseas with the intention of them being smuggled back into UK.³⁷ HMRC has not, however, fined any UK tobacco manufacturer for over-supplying products or failing to control its supply-chain, and has issued only one statutory warning letter threatening a fine.³⁸

26. It is astonishing that no UK tobacco manufacturer has ever been fined for over-supply of products to high-risk overseas markets, and that only one statutory warning letter has been issued. The penalties available are too weak and enforcement too rare. We find it farcical that a respected enforcement agency such as HMRC has not imposed tougher punishments on those over-supplying overseas markets. We recommend that HMRC publish a clear set of criteria setting out the circumstances in which it would normally impose a fine and that an immediate review be taken against all historic and ongoing cases against this criteria in order to ensure those who have committed an offence do not go unpunished.

27. Sanctions targeted at intermediaries in the illicit supply chain include: revocation of hauliers' licences and, for retailers, a fine of up to £5,000, a six-month prohibition on the sale of tobacco products, removal of any National Lottery terminal, and revocation of any alcohol licence. HMRC also publishes details of people or companies deliberately evading duty of more than £25,000 or convicted of a criminal offence.

28. Large scale smuggling, along with cases of strategic importance or repeated non-compliance are investigated to a criminal standard and referred for prosecution. Conviction for the fraudulent evasion of excise duty carries a maximum sentence of seven years imprisonment.³⁹

29. Other sanctions include civil sanctions, which are primarily used to tackle small-scale smuggling. Trading Standards Officers have additional sanctions and penalties for contraventions of labelling and packaging requirements, age of sale restrictions, and trademark offences.⁴⁰

34 HMRC, Tobacco products duty: control of supply chains

35 Q 111 (Jim Harra)

36 HM Treasury, Treasury Minutes: Government responses on the Twenty Third to the Twenty Sixth, the Twenty Ninth and Thirtieth Reports from the Committee of Public Accounts (Session 2013–14), and progress on Government Cash Management (2014) p. 2

37 Q 111 (Jim Harra)

38 Q 112 (Jim Harra)

39 Submission by Border Force, HMRC and National Crime Agency

40 Ibid.

30. The Government states that a new communications strategy is being developed to maximise deterrence.⁴¹ HMRC indicates that it aims to maximise the use of free media “to broaden the knowledge and awareness of enforcement action and penalties, in order to increase its deterrent impact; to raise awareness and understanding of illicit tobacco products and change behaviour; to encourage the public and businesses to pass on information and intelligence on the illicit market.”⁴²

31. The lack of media reports relating to prosecutions and enforcement activity in this area is disappointing for two organisations held in high public regard. As part of their new communications strategy, HMRC and Border Force should publicise prosecutions and enforcement action more widely to deter potential offenders. It is important that the agencies work together to ensure that those who offend are named and shamed and that the public money, spent combating this crime, is shown to have been used effectively.

Mandatory plain packaging

32. Between April and August 2012, the Department of Health ran a public consultation on the introduction of mandatory ‘standardised’ packaging for tobacco products.⁴³ Some 2,269 detailed responses addressed the question of whether requiring standardised tobacco packaging would increase the supply of, or demand for, illicit tobacco or non-duty-paid tobacco in the United Kingdom, with opinion almost equally divided on the issue.⁴⁴

33. The summary report on the consultation concluded that almost all replies from businesses and business-related organisations suggested that standardised packaging would both increase the supply of and the demand for illicit tobacco. These respondents said that standardised packaging would be easier to counterfeit, reduce counterfeiters’ costs and make it easier for counterfeiters to enter the market. They also believed that standardised packaging would make it more difficult for law enforcement officers to detect counterfeit tobacco, especially as members of the public would be less able to identify when they had been sold counterfeit tobacco.⁴⁵

34. Some consultation respondents considered that an increase in the size of the illicit tobacco market would be less of a risk to public health than not introducing standardised packaging. Some respondents also described how easily and cheaply counterfeiters could

41 HM Treasury, Treasury Minutes: Government responses on the Twenty Third to the Twenty Sixth, the Twenty Ninth and Thirtieth Reports from the Committee of Public Accounts (Session 2013–14), and progress on Government Cash Management (2014) p. 2

42 Tackling tobacco smuggling – Quarter 3 outputs (October to December 2013), March 2014

43 Standardised packaging (or ‘plain packaging’) of tobacco products is generally taken to mean the removal of all attractive promotional aspects. Except for the brand name (which would be presented in a standardised way), all other trademarks, logos, colour schemes and promotional graphics would be prohibited. The package itself would be standardised and display only information (such as health warnings) required by law. See *Standardised packaging of tobacco products*, House of Commons Library Standard Note SN/HA/6175 (March 2014).

44 Department of Health, Consultation on standardised packaging of tobacco products: Summary report, July 2013, p. 22

45 Ibid.

copy current branded packaging and argued that requiring standardised packaging was largely irrelevant and would make it neither easier, nor more difficult, for counterfeiters.⁴⁶

35. Written evidence produced during this inquiry has revealed similar splits in opinion. For instance, the TaxPayers' Alliance, which describes itself as an "independent grassroots campaign for lower taxes", argued that that the introduction of standardised packaging would be "a gift to counterfeiters and smugglers", citing a 2012 Populus study of 501 serving police carried out on behalf of the tobacco company Philip Morris International.⁴⁷ When asked whether the introduction of plain packaging would 'make it easier to produce/sell counterfeit cigarettes because all packs will look the same', 86% said that it would, while 68% said that plain packaging would 'lead to an increase in black market cigarettes where smuggled branded packs will be available'.⁴⁸

36. Conversely, the Trading Standards Institute (TSI), a UK national professional association for trading standards professionals working in the private and public sectors, argues that counterfeiters are typically able to produce quality counterfeit packaging quickly and cheaply and that counterfeit tobacco product is detected currently by the identification of covert markings (on the packaging) using a hand held scanner, with these and other industry-specific markings applied to the packaging and product itself. These methods will continue to be used and thus Trading Standards officers will be able to detect counterfeit products whether the product is supplied in standardised packs or not.⁴⁹

37. Nicholas Ilett, an investigation director at the European Commission (European Anti-Fraud Office), has argued that "the quality of counterfeits now is so high that it does not make a great deal of difference whether or not the packs are plain".⁵⁰

38. In Australia, the Tobacco Plain Packaging Act 2011 and the Trade Mark Amendment (Tobacco Plain Packaging) Act 2011 make it an offence to sell, supply, purchase, package or manufacture tobacco products or packaging for retail sale that are not compliant with the plain packaging requirements.⁵¹ In July 2013, the Secretary of State for Health, Rt Hon Jeremy Hunt MP, stated that the Government had decided to wait to make a decision until the emerging impact of the introduction of standardised packaging in Australia could be measured.⁵²

39. In November 2013, the Government commissioned an independent review of standardised packaging for tobacco by Sir Cyril Chantler, assessing whether there is likely to be an effect on public health, particularly for children, if standardised tobacco packaging were to be introduced. The review was published in April 2014.

46 Department of Health, Consultation on standardised packaging of tobacco products: Summary report, July 2013, p. 22

47 Submission by Jonathan Isaby, TaxPayers' Alliance

48 UK Law Enforcement Views on Illegal Tobacco and Plain Packaging, Populus, p. 17

49 Submission by Trading Standards Institute

50 House of Lords European Union Sub-committee (Home Affairs), July 2013, Q 18 (Nicholas Ilett)

51 Australian Government Department of Health, Plain packaging of tobacco products, 31 July 2013

52 Department of Health, Press release: Consultation on standardised packaging of tobacco products, 12 July 2013

40. Regarding the likely effects on the illicit trade, Chantler stated that he was “not convinced by the tobacco industry’s argument that standardised packaging would increase the illicit market, especially in counterfeit cigarettes” and that there was “no evidence that standardised packaging is easier to counterfeit.” He concluded that the solution to illicit use was an effective enforcement regime.⁵³

41. HMRC have stated that the introduction of standardised packaging is “not going to create any new risks” for them, but it could well change the profile of the illicit market.

42. The Committee is encouraged that HMRC is collaborating with officials in Australia to learn lessons from the introduction of standardised packaging.⁵⁴ However, it is worth noting that there are significant differences between the markets in the UK and Australia, particularly in terms of the proximity to other countries, so the lessons learnt from the introduction of standardised packaging in Australia may not necessarily translate to the UK.⁵⁵

43. On 3 April 2014, Parliamentary Under Secretary of State for Public Health Jane Ellison MP announced that, in light of the Chantler report and the responses to the previous consultation in 2012, she was “currently minded to proceed with introducing regulations to provide for standardised packaging.” Before reaching a final decision, the Government will publish the draft regulations alongside a final, short consultation.⁵⁶

44. We believe that the decision on standardised packaging should be driven by health reasons and the imperative need to reduce the numbers of young people who start smoking. We note the statement of Sir Cyril Chantler to the effect that he was not convinced that standardised packaging would bring about an increase in the illicit market; even if this were the case, we believe that the proper response would be a more vigorous effort on enforcement rather than any lessening in the Government’s drive towards introducing standardised packaging.

Track and trace technology

45. A secure track and trace system begins by securely marking a unit of product, such as a pack of cigarettes, and assigning to it a unique identity which is stored in a government-owned and -controlled database. This could provide a fully reliable test of authenticity and be linked to data, for instance about product type, time and place of manufacture and intended market of sale.⁵⁷

53 Sir Cyril Chantler, Standardised packaging of tobacco: Report of the independent review undertaken by Sir Cyril Chantler, 3 April 2014, p. 6

54 Q 102 (Jim Harra)

55 Submission by Border Force, HM Revenue and Customs and National Crime Agency, p. 5

56 Department of Health, Oral statement to Parliament: Chantler report on standardised packaging of tobacco products, 3 April 2014

57 Submission by SICPA UK

46. The unique identity and the database are the building blocks of a tracking capability which allows the unit to be followed throughout the supply chain—if required, up to the point of sale to the consumer. They also provide the means to trace backwards in real-time to point of origin or manufacture at any time during the product lifecycle.⁵⁸

47. In 2011, the four major tobacco companies, British American Tobacco, Imperial Tobacco Group PLC, Japan Tobacco International & Philip Morris International, founded the Digital Coding and Tracking Association (DCTA) with the stated aim of promoting cost effective industry standards and supporting technology solutions to tackle the illicit trade.⁵⁹ Full implementation of the proprietary track and trace technology, known as ‘Codentify’, is expected in late 2014 or early 2015.⁶⁰

48. Research in the *Journal of Tobacco Control* has raised concerns over the adequacy of Codentify. The authors acknowledged that they had access to only limited information on Codentify, through documentation PMI provides publicly, the patent and that leaked to the authors. The limitations identified in Codentify are that, if a code is used twice, the Codentify system cannot alone determine which of the two products with this code is genuine or counterfeit. An analysis of the package at the consumer service centre is required to confirm the authenticity. More generally the code is visible on the packs, making it easy to read and recognise, but less secure as visible codes are easier to falsify.⁶¹

49. The revised EU Tobacco Products Directive, governing the manufacture, presentation and sale of tobacco and related products, was formally approved by the European Parliament on 26 February 2014, and was officially adopted by the European Council on 14 March 2014.⁶²

50. The new Directive introduces an EU-wide tracking and tracing system for the legal supply chain and visible and invisible security features, such as holograms, to facilitate law enforcement and help authorities and consumers detect illicit products.⁶³

51. The new Directive specifically allows Member States to introduce further measures relating to standardisation of packaging, where they are justified on grounds of public health, are proportionate and do not lead to hidden barriers to trade between Member States.⁶⁴

58 Submission by SICPA UK

59 Submission by Tobacco Manufacturers’ Association

60 Ibid.

61 Luk Joossens & Anna B Gilmore, ‘The transnational tobacco companies’ strategy to promote Codentify, their inadequate tracking and tracing standard’, *Journal of Tobacco Control*, March 2013

62 European Commission, Revision of the Tobacco Products Directive

63 European Commission (Public Health), Questions & Answers: New rules for tobacco products, 26 February 2014

64 Ibid.

52. The new Directive should enter into force in May 2014. A transposition period of two years for Member States to bring national legislation into line with the revised Directive means that most of the new rules will apply in the first half of 2016.⁶⁵

53. An effective track and trace system could potentially mitigate many of the possible risks which have led the Government to adopt a more cautious approach to standardised packaging. Any increase in criminality should be avoided at all costs and considerations on standardised packaging must be taken on health and commercial grounds. Therefore, we recommend that any future legislation to introduce standardised packaging should include a requirement for appropriate security and tracking features, in accordance with the EU Tobacco Products Directive and best evidence.

65 European Commission (Public Health), Questions & Answers: New rules for tobacco products, 26 February 2014

Conclusions

1. We are worried that not enough is being done by the Government and its appropriate agencies to combat the problem of tobacco smuggling at source. We urge the members of HMRC and Border Force set up firm relationships with their counterparts in countries such as Malaysia. This will ensure that intelligence and best practice is shared. (Paragraph 16)
2. While there have been some high profile successes, over the last three years the numbers of prosecutions and convictions for organised crime cases involving tobacco have fallen. We do not believe that these numbers are decreasing due to the reduction in this type of crime and are deeply concerned that these figures may indicate a reduction in enforcement action. (Paragraph 17)

Recommendations

1. HMRC and Border Force must continue to strengthen the lines of communication between the two organisations, to ensure that relevant and up-to-date information is passed between teams. In particular, it is vital that referrals be made to HMRC in all cases of seizures where it appears that there might be scope for sanctions to be imposed. HMRC and Border Force should create a platform where effective examples of joint-working with local police forces and partner agencies such as Trading Standards across the UK can be accessed for training and in order to share good practice. Without sharing information, raising prosecution and arrest rates for tobacco smuggling will be more difficult, if not impossible. (Paragraph 22)
2. It is astonishing that no UK tobacco manufacturer has ever been fined for over-supply of products to high-risk overseas markets, and that only one statutory warning letter has been issued. The penalties available are too weak and enforcement too rare. We find it farcical that a respected enforcement agency such as HMRC has not imposed tougher punishments on those over-supplying overseas markets. We recommend that HMRC publish a clear set of criteria setting out the circumstances in which it would normally impose a fine and that an immediate review be taken against all historic and ongoing cases against this criteria in order to ensure those who have committed an offence do not go unpunished. (Paragraph 26)
3. The lack of media reports relating to prosecutions and enforcement activity in this area is disappointing for two organisations held in high public regard. As part of their new communications strategy, HMRC and Border Force should publicise prosecutions and enforcement action more widely to deter potential offenders. It is important that the agencies work together to ensure that those who offend are named and shamed and that the public money, spent combating this crime, is shown to have been used effectively. (Paragraph 31)
4. We believe that the decision on standardised packaging should be driven by health reasons and the imperative need to reduce the numbers of young people who start smoking. We note the statement of Sir Cyril Chantler to the effect that he was not convinced that standardised packaging would bring about an increase in the illicit market; even if this were the case, we believe that the proper response would be a more vigorous effort on enforcement rather than any lessening in the Government's drive towards introducing standardised packaging. (Paragraph 44)
5. An effective track and trace system could potentially mitigate many of the possible risks which have led the Government to adopt a more cautious approach to standardised packaging. Any increase in criminality should be avoided at all costs and considerations on standardised packaging must be taken on health and commercial grounds. Therefore, we recommend that any future legislation to introduce standardised packaging should include a requirement for appropriate security and tracking features, in accordance with the EU Tobacco Products Directive and best evidence. (Paragraph 53)

Appendix

Excerpt from the Chantler Review⁶⁶

Is it likely that standardised packaging will lead to an increase in tobacco consumption by lowering the price of tobacco as the market is commoditised or by increasing the consumption of illicit products?

The likelihood of effects on price

- 5.1 Opponents of standardised packaging argue that it could cause large scale price reductions and, as a result, smoking would increase. In the extreme, it is argued that complete commoditisation of the market could occur, with all tobacco selling at prices just above the level of tax plus cost. This is based on the view that standardised packaging would remove product differentiation between tobacco brands so that smokers are only willing to pay for the cheapest brand and manufacturers are forced to compete on price alone.
- 5.2 The intent of standardised packaging is indeed to remove appealing brand differentiation. Standardised packaging is aimed at encouraging smokers to see all cigarettes as equally harmful and unappealing, rather than to identify with particular brands and associate them with positive qualities such as glamour, slimness or sophistication. Similarly the measures in the European Tobacco Product Directive (for example restricting flavourings and slim cigarettes) can also be seen as removing product differentiation and moving nearer to a commoditised market.
- 5.3 In order to address these issues thoroughly, I commissioned an analysis from a professional economist recruited to the Review team. My team and I discussed these issues with academics and experts from both sides of the debate.
- 5.4 Having considered the evidence, including the analysis I commissioned (annexed to this report), it is my view that the risk of such effects undermining the objectives of a standardised packaging policy are small and that the impacts could be readily mitigated through taxation if nevertheless they were to materialise. Overall, I have come to the view that the magnitude of effects suggested by opponents of standardised packaging are exaggerated and the likelihood of complete market commoditisation is very low, especially in the short to medium term.

The likelihood of effects on the illicit trade

- 5.5 I now turn to consider whether standardised packaging will increase the consumption of illicit tobacco (tobacco that is imported for sale in the UK without paying UK duty). The tobacco industry has argued that it will for the following reasons:
 - manufacturers will find it easier and/or cheaper to make counterfeit packaging – standardised packaging regulations provide a single easy blueprint to follow for all brands;

66 <http://www.kcl.ac.uk/health/10035-TSO-2901853-Chantler-Review-ACCESSIBLE.PDF>

Is standardised packaging likely to lead to a reduction in the consumption of tobacco?

- consumers will be more likely to be duped by counterfeits,
- consumers' will increasingly choose to buy illicit products:
 - in an increasingly commoditised market where brand loyalty no longer holds
 - because they prebranded packaging, now only available in the illicit market as contraband or "illicit whites" (Box 3 describes the different categories of illicit tobacco).

Box 3: Illicit product categories

Contraband: legally manufactured by the major tobacco companies. Smuggled into the UK either from other countries (where they are duty paid in that country but due to higher UK duty are still worth smuggling into the UK). Typical examples of this in the UK would be French cigarettes in French packs.

Illicit Whites: legally manufactured by companies often based in emerging economies with the intent on exporting illegally to other countries through a smuggling network. Brands are typically imitation brands, copying the "look and feel" of well-known legal brands. Known illicit white brands are 'Manchester' and 'Jin Ling'.

Counterfeit: illegally manufactured copies of well-known existing brands. Often very high quality copies of the pack, but distinguishable from legal duty free through the lack of identifiable production/security markings. Product quality is often poor.

5.6 Tobacco manufacturers cite the industry funded KPMG report on illicit tobacco in Australia,⁷² which purports to show that there has been a large increase in illicit trade since the introduction of plain packaging. I have considered both this report and a critique.⁷³ My team have also met with KPMG in order to understand their methods⁷⁴ I note that Australian Government departments, both Health and Customs, appear to be strongly of the view that KPMG's methodology is flawed. These Departments point to official Customs data,⁷⁵ which shows no significant effect on illicit tobacco following the introduction of plain packaging, backed by analysis undertaken by the Cancer Council Victoria (based on data from the National Drug Strategy Household Survey) that suggests that illicit tobacco in Australia is only 10-20% of the level proposed by KPMG.⁷⁶ In a situation where estimates differ by such magnitudes, I do not have confidence in KPMG's assessment of the size of – or changes in – the illicit market in Australia.

Ease of counterfeit production

5.7 In my view, the argument that standardised packaging makes it materially easier or cheaper for criminals to produce counterfeit packaging is not supported by the evidence I have seen. Although some

⁷² KPMG(October 2013). Illicit tobacco in Australia. prepared by KPMG LLP in accordance with specific terms of reference ("terms of reference") agreed between British American Tobacco Australia, Philip Morris Limited and Imperial Tobacco Australia Limited.

⁷³ Quit Victoria (11th November 2013). Analysis of KPMG LLP Report on use of illicit Tobacco in Australia. Cancer Council Victoria Website.

⁷⁴ Review team meeting with KPMG, (22nd February). The purpose of the meeting was to discuss the KPMG report on illicit tobacco in Australia. Note available from:<http://www.kcl.ac.uk/health/packaging-review.aspx>

⁷⁵ Australian Customs and Border Protection Service, table on Tobacco Smuggling in Annual Report 2012 – 2013.

⁷⁶ Quit Victoria (11th November 2013). Analysis of KPMG LLP Report on use of illicit Tobacco in Australia. Cancer Council Victoria Website. And Gilmore AB, et al (2013) Towards a greater understanding of the illicit tobacco trade in Europe: a review of the PMI funded 'Project Star' report. Tobacco Control.

STANDARDISED PACKAGING OF TOBACCO

branded packages are complex and therefore difficult to copy, many of the top 10 brands in the UK are relatively simple in pack design. Counterfeiters already target these, cheaply producing convincing copies⁷⁷ on simple and widely available “offset” printing technology.⁷⁸ Although complex packaging creates a technical obstacle for counterfeiters on any specific complex packaging, this is very easily avoided by choosing instead to mimic the brand variant with the simplest packaging⁷⁹, of which there are many popular versions.

- 5.8 I understand that there is no evidence of increased counterfeiting following the introduction of plain packaging in Australia and that this is now accepted by tobacco manufacturers locally: Mark Connell of BAT told the review team:

“One of the things that we did say... is that there would be an increase in counterfeit of the standardised packaging. In other words, the legislation was virtually a blueprint that was given to counterfeiters... that hasn’t happened, well it may have happened in small quantities...” “Our biggest brand which was counterfeited all the time, very professionally I have to say, at least contained a health warning and a graphic health warning” [unlike these illicit white brands now prevalent]. Review team: “have you actually seen a reduction in counterfeit?” Mr Connell: “Absolutely. Absolutely.”⁸⁰

Are consumers duped by counterfeits?

- 5.9 I have learned that counterfeit cigarettes primarily deceive the illicit buyer in their desire to buy contraband. Consumers do not buy illicit cigarettes by accident. They choose to buy illicit because of the price. A typical pack of illicit cigarettes costs about £3 to buy, which is about half the price of the cheapest pack available legally in the UK.⁸¹ Consumers know they are buying illicit not only because of the price they pay, but where they purchase the product.⁸² Typically illicit cigarettes are bought from friends, family and colleagues or through known illicit routes, such as destination shops like “fag houses” or approaches in pubs or clubs. Only about 20% of illicit is purchased from local shops, and at prices that make clear that it is not tax-paid legal product. It is clear that consumers are not being duped into buying counterfeit when they think they are buying licit.⁸³

⁷⁷ Ronald Ridderbeekx, meeting with TMA 29 Jan 2014, “We have our own investigators scouring the world for counterfeiters and helping law enforcement officials to find them and capture them because they are very good. Sometimes we even struggle to distinguish a counterfeit pack from a real one. It’s a really big problem because, yes, that counterfeit pack would be undetectable to others.”

⁷⁸ Review team meeting with Association of Packaging Industry, (12th February 2014). The purpose of this meeting was to better understand issues around the production of tobacco packaging; the industry’s knowledge of illicit and counterfeit packaging; the pricing component in packaging and ultimately public health implications of plain packaging from the packaging company’s point of view. Note available from: <http://www.kcl.ac.uk/health/packaging-review.aspx>

⁷⁹ Review team meeting with Luk Joossens, Association of European Cancer Leagues (20th February). The purpose of the meeting was to inform in more detail, the illicit section of report. Note available from: <http://www.kcl.ac.uk/health/packaging-review.aspx>

⁸⁰ Transcript of Sir Cyril Chantler meeting with Australian tobacco industry (13 March 2014). Available from: <http://www.kcl.ac.uk/health/packaging-review.aspx>

⁸¹ Review team meeting with Luk Joossens, Association of European Cancer Leagues (20th February).

⁸² Review team meeting with Andy Leggett and Judith Kelly, HMRC (7th March 2014). The purpose of the meeting was to discuss an analysis on illicit tobacco data. Note available from: <http://www.kcl.ac.uk/health/packaging-review.aspx>

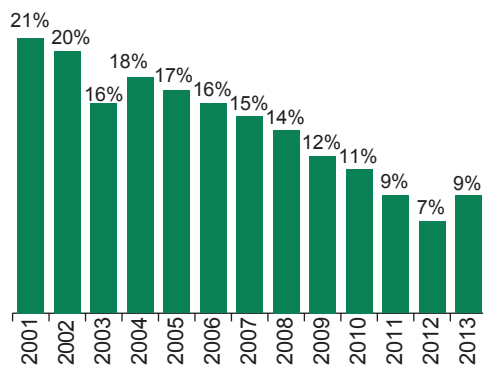
⁸³ Meetings as above and Moodie C, Hastings G, Joossens L, (2011b). Young adult smokers’ perceptions of illicit tobacco and the possible impact of plain packaging on purchase behaviour. *European Journal of Public Health*

Is standardised packaging likely to lead to a reduction in the consumption of tobacco?

Will standardised packaging boost demand for illicit branded products?

5.10 Consumers' main reason for wanting to purchase illicit cigarettes is price not packaging. But it is possible that some consumers put off by standardised packaging may become more attracted to purchasing contraband. However, what constrains the size of the illicit market is not a lack of demand, but restrictions placed on supply by border controls. If this were not the case then the size of the illicit market would have increased over the last 14 years as tobacco taxes have risen in real terms. Instead the size of the illicit market in the UK has roughly halved. HMRC's actions in combating illicit trade appear to have been very effective.

UK Illicit Cigarette Market Share

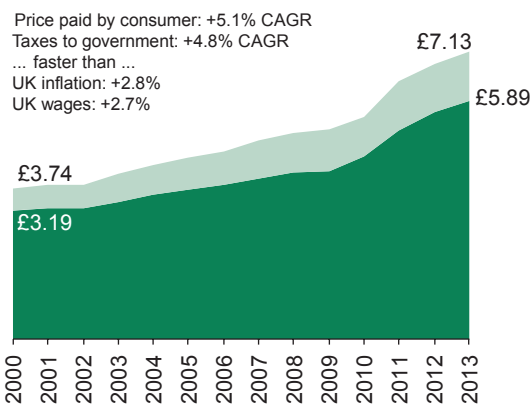


Note: 2008 is 12% according to HMRC Measuring tax Gaps 2013 edition

Note: Cancer Research Council (CRC) factsheet numbers for tax years ending 2008 to 2010 are 13%, 11%, 10%

Source: 2008-2013 data from HMRC Tobacco Gap Estimates 2012-13, CRC factsheet

UK Nominal Price per Pack of 20



Note: CAGR = Compound Annual Growth Rate

Source: Table 3.6 from HMRC Tobacco factsheet 29 Nov 2013, ONS for inflation

5.11 I have seen no convincing evidence to suggest that standardised packaging would increase the illicit market. Illicit tobacco is and will continue to be an important issue in relation to under-age access to tobacco, and effective enforcement efforts would remain, as now, essential, but this is not closely entwined with the issue of standardised packaging. The industry has argued in particular that standardised packaging would be easier to counterfeit. But both HMRC here, and the tobacco companies themselves in Australia tell me that they are not convinced.⁸⁴ My understanding from these discussions is that standardised packaging is not easier to counterfeit, and indeed in Australia, hardly any counterfeit standardised packages have been found.

5.12 Any tobacco control policy that aims to hold prices up (through tax) or to reduce demand through packaging restrictions (health warnings, standardised packaging etc.) can be accused of giving a comparative advantage to the illicit market to whom these restrictions do not apply. But the solution cannot be for Government to pursue the lowest common denominator by allowing the legal market to compete with illicit in terms of attractive branding, lack of graphic health warnings, and low tax.

⁸⁴ Transcript of Sir Cyril Chantler meeting with British American Tobacco Australia, and Imperial Tobacco Australia, 12 March 2014 (p39). Available from: <http://www.kcl.ac.uk/health/packaging-review.aspx>

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Many high tax jurisdictions, including the UK, have already demonstrated that an effective enforcement regime and appropriate sanctions can keep illicit to low levels. Illicit tobacco is not a normal market – more people would buy illicit cigarettes today if they could, but they cannot because supply is limited by effective enforcement.

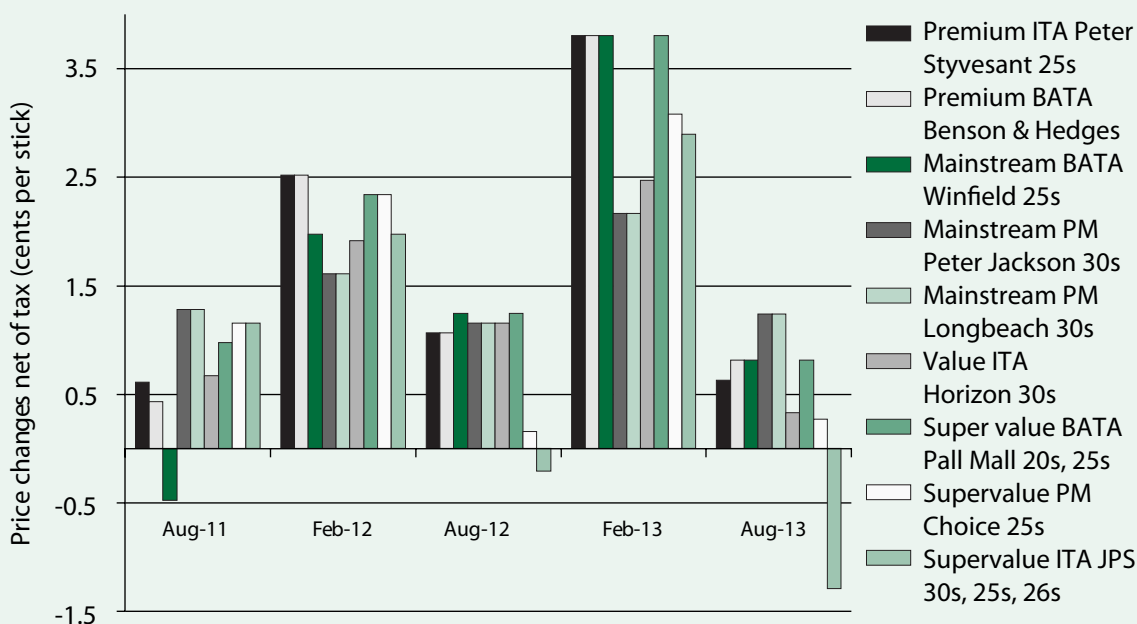
Box 4. Australia – prices and illicit

Prices

There has been a continuation of a trend of down-trading towards value brands in Australia. This trend appears to have accelerated somewhat in the last year, with an increase in market share (by volume) of low price cigarette brands from 32% in 2012 to 37% in 2013. This compares to increases of 3 percentage points in each of the previous two years.⁸⁵ Much of this impact is likely to reflect a greater focus on value products following tax increases as opposed to plain packaging.

Prices have generally increased in the data available to date, with most leading brands in Australia increasing prices by more than the inflation tax rises since plain packaging was introduced (see the figure below). This is a continuation of the trend for prices of leading brands to increase by more than tax rises which has occurred for several years in Australia. This provides evidence that the widespread price reductions predicted by some opponents of plain packaging have not materialised to date.

Price changes net of tax for leading brands and super value brands in Australia⁸⁶



⁸⁵ InfoView Exchange of Sales data, provided by British American Tobacco

⁸⁶ Cancer Victoria analysis of Recommended Retail Prices data.

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6401.0Dec%202013?OpenDocument>

Is standardised packaging likely to lead to a reduction in the consumption of tobacco?

Box 4. Australia – prices and illicit (continued)

Illicit

Estimates of the absolute size of the illicit market vary considerably. A recent industry funded KPMG report⁸⁷ concludes that the level of illicit cigarettes as a percentage of total cigarette consumption is in the low teens and has increased since plain packaging was introduced. However, Australian Government departments, both Health and Customs, appear strongly of the view that KPMG's methodology is flawed. These Departments point to the Customs data which shows no significant impact on illicit tobacco⁸⁸ backed by analysis undertaken by the Cancer Council Victoria⁸⁹ that suggests that illicit tobacco in Australia is only 10-20% of the level proposed by KPMG

Conclusion

- 5.13 It is my view that the risks of price effects undermining the objectives of a standardised packaging policy are small and that the impacts could be readily mitigated through taxation if nevertheless they were to materialise. I am not convinced by the tobacco industry's argument that standardised packaging would increase the illicit market, especially in counterfeit cigarettes. It seems to me that the solution to illicit use is instead to have an effective enforcement regime, and the enforcement agencies in the UK have already demonstrated that an effective enforcement regime and appropriate sanctions can keep illicit to low levels, even in a relatively high tax jurisdiction.

⁸⁷ KPMG LLP (2013), 'Illicit tobacco in Australia: 2013 half year report'

⁸⁸ Australia Customs and Border Protection Service

⁸⁹ Various reports, available at <http://www.cancervic.org.au/plainfacts/browse.asp?ContainerID=plainfacts-myths>

Formal Minutes

Wednesday 11 June 2014

Members present:

Keith Vaz, in the Chair

James Clappison
Michael Ellis
Paul Flynn

Lorraine Fullbrook
Dr Julian Huppert

Draft Report (*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 53 read and agreed to.

Appendix agreed to.

Resolved, That the Report be the First 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.

[Adjourned till Tuesday 17 June 2014 at 2.30 pm]

Witnesses

Tuesday 5 November 2013

Page

Paul Williams, Head of Corporate Affairs UK, and **Steve Payne**, Anti-Illicit Trade Government Relations & Communications, JTI UK

Ev 1

Tuesday 11 March 2014

Sir Charles Montgomery, Director General, Border Force, and **Jim Harra**, Director General, Business Tax, HM Revenue & Customs

Ev 8

List of printed written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/home-affairs-committee/inquiries/parliament-2010/tobacco-smuggling/>

- 1 Terence E Rowe (TOB 0001)
- 2 TaxPayers' Alliance (TOB 0002)
- 3 Transcrime (TOB 0003)
- 4 Royal College of Physicians (TOB 0004)
- 5 Will O'Reilly (TOB 0005)
- 6 Association of Convenience Stores (TOB 0006)
- 7 National Federation of Retail Newsagents (TOB 0007)
- 8 Action on Smoking and Health (TOB 0008)
- 9 Fresh, Tobacco Free Futures and Smokefree South West (TOB 0009)
- 10 Trading Standards Institute (TOB 0010)
- 11 Tobacco Manufacturers Association (TOB 0011)
- 12 Philip Morris Ltd (TOB 0012)
- 13 Cancer Research (TOB 0013)
- 14 Imperial Tobacco Ltd (TOB 0013)
- 15 Japan Tobacco International (TOB 0015)
- 16 Asian Media and marketing Group (TOB 0016)
- 17 Scottish Grocers' Federation (TOB 0017)
- 18 Petrol Retailers Association (TOB 0018)
- 19 SICPA UK (TOB 0019)
- 20 Irish Cancer Society (TOB 0020)
- 21 Action on Smoking and Health (ASH) Scotland (TOB 0021)
- 22 Federation of Wholesale Distributors (TOB 0022)
- 23 Center for Regulatory Effectiveness (TOB 0023)
- 24 De La Rue International Limited (TOB 0024)
- 25 British American Tobacco UK Limited (TOB 0025)
- 26 Derbyshire County Council (TOB 0026)
- 27 Len Tawn (TOB 0027)
- 28 North East Trading Standards Association (TOB 0028)
- 29 National Asian Business Association (TOB 0029)
- 30 Cllr Paul Rone (TOB 0030)
- 31 Herefordshire Council (TOB 0031)
- 32 Border Force, HM Revenue and Customs and the National Crime Agency (TOB 0032)
- 33 Japan Tobacco International Supplementary (TOB 0033)
- 34 HM Revenue and Customs (TOB 0034)
- 35 Border Force (TOB 0035)
- 36 Australian High Commission (TOB 0036)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/home-affairs-committee/publications/>

Session 2013–14

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Second Report	Child sexual exploitation and the response to localised grooming	HC 68
Third Report	Leadership and standards in the police	HC 67
Fourth Report	The work of the UK Border Agency (Oct–Dec 2012)	HC 486
Fifth Report	E-crime	HC 70
Sixth Report	Police and Crime Commissioners: power to remove Chief Constables	HC 487
Seventh Report	Asylum	HC 71
Eighth Report	The work of the UK Border Agency (Jan–March 2013)	HC 616
Ninth Report	Pre-Lisbon Treaty EU police and criminal justice measures: the UK's opt-in decision	HC 615
Tenth Report	Leadership and Standards in the Police: follow-up	HC 756
Eleventh Report	Khat	HC 869
Twelfth Report	Drugs: new psychoactive substances and prescription drugs	HC 819
Thirteenth Report	The work of the Permanent Secretary	HC 233
Fourteenth Report	The Government's Response to the Committees' Reports on the 2014 block opt-out decision	HC 1177
Fifteenth Report	The work of the Immigration Directorates (April–September 2013)	HC 820
Sixteenth Report	Police and Crime Commissioners: Progress to date	HC 757
Seventeenth Report	Counter-terrorism	HC 231
Eighteenth Report	Reform of the Police Federation	HC 1163

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Second Report	Work of the Permanent Secretary (April–Dec 2011)	HC 145
Third Report	Pre-appointment Hearing for Her Majesty's Chief Inspector of Constabulary	HC 183
Fourth Report	Private Investigators	HC 100
Fifth Report	The work of the UK Border Agency (Dec 2011–Mar 2012)	HC 71
Sixth Report	The work of the Border Force	HC 523
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Eighth Report	The work of the UK Border Agency (April–June 2012)	HC 603

Ninth Report	Drugs: Breaking the Cycle	HC 184-I
Tenth Report	Powers to investigate the Hillsborough disaster: interim Report on the Independent Police Complaints Commission	HC 793
Eleventh Report	Independent Police Complaints Commission	HC 494
Twelfth Report	The draft Anti-social Behaviour Bill: pre-legislative scrutiny	HC 836
Thirteenth Report	Undercover Policing: Interim Report	HC 837
Fourteenth Report	The work of the UK Border Agency (July-Sept 2012)	HC 792

Session 2010–12

First Report	Immigration Cap	HC 361
Second Report	Policing: Police and Crime Commissioners	HC 511
Third Report	Firearms Control	HC 447
Fourth Report	The work of the UK Border Agency	HC 587
Fifth Report	Police use of Tasers	HC 646
Sixth Report	Police Finances	HC 695
Seventh Report	Student Visas	HC 773
Eighth Report	Forced marriage	HC 880
Ninth Report	The work of the UK Border Agency (November 2010-March 2011)	HC 929
Tenth Report	Implications for the Justice and Home Affairs area of the accession of Turkey to the European Union	HC 789
Eleventh Report	Student Visas—follow up	HC 1445
Twelfth Report	Home Office—Work of the Permanent Secretary	HC 928
Thirteenth Report	Unauthorised tapping into or hacking of mobile communications	HC 907
Fourteenth Report	New Landscape of Policing	HC 939
Fifteenth Report	The work of the UK Border Agency (April-July 2011)	HC 1497
Sixteenth Report	Policing large scale disorder	HC 1456
Seventeenth Report	UK Border Controls	HC 1647
Eighteenth Report	Rules governing enforced removals from the UK	HC 563
Nineteenth Report	Roots of violent radicalisation	HC 1446
Twentieth Report	Extradition	HC 644
Twenty-first Report	Work of the UK Border Agency (August-Dec 2011)	HC 1722

Oral evidence

Taken before Home Affairs Committee

on Tuesday 5 November 2013

Members present:

Keith Vaz (Chair)

Ian Austin
Nicola Blackwood
Mr James Clappison
Michael Ellis

Dr Julian Huppert
Mark Reckless
Mr David Winnick

Examination of Witnesses

Witnesses: **Paul Williams**, Head of Corporate Affairs UK, Japan Tobacco International, and **Steve Payne**, Anti-Illicit Trade, Government Relations & Communications, Japan Tobacco International, gave evidence.

Q1 Chair: Mr Williams, Mr Payne, thank you for coming today to give evidence to this Committee. This concerns our inquiry into tobacco smuggling. You are our first oral witnesses. We will be hearing further evidence from other witnesses as we proceed with this inquiry.

Can I begin by asking a question about the extent of tobacco smuggling? How big is it, Mr Williams?

Paul Williams: The estimates that we have seen from HMRC in the latest set of statistics for 2012 and 2013 would suggest, at their upper estimate, that it is 16% of cigarettes and some 48% of hand-rolling tobacco that is consumed in the UK.¹

Q2 Chair: Is this a UK problem? Or is smuggling a worldwide problem?

Paul Williams: It is certainly driven by differentials cross-border, between many countries within the EU. Generally, you would tend to find that it is driven from east to west in terms of the very low prices of product in the eastern side of Europe, and certainly in the former Soviet Union countries, and ever-increasing prices as you move further west, with the UK and Ireland being two of those countries with the highest prices within the EU for tobacco products.

Q3 Chair: At the moment, as I understand it, there are allegations of complicity by tobacco companies in illegal smuggling.

Have you heard of these allegations, that it is the tobacco companies who are complaining of smuggling who have ended up being part of the whole process of smuggling cigarettes into this country?

Paul Williams: Clearly, I have heard of the allegations.

As far as JTI is concerned, if we look at the seizures over the last few years, JTI has been responsible for the manufacturing of less than 1% of the seizures made by HMRC in the UK of hand-rolling tobacco

and similarly around 1% of any seizures of ready-made cigarettes.² So, a very small proportion of anything that is coming into this market is legitimate product as it were.

Q4 Chair: So you can tell us unequivocally today that there is no question that any tobacco companies are involved in the illicit smuggling of tobacco.

Paul Williams: We certainly work very closely with Her Majesty's Revenue and Customs and the Border Agency in ensuring that our supply chain is secure. We have a very strict code of conduct in supplying our direct distributors: people who purchase product direct from our factories.³ We have put in place stringent controls of those particular customers to make sure that our supply chain is secure.

Q5 Chair: So what would you say to the Royal College of Physicians who have told us that the credibility of the tobacco industry in debates on the illegal tobacco trade is highly suspect?

Paul Williams: I have read their submission. Clearly, they have made a statement regarding an investigation by OLAF, which started some two years ago. We have seen nothing that has come out of that investigation to infer that JTI has any case to answer.

Q6 Chair: Thank you for reminding the Committee; you are currently under investigation by OLAF, the European anti-fraud agency, in respect of JTI's involvement in the illicit tobacco trade. You are telling us that after four years no evidence has been produced against you.

Paul Williams: I would say that it was alleged involvement and obviously the allegation has been

¹ Note by witness: These figures refer to total non-UK duty paid consumption in 2012/13, which includes illegally smuggled tobacco.

² Note by witness: This 1% is calculated by comparing all UK seizures of JTI product that JTI has become aware of, including information on seizures (both above and below the notifiable limits) reported by HMRC, the police, inquiries from Trading Standards, and UK seizures from OLAF, to the overall HMRC seizures. JTI has requested additional data from HMRC on all seizures below notifiable limits, but JTI understands that HMRC does not keep full records on these seizures, so no information has been provided.

³ Note by witness: To clarify that JTI has a number of compliance programs see <http://www.jti.com/how-we-do-business/anti-illicit-trade/our-programs/>.

5 November 2013 Paul Williams and Steve Payne

and is being investigated. We can only assume OLAF investigates all allegations of any duty fraud, regardless of the category. As far as JTI is concerned, there is no case to answer.

Q7 Chair: In respect of allegations that you all supplied the Assad regime with tobacco products while that regime is under sanctions, is there no truth in that?

Paul Williams: Again, this would refer I assume to when sanctions came into play in May 2011. To date, we have had no response in respect of those allegations as far as JTI is concerned.

Q8 Mr Winnick: As I understand the arguments of your industry, you say in effect that the affordability gap between cigarette prices in the UK and overseas is the main driver for the illegal trade. Is that the argument?

Paul Williams: I think affordability clearly does play a huge part. It is not the only component in all of this.

Mr Winnick: But in your view, it is an important one.

Paul Williams: It is an important one.

Q9 Mr Winnick: So the implication therefore is that the UK Government, whichever Government happens to be in power at any given time, should reduce the price of cigarettes.

Paul Williams: To be pragmatic, I do not see that happening. However our view—

Mr Winnick: No, you are quite right; you do not see it happening. The likelihood is very remote, but your industry would like to see that.

Paul Williams: I think if the Government are intent on having very high levels of duty that apply to our particular products, then clearly enforcement becomes a critical component in that. If you are going to heavily tax a product, then you clearly need to enforce your borders to make sure that the product is not smuggled back in to the UK market, therefore denuding the Government of up to £3 billion in duty at their higher revenue limits⁴.

Q10 Mr Winnick: Mr Williams, Mr Payne, I wonder if I can give you a statistic and whether you are aware of it.

In England in 2011—apparently the information has not yet become available for 2012—it is officially stated that around 75,100 deaths were as a result of smoking. Are you familiar with that statistic?

Paul Williams: I am not familiar with the specific statistic. Clearly, there are risks associated with smoking.⁵

Q11 Mr Winnick: If I have just heard you correctly, you accept that smoking does cause deaths.

Paul Williams: No. What I have said is that there are risks associated with smoking. When the first health warnings were put on packs in 1971, it clearly stated on the front the health risks associated with smoking.

⁴ Note by witness: Based on HMRC's upper estimates of non-UK duty paid product (up to 16% of cigarettes and up to 48% of RYO) the estimate loss of duty is £2.9 billion.

⁵ Note by witness: For more complete details of JTI's views on smoking and health please visit www.jti.com.

Consumers were first made aware of those risks 42 years ago.⁶ At the end of the day, smoking is an adult choice. People should be aware of the risks and they should not take those risks unless they are aware.

Q12 Mr Winnick: To the best of my knowledge, no one has suggested that smoking should be banned. We know what happens when, for instance, drugs are banned, and all the criminal activity and the rest of it that is involved.

But the question I would ask you—I am sure you have been asked this on previous occasion—is, do you not sometimes feel you are involved in a death trade?

Paul Williams: I am not quite sure what this has to do with the Committee.

Mr Winnick: You are trading in a commodity that from every form of notable evidence undoubtedly causes death.

Paul Williams: We are trading a commodity on which the Government received £12 billion in duty and £3 billion of that is avoided as a result of the illicit trade. We came here today to assist the Committee in addressing what we believe is that duty loss and how we believe that could be better handled. Part of that issue, of course, is that it also undermines the legitimate business within the UK.

Q13 Mark Reckless: Did you say that you do not think that cigarettes cause deaths?

Paul Williams: I am saying there are risks associated.

Mark Reckless: I heard that but I am not sure if I misheard. I know that is the line you had, but is it your position that cigarettes cause deaths? Or are you denying that?

Paul Williams: I am not a medical professional.

Mark Reckless: You do not know?

Paul Williams: I am not a medical professional.

Mark Reckless: I am aware of that.

Paul Williams: All I can say is that there are 14 different health warnings on the packs.

Mark Reckless: I thought the tobacco industry had abandoned this many years ago, the suggestion that cigarettes did not cause deaths. It seems that you are repeating that today.

Paul Williams: It says on the front of the pack that smoking kills.

Mark Reckless: Do you accept that?

Paul Williams: Yes.

Mark Reckless: So cigarettes cause deaths.

Paul Williams: Cigarettes can, in certain circumstances, cause deaths.

Q14 Mark Reckless: In principle, do you believe the Government is right to pursue policies to make smoking less attractive and less affordable?

Paul Williams: I think the policies that the Government chooses to adopt very often have unintended consequences. I think they are done with the best intentions. However, as we have said, smoking is an adult choice and people are aware of the risks and have been for a number of years. It is our view that clearly affordability may be a part and

⁶ Note by witness: To clarify that the 1971 introduction of health warnings was the first time UK cigarette packs expressly drew consumers' attention to the risks of smoking.

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parcel of why some people may decide not to smoke but also that the increased cost of product and the lack of affordability drives people to make other decisions, which moves them into an illegal channel where clearly the product is unregulated.

Q15 Mark Reckless: When the Government drives up prices of cigarettes in the taxed and formal market, do you believe any reduction in demand that might constitute is partly offset by increased illegal smuggling? Or entirely offset? Or even more than offset by the consequences you cite?

Paul Williams: I think if you combine the illegal and the legal market—the UK duty-paying market—the size of it has changed very little. So clearly people do find alternative sources. I think price is one of those key drivers. There comes a tipping point.

Q16 Mark Reckless: So the size of the market has not changed: people are not giving up smoking in the way I thought they had been.

Paul Williams: According to the ONS statistics, there has been very little change over the last five years. We are still seeing that 20% of the adult population are smoking, so the rate of decline is very, very slow. The number of cigarettes per day has declined somewhat and that is now sitting at around 12 cigarettes a day. I think it has dropped by about one cigarette over the last three to four years, so people are perhaps consuming slightly fewer and maybe the point you make about affordability is that that is what might encourage people to consume fewer.

Q17 Ian Austin: I think we could all agree that it would be quite a good thing to reduce the numbers of young people who start smoking. As I understand it, your argument is that the proposed EU ban on packets of 10 cigarettes would make cheap illicit tobacco more attractive.

What I want to ask is whether it would not also discourage young people from taking up smoking by raising the price that they would have to pay to start in the first place.

Paul Williams: The reason why I think 9 December is such a crucial date for the Committee is that on that date the EU Parliament will decide whether or not small pack sizes, 10s, and 12.5 grams of roll-your-own, will no longer be permissible in the UK market. If we look at the number of cigarettes that are sold in the UK market, 1.5 billion packs are sold in 20s and 1 billion packs are sold in 10s. From my perspective that is about adult choice. It is also about price. So the price of those 1 billion packs is about £4 a pack. If you ban those, you are overnight doubling the price of cigarettes in the UK market.⁷ I have to believe that that will have a significant impact on the tipping point as to whether or not people move into the illicit market.

As far as 12.5 grams roll-your-own tobacco is concerned—and that is now the product that is most smoked by adults in the UK—the minimum pack size

now could be as high as 40 grams. So the price would quadruple from £4 to £16 per pack.

When one in every two packs in the UK is already illicit and two in every five packs are bought in the UK as a 10, that would seem an illogical step. I think that is what will encourage illicit trade.

When it comes to affordability, I think most experts would say that the reason children start smoking is peer-group pressure: family and social pressures. It is not about going out and buying a pack of cigarettes. That may come later. But we do not see a link between small pack sizes and children's purchases. Children should not be able to buy cigarettes. The key is that children should not be able to buy cigarettes in the first place.

Q18 Ian Austin: They may start smoking or be interested in starting smoking for any of the reasons that you have just suggested but they then have to be able to go and buy the cigarettes, do they not, and the cheaper they are, the easier it would be for them to buy them?

Do you have any information about who buys packets of 10 as opposed to packets of 20? Are they predominantly bought by younger people?

Paul Williams: If you are under the age of 18, you are legally not permitted to be sold cigarettes. So if we address that and say that children should not have access to cigarettes, which is what we firmly believe, then clearly the argument does not take place.

Ian Austin: Yes, but do you know who is buying the packets of 10? Do you know anything about it? You must do. You spend a fortune on marketing and research and all the rest of it.

Paul Williams: Yes, I can give you prime example of a particular account in Canary Wharf in London. It has only six outlets in Canary Wharf—50% of his sales is in 10s. He has no children in Canary Wharf. Children do not purchase in Canary Wharf. This is about meeting adult demand. People in that particular area buy 10s.

Ian Austin: Set aside the six shops in Canary Wharf, generally, who is buying packets of 10s? You must know.

Paul Williams: It is about affordability. And you are right, the earlier question about—

Q19 Ian Austin: Let me ask you another way. Are they more likely to be bought by young people?

Paul Williams: There is no evidence to suggest they are more likely to be bought by young people.

Ian Austin: None of your market research or anything at all?

Paul Williams: Not in the slightest, no. Definitely not.⁸ This is about adult choice and it is about people saying, "If I want to afford to smoke, and I normally smoke 10 to 12 cigarettes per day, then 10s is the appropriate pack for me". And it seems odd to me that we would want to encourage people to buy 20 when for every other product category, whether it be alcohol, calories, everybody is told to cut down. However, the EU is saying that you should double your purchase on your cigarettes and quadruple your

⁷ Note by witness: For example the RRP of Sterling King Size (a JTI product) 10s is £3.52 and the RRP of the same product in a 20s pack is £6.86.

⁸ Note by witness: To clarify that JTI does not conduct market research on under 18s.

purchase on roll-your-own tobacco. That does not make sense to us.

The change in the law will effectively take place in 2015. I was in Ireland from 2003 to 2008, and when 10s were banned in the Irish market in 2007, illicit trade went up by 5% that year from 23% to 28%.

Q20 Chair: You are a company that had, I think, sales of \$11 billion. Is it sales or profits of \$11 billion?

Paul Williams: No. In the UK market?

Chair: Globally.

Paul Williams: I could not tell you what our global sales are. I do apologise.⁹

Chair: But it is a lot.

Paul Williams: Yes. We sell a lot of cigarettes. We are the third biggest international tobacco company in the world.

Q21 Chair: What I am interested in is this: trying to find out who is peddling these illegal cigarettes. Where is it coming from?

You have given the Committee a number of very important theories but at the end of the day this is a problem that is bigger than Customs and Excise and Inland Revenue, is it not? They need a lot of help to track down these gangs. This is serious and organised crime, is it not?

Paul Williams: It is serious and organised crime.

Q22 Chair: What percentage of your profits or time is spent on trying to track down the Mr Bigs who are behind the illegal trafficking of cigarettes?

Steve Payne: That is unfortunately not something we can do. We are not law enforcement people. It is not our area where we can get involved in investigating people and who is behind it. That is not something we would get involved in. That has to be left to law enforcement agencies.¹⁰

Q23 Chair: When I came to Northern Ireland to look at your factory, you showed me a new mechanism for tracking the cigarettes that you produce, so you knew where these cigarettes were going to end up. Is this something that has been adopted by other people in the industry or is it just JTI that is doing it? There seems to be an attempt to try to find out who is behind it. We know you cannot turn detective, but this is a very important issue, is it not?

Steve Payne: Yes, you are correct. These are our cigarettes, which are the genuine product. What we cannot track is the illicit product that we do not make, which is the 16% HMRC are referring to or the 20%

we think it is in the market.¹¹ They are not made by us, so we have no mechanism to identify who is behind it and who is selling it. It is something that law enforcement have to take the lead on.

Q24 Chair: Of course, but you would have anecdotal evidence. You have views as to where this is coming from.

Paul Williams: Yes, we do, in terms of illicit whites manufacturers; certainly.

Q25 Chair: Yes. Who is it?

Paul Williams: It comes out of Jebel Ali—

Steve Payne: Yes, lots of locations. It is coming from many, many countries around the world, from small and medium-sized manufacturers who do not have strong due diligence processes on who their customers are.

Q26 Chair: Would you say that some countries may be complicit in what is going on with illegal trafficking of tobacco?

Steve Payne: It is hard to say a country is complicit. I would say that the organised—

Q27 Chair: What about law enforcement agencies turning a blind eye?

Steve Payne: I would say the organised crime gangs are targeting certain jurisdictions where they know they can use the regulations to their benefit, for example, Jebel Ali, which is a free trade zone. They will purposely place their factories in that location because they know they can manufacture and export out of there without breaking any local laws. Therefore the local law enforcement cannot do anything because nothing wrong is being done. Take the pack here. Do you have the Jin Ling?

Paul Williams: No.

Steve Payne: Jin Ling is a very popular pack that comes out of Russia and Ukraine. Many of you may have seen it. This particular product is made perfectly legitimately in Russia and Ukraine and the law enforcement agencies cannot do anything about it because it is made legitimately, taxes are paid and everything is done above board. But then when it is sold to the customer, they are the ones who smuggle it to another country. That is where the problems start.

Q28 Chair: I heard of an investigation that suggests that the product inside the illegal cigarettes in many cases could be extremely dangerous—obviously we take Mr Reckless' point that smoking kills and indeed, Mr Williams, you supported that view because it is clearly on the packet. Are the substances that have been put into some of these rolled up cigarettes a concern to you?

Steve Payne: They are totally unregulated. Our product is very regulated and we have to follow very specific regulations.

I saw the piece on the television news this morning when you were on ITV, on *Daybreak*, and there was a technician on there saying that they had all sorts of

⁹ Note by witness: To confirm that JTI's global core revenue for 2012 was USD 11.8 billion Core Revenue (core revenue does not include revenue from distribution, contract manufacturing and other peripheral businesses).

¹⁰ Note by witness: To clarify that JTI does have an AIT program, that it has spent \$200 million internally on its AIT department and related initiatives since 2007 and has, through JTI's EU agreement, committed to provide \$400 million over a 15 year period to fight illicit trade in the European Union (For more information please visit <http://www.jti.com/how-we-do-business/anti-illicit-trade/overview/>).

¹¹ Note by witness: To clarify these percentages refer to non-UK-duty-paid product, a proportion of which is illicit tobacco.

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things inside the cigarettes. We do not, as a course, test all the different cigarettes inside for the tobacco, but we have seen a number of reports over the years of all sorts of things inside, yes, because they are not regulated.

Q29 Mr Winnick: I wonder if I could ask you a personal question, which you are under no obligation to answer. Do either of you smoke?

Steve Payne: I do not.

Paul Williams: I do not.

Mr Winnick: You do not.

Q30 Mr Winnick: And if you have children, would you be encouraging them not to smoke?

Steve Payne: I would not encourage my children to smoke.

Paul Williams: No, as a father and a grandfather, definitely not.

Mr Winnick: Neither of you smoke.

Paul Williams: No.

Mr Winnick: Thank you very much.

Q31 Paul Flynn: Is there some suggestion that smuggled cigarettes are somehow more toxic than other cigarettes, that you get a better form of cancer by having your cigarettes rather than smuggled one?

Paul Williams: Smuggled cigarettes are obviously unregulated so they do not have to comply with any of the regulations that we would have to comply with as a legitimate manufacturer.

Q32 Paul Flynn: How does this affect the likelihood of their causing cancer?

Paul Williams: Again, we are not experts in what the components of illegal cigarettes are. We can only go on what we hear, as well, that they contain various other components that you would not find in our tobacco products.

Q33 Paul Flynn: So no reason why they might be more dangerous than cigarettes that are regulated.

Paul Williams: I think the comments from this morning were that people who have conducted evidential surveys on these particular brands have said they contain higher levels of tar and nicotine and so clearly they are not regulated as we are regulated.

Q34 Paul Flynn: You suggest the National Crime Agency could have a role to play in combating the illicit trade in tobacco, particularly given the involvement of organised criminal gangs. It is a pretty bleak picture of a deteriorating situation.

Do you think that they would be hampered by restrictions on their operations in Northern Ireland if your proposal were supported and put forward?

Paul Williams: If our proposal for, sorry—

Paul Flynn: For the National Crime agency to have a greater role.

Paul Williams: Our belief is that hopefully all of the enforcement agencies will work very closely together, including with us. For example, this year to date we have supplied HMRC with 83 pieces of intelligence relating to some 3 billion cigarettes that were suspect that were heading for the UK. We want to work in

collaboration and we hope that the agencies will all work in collaboration.

Q35 Paul Flynn: What is your view of the reason why the number of arrests, prosecutions and convictions for tobacco smuggling has fallen over the past three years when apparently the activity continues, if not increases?

Paul Williams: We understand what a difficult job it is for HMRC. Clearly, very often you cannot get to the source. We would say that fake cover loads and various other documentation makes it exceedingly difficult if you are getting to the larger organised criminals. I think that is one of the issues. They are becoming more and more sophisticated.

Recent reports would suggest that the Border Force—certainly with seizures at major ports of product coming into the UK—have been fairly successful but that we are seeing significantly more issues inland and inland detection and the availability of product in communities is becoming more prevalent.

Q36 Paul Flynn: The maximum fine for breaking the tobacco display ban regulation is £5,000, significantly lower than many of the other fines issued for the evasion of excise duty. Is there a case for changing that sum of £5,000?

Paul Williams: Our view would be that the penalties, such as seven years' imprisonment, are in place and that the fines are there to be applied. The issue of whether or not the courts apply them and whether prosecutions turn into convictions is probably more our concern. There are lots of prosecutions but few convictions.

Our particular position would be that it is about going after the proceeds of crime as well. That is where it really starts to hurt, as long as the proceeds of crime are being followed through. I think that of those individuals who have tried to profit, 13 or so of HMRC's top 30 most-wanted tax fugitives are involved in tobacco smuggling of some type. So clearly there are huge profits to go after.

Q37 Paul Flynn: What is the likely benefit, financially, now for a small trader for evading the rules, in relation to the £5,000 fine? Is it realistic? Or is it an advantage for them to take a risk?

Steve Payne: The display ban is not in practice for small retailers yet.

Paul Williams: No. There is no display ban for small retailers at this point in time. It does not come into play until 2015.

Q38 Paul Flynn: What would you see as the ideal situation for tackling this? What should the level of fine be? What should the penalty be, to discourage anyone from breaking the new rules?

Paul Williams: Inland is where HMRC and Trading Standards can work together very closely. We support them in identifying outlets where we believe there are issues in relation to illicit products. I think if they worked closely together, that would be a big help.

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Q39 Paul Flynn: Can you say with absolute certainty that none of the smuggled tobacco product is manufactured by your company?

Paul Williams: I think as we mentioned only 1% of the seizures by HMRC related to JTI product. Clearly, we have our supply chain controls in place. We work very, very co-operatively and collaboratively with HMRC in all markets. Certainly, we believe that is why so little of the product that is seized is relevant to JTI.

Q40 Chair: In terms of jobs in your industry, what is the current level of employment?

Paul Williams: We currently employ 1,800 people within the United Kingdom. Most importantly, we employ 900 people at our factory in Northern Ireland. That is what we believe will potentially be at huge risk should, for example, 10s packs be banned and 12.5 grams. We invested significantly to meet the demand of adult smokers within the United Kingdom market and that factory is pretty much the sole producer of those. So on 9 December there could be serious consequences for employment in Northern Ireland.

Q41 Chair: Of course you have your own local Member of Parliament, Ian Paisley, who I know has raised this issue. It was also raised at Prime Minister's questions and the Prime Minister said he would look at it.

But in respect of illicit whites, the Jin Ling, is that a Jin Ling you have in front of you?

Paul Williams: This is a Jin Ling.

Chair: They have 51% of the market. Is that right?

Paul Williams: Yes. Jin Ling is 51% of illicit whites within the United Kingdom.

Q42 Chair: How would a packet of Jin Ling, such as you have in front of you there, get to a place such as Leicester, if it is manufactured in Russia?

Steve Payne: The majority of them are manufactured in Russia and in Ukraine. But it is quite ironic that even this, because it has become so popular, is now being counterfeited. So even the illicit whites are being copied.

Chair: Illicit whites are being made illicitly. But how would that get to Leicester? How would that get to Birmingham? How would it get to the midlands?

Steve Payne: Well, what will happen is that Jin Ling, as I said, will not be doing too many careful checks on who the customer is and the customer will be saying, "I will be taking it out of the country".

Q43 Chair: So that bit is legal?

Steve Payne: So that bit is legal inside Russia so the Russian authorities cannot do anything about it.

Once it leaves the country, it never arrives anywhere else. It does not arrive in a second country. It just disappears. It is driven by truck, put on a ship, or whatever mode of transport they use, and taken into Europe and obviously some of it then ends up in the UK.

Q44 Chair: So the main method by which it comes to the UK is, you think, by truck, which means it goes

through Dover. So in respect of the UK Border Force, who did not meet their targets, I think, last year for dealing with smuggling, what is the problem there? Do they need more resources to stop it coming into the country?

Steve Payne: Definitely.

Chair: Because once it is in, it is too late, is it not?

Steve Payne: Yes. It is too late and they do need more resources and more ability to tackle all sorts of transportation. It will not be just trucks. There will be different methods of bringing it in. They will take some by ship and bring it in in containers. But our information in recent years has been that there is less and less in containers now. They are taking it in smaller loads because they realise that is a little safer because if the whole container is seized, they have lost a whole load, whereas if they break it down into smaller truck-sizes, and one or two get caught, some of it still gets through.

So yes, it is coming in. They use the ferries. It will not just be Dover. There are lots of ports all around the UK. We have even seen a lot of evidence of it going into southern Ireland by ferries and different ways and then driven into Northern Ireland and then coming from the Northern Ireland back into other parts of Scotland and...

Q45 Chair: What more can the UK Border Force do to stop this happening? What more needs to be done? They cannot check every single truck. If you check every single truck at Calais, this Committee would begin to be very concerned about other, legal goods.

Steve Payne: It is a problem that everybody has, not just here. If 1% or 2% of containers are checked at ports around the world, that would be unusual. It is very rare that it is more than that. That is the reality of the dilemma we have—98% of goods that go through will not be checked.

Q46 Chair: Mr Williams, is there anything else you want to say to the Committee about this trade?

Paul Williams: Yes. I think we are seeing significant emerging threats. Mr Payne has mentioned that clearly the Middle East is one. The Canaries is another, where there is again an enterprise zone where there are significant set-ups of manufacturing at this time with a vast array of products available now between €1 and €1.80 per pack covering every conceivable type of cigarette product. That I think is an emerging threat that needs to be considered.

The internet is another one. Just in advance of the Committee we asked one of our providers to see what he could acquire and he acquired a kilo of tobacco leaf.

Q47 Chair: Where from?

Paul Williams: Over the internet, for £30.

Q48 Chair: Is that legal or illegal?

Paul Williams: It is legal until you do something with it.

Chair: So to have it and wave it about at a Select Committee is perfectly legal?

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Paul Williams: It is. Until you shred it or put it through a Moulinex blender and try to turn it into something you can smoke, it is legal.

Mr Winnick: At least we will not be reported today.

Q49 Chair: What else do you have in your bag? You are like Mary Poppins.

Paul Williams: This is interesting as well. Over the internet: 50 pouches of 50 gram Amber Leaf, all of which is counterfeit; all of which has tax stamps on it. In fact, we ordered 50 but only got 42 so that was amusing in itself.

Chair: So they are short-changing you.

Paul Williams: We have been scammed already and whether or not any of them weigh 50 grams of course is another matter. Again, this is the scale of what is available.

Q50 Chair: So that is illegal, what you have in your hands.

Paul Williams: That is illegal. This is both intellectual property fraud and also duty fraud.

Chair: Right. Maybe you could open the bag and hand them round—not for us to use, but to see. Oh, it cannot be opened? Do not worry. We will look at it later.

Steve Payne: We have one sample here.

Q51 Chair: Maybe you can pass that round. That is a legitimate stamp and a legitimate covering that has been illegally copied. Is that right?

Paul Williams: Yes. These are fake tax stamps.

Q52 Chair: They come with the tax stamp already stamped on it?

Paul Williams: No. Those come separate. These are the pouches.

Chair: They are separate. It is a do-it-yourself kit

Paul Williams: A do-it-yourself kit.

Q53 Chair: What is the value of this do-it-yourself kit nationally; not this little bag but generally? What do you put it at?

Paul Williams: This would be responsible for the largest percentage of all the non-UK-duty-paid.¹²

Chair: Which is how much?

Paul Williams: It is sitting currently at 48% of the market. The majority of that is counterfeit.¹³

Q54 Chair: You can order it on the internet.

Paul Williams: You can order that. We ordered that on the internet.

Q55 Chair: Has anyone informed the internet companies that this is happening and this needs to be stopped?

Paul Williams: Clearly, we will be passing this on to the authorities after this Committee meeting.

Q56 Chair: When you say the authorities, who is that?

Paul Williams: HMRC.

Chair: So, to Lin Homer, who will be giving evidence to us at some stage in the future.

Paul Williams: Yes. We will pass that on.

Q57 Chair: Do you not feel this is just overwhelming: that there is nothing you can do to stop all this?

Paul Williams: I think it is the scope and scale. As well as already packed, we also have 1.5 million empty pouches, such as the one Mr Ellis is looking at at the moment. Those were seized. We know that tonnes and tonnes of loose tobacco are seized. They were being seized at Coventry in the postal depots.

Clearly, the empty pouches come in because that is not duty fraud: that is intellectual property fraud. The tobacco comes in separately and the two are put together. When you consider you pay £16 for this within the UK, but you can probably make this for somewhere under £1 and then sell it at £8 to £10 illegally, it is a huge, huge profit margin. That is really what is driving it.

Q58 Chair: We are coming to the end of this session. Finally, if you had a message to the public what would it be? What would you be saying to the public about reporting these kinds of activities?

Paul Williams: It is a message we are taking out into the local communities through media and saying, “Don’t be tempted. Please do not be tempted. These cigarettes contain components that clearly are very dangerous and realistically you must report it to the HMRC hotline”. That is our message: do not be tempted.

Q59 Chair: Once they report it, it is then going to be acted upon. Hopefully.

Paul Williams: Absolutely. It must be acted upon. If it is cheap, it is too good to be true.

Q60 Chair: Mr Williams, Mr Payne, thank you very much for coming to give the first oral evidence of our inquiry session into tobacco smuggling. We are most grateful. We might write to you again. Before you leave, please would you collect all your legal and illegal substances so the Committee is not left in difficulties.

Thank you very much.

¹² Note by witness: To clarify RYO tobacco makes up the largest percentage of all non-UK-duty-paid tobacco products.

¹³ Note by witness: To clarify that a proportion, not the majority, of the estimated 48% of non-UK-duty-paid RYO tobacco is counterfeit tobacco.

Tuesday 11 March 2014

Members present:

Keith Vaz (Chair)

Ian Austin
Michael Ellis
Paul Flynn
Lorraine Fullbrook

Dr Julian Huppert
Yasmin Qureshi
Mark Reckless
Mr David Winnick

Examination of Witnesses

Witnesses: **Sir Charles Montgomery**, Director General, Border Force, and **Jim Harra**, Director General, Business Tax, HM Revenue and Customs, gave evidence.

Q61 Chair: Could I call the Committee to order? We have the possibility of further votes during this session, so I say to the witnesses that we will adjourn and return if we haven't completed our questioning. My apologies for keeping you waiting outside. I ask all those present to indicate if they have any matters that need noting before the Committee, other than what is in the Register of Members' Interests.

We are starting today's session with a look at tobacco smuggling and we welcome back Sir Charles Montgomery, the Director General of the Border Force, who is celebrating his year in office, 374 days by my calculation—I don't know whether you count your tenure by days, Sir Charles, but there you have the figure—and Mr Harra who has been there slightly longer as Director General of Business Tax at HMRC. Thank you for coming.

Before we get on to tobacco smuggling, I want to ask you, Sir Charles, a question about border checks, especially in view of what has happened in respect of the Malaysian airline that has ended up in the South China sea. There was a report in the *Telegraph* this morning that suggested that up to 20 million people's passports are not checked when they leave the United Kingdom. Do you recognise that figure and, if you do, it is a very large figure, is it not?

Sir Charles Montgomery: Can I first of all say that is not the case? It is not the case that 20 million people's passports are not checked when they depart the United Kingdom. Indeed, Chair, I perhaps would take this opportunity, without referring to the two individuals concerned, to just make the point more generally that our borders, since the introduction of the 100% checks on arrival at our immigration controls, are the most secure in Europe and one of the most secure in the world. I would also say that by dint of our advance passenger information regime, where we are achieving well over 90% now—you will remember last time I was before you it was rather less than that—we are making some significant progress. We are achieving well over 90% of the advance passenger information—

Q62 Chair: Can I stop you there because I just want to get the facts right so nobody is under any confusion as to the numbers we are talking about? You do not recognise the figure of 20 million?

Sir Charles Montgomery: I do not.

Q63 Chair: So what figure is it?

Sir Charles Montgomery: All passengers who are departing the United Kingdom, of course, have to go through checks that are conducted by the airline operators.

Chair: Yes, we know that.

Sir Charles Montgomery: Of course that includes passport checks in almost all cases other than those travelling within the European Union where some other form of identity may be acceptable.

Q64 Chair: Sure, so what is the figure? We understand that. The Committee has been sitting for a number of years and we have been to Heathrow Airport. If the figure of 20 million is wrong, what is the figure? What is the estimate—you must have these estimates as the head of the Border Force—of those you are going to check? You also have concerns no doubt about those we can't check because we can't check 100% on departure—you have said so yourself. What is the figure?

Sir Charles Montgomery: The figure, Chair, as I have indicated, is always passengers going out of the United Kingdom will have their passports checked, other than the European Union passengers who will have some other form of valid identity checked. So their identities are being properly checked.

Q65 Chair: That does not take us much further. You are saying we are above 90%—I think you said “well above”. We would like a bit of precision before this Committee and at the moment you have not given us any precise figures. You have talked about “well above” and you have distanced yourselves from the figures in the *Telegraph*, but you have not given us any figures. I can give you another figure from Interpol. It said on Sunday that more than 1 billion air journeys take place worldwide without passenger details being checked against its stolen passport database. Do you recognise the Interpol figure?

Sir Charles Montgomery: I don't I am afraid. I am not an expert on Interpol but I am an expert on—

Q66 Chair: But have you seen that figure?

Sir Charles Montgomery: I am an expert on Border Force.

Q67 Chair: No, we understand that. We don't expect you to be an expert in Interpol, I don't think anyone would claim to be, but I would have thought the head of the Border Force would have picked up an alarming

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figure put out by the international police organisation—we know it is not part of the Border Force and is a quite separate organisation.

Sir Charles Montgomery: It is. It is an alarming figure.

Q68 Chair: Right, are you hearing it for the first time today?

Sir Charles Montgomery: What I picked up from the Interpol announcement was that the United Kingdom is second only to the United States in terms of the amount of information we provide to Interpol and the amount of information we extract from Interpol. I think that is the most significant detail.

Q69 Chair: We are not just interested in good news, we would like the facts. We know the United Kingdom is doing splendidly and we know you are a splendid head of the Border Force because you have been in office for a year, which is longer than your predecessor. You still have not told this Committee and it worries me, it means that you as head of the Border Force have no estimates and no knowledge of how many people leave the country without their passports being checked. That makes me more worried than when the session began.

Sir Charles Montgomery: There are two issues, Chair, if I may, and I tried to address but clearly I didn't do it clearly enough. The over 90% figure, of course, refers to the advance passenger information that my organisation harnesses, analyses carefully and uses that as the basis of doing intelligence based targeting for both inbound and outbound passengers. Now, it is right to say that just over 100 million leave the United Kingdom every year, so it is right to say, therefore, that well over 90% of that 100 million—

Q70 Chair: Which is what then? We are at the situation where we nearly have a figure from you. What does the 10% represent in terms of numbers?

Sir Charles Montgomery: About 5 million.

Chair: Right, brilliant.

Sir Charles Montgomery: But that is advance passenger information, Chair, not the question you asked, which was passport checks.

Q71 Chair: So the answer to the question on the number of people who leave the United Kingdom who do not provide us with API is about 5 million?

Sir Charles Montgomery: It is about 5 million.

Q72 Chair: Right, thank you. So what is your estimate as to the number of people who leave the country who do not have their passports checked at the border?

Sir Charles Montgomery: I can provide you with a very exact figure of that but I do not have it with me.

Q73 Chair: That is fine. We are very happy to accept that you have to go away and come back. I would be grateful if you could do that by Friday of this week.

Sir Charles Montgomery: I would be delighted to.

Q74 Chair: The Committee has just returned from Nairobi where we have been looking at counter-terrorism. When we arrived at Jomo Kenyatta Airport, our bags were checked and put through security. We are not suggesting this should happen at Heathrow because we have many more passengers than Jomo Kenyatta Airport, but when we got to the check out, through immigration, and when we were waiting to board the plane, we then went through another security check where our hand luggage was put through security and they tested some of the passengers, including my own baggage, as to whether or not they had been contact with any equipment that could relate to terrorism. Are you satisfied, leaving aside the issue of passports and those checks, that we have our security system right to prevent those who may be terrorists from boarding our flights?

Sir Charles Montgomery: I am content.

Q75 Chair: You are content.

Sir Charles Montgomery: I am content. I am content that we have a perfectly proportionate response to all those who are passing both inbound and outbound of the United Kingdom to check them, whether they be in the business of terrorism, crime or immigration crime, or whether they are just travelling legally.

Q76 Chair: The Home Office Minister, Mr Baker, said that the Liberal Democrats are firmly committed to exit checks at the earliest opportunity. You came before this Committee and you said that by the time we got to the end of the Parliament e-borders would be in place. That is 422 days to go. Are you still happy with that timetable?

Sir Charles Montgomery: To be clear, what I said was that I was confident that we would have an exit check regime in place and I am still confident we will do so.

Q77 Chair: So you are not confident—the Permanent Secretary who gave evidence to us is—that e-borders would be in place by the time of the general election, which is 7 May 2015?

Sir Charles Montgomery: Chair, I do not recognise the Permanent Secretary's comment. The Permanent Secretary is aware that the e-borders programme has been terminated. We are in the business now of replacing warnings index and Semaphore. I am confident that we will be well on track to deliver that but not the full e-borders capability, as it originally was, by the general election.

Q78 Chair: That is new information you are giving us because that is certainly different to what the Permanent Secretary has said.

In respect of the arbitration, when you appeared before us you did say that you hoped that it would be completed within months. That was October. What has happened to this arbitration?

Sir Charles Montgomery: The arbitration is out of my court, Chair, as you will know. This is being scrutinised independently. I can tell you that the Home Office is as anxious for the outcome of that as anybody else but it is not within the Home Office's gift to determine timelines, and it certainly is not mine as Director General, Border Force.

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Q79 Chair: Can you reassure the Committee, especially after this terrible catastrophe in the South China sea, that everyone's passport—everyone who leaves the country—is checked against the lost and stolen passport list that is held by Interpol?

Sir Charles Montgomery: No, I can't do that and I didn't say that. Your question was—

Q80 Chair: Well, this is a new question.

Sir Charles Montgomery: The link with Interpol is a new question.

Q81 Chair: So we can't be sure that every stolen or lost passport is checked against the Interpol database?

Sir Charles Montgomery: Every lost and stolen passport, whether it be UK or other, is checked on the way into the United Kingdom against the Interpol list. On outbound, every UK false or stolen passport, but not other than the UK outbound, would trigger an alert at the border and therefore an intervention potentially. What we do on outbound—it goes back to my original point—is have a system of advance passenger information, which of course is watched against a warnings index and other data, including the police national computer. If there are people who trigger an alert on that, of course we may well intervene.

Q82 Chair: Of course. We understand. But as far as you are concerned there are 5 million people at the moment. You want to see it brought down—we know you do, and it is the wish of this Committee that it be brought down—but there is still risk from 5 million people. Are they able to leave the country without being checked out?

Sir Charles Montgomery: No, they are not subject to advance passenger information, Chair. That is the point. None the less they are still, of course, checked by the airline operator on the way out, including either their passport or, if they are European Union citizens, some other valid form of identity.

Q83 Chair: The point the Committee has made to yourself and other Ministers, and to your predecessor, is that it is checked not by you, but by the airline.

Sir Charles Montgomery: That is correct.

Q84 Chair: It depends on the airline being able to co-operate with you if they want to give you that information?

Sir Charles Montgomery: Yes, it does. I would emphasise, however, that the Home Office forward analysis and detection unit does provide training to those airlines, and that that unit itself is recognised worldwide as being a source of international training as well.

Q85 Chair: Of course, but we remain concerned about the fact that still there are so many passengers in this position, and we urge you to redouble your efforts to try and make sure it is 100%, which I know is what you want.

Sir Charles Montgomery: Indeed, I can assure you there will be no stone left unturned to close that gap down to 100%.

Chair: Excellent. Mr Winnick has a supplementary on this.

Q86 Mr Winnick: As regards the passport issue that the Chair has raised, and airport security—he made the comparison with Kenya—would it not be the position that to a very large extent countries, certainly our own, would decide security on the obvious question of how acute is the terrorist threat?

Sir Charles Montgomery: That would be correct.

Q87 Mr Winnick: Therefore Kenya, like Israel, which comes readily to mind, would have far stricter controls simply because the threat of terrorism is so acute, where in Britain—which no one for one moment underestimates after 7/7—the position is less so.

Sir Charles Montgomery: I wouldn't like to compare Kenya to the United Kingdom because, of course, different terrorist groups which would target the two different countries. I would like to satisfy this Committee that my organisation, and indeed the Home Office more widely, takes the terrorist threat to the United Kingdom extremely seriously and therefore we regard the terrorist threat to be a major driver of our activity at the United Kingdom border.

Q88 Mr Winnick: This is my final question on this. When passengers, including myself, leave Heathrow, say, on holiday, the procedures that are adopted seem—even the taking off of shoes for very obvious reasons—to be adequate to deal with the terrorist threat. Obviously none of us are complacent—the terrorists will remain for many years to come a danger to our people. What I am really asking you, Sir Charles, is whether there is any danger at the moment arising from the fact that all is not what the Chair has indicated.

Sir Charles Montgomery: I would just like to be clear about the question.

Mr Winnick: What I am saying is that, given the points the Chair has rightly made, do you in anyway believe at this stage that the absence of what is occurring presents a day-to-day terrorist threat to our country?

Sir Charles Montgomery: The answer to that is no. I believe our response is being utterly proportionate and is being very closely allied to the intelligence and the risk that the United Kingdom faces. If the question is whether I believe our posture at the border reflects the real risk to the United Kingdom, the answer is yes.

Q89 Chair: Thank you, that is very helpful. Let us move to tobacco smuggling and the report that was written by John Vine last year. He was highly critical of the relationship between the UK Border Force and HMRC. I think he said that there was a breakdown in communication at an operational level between your two organisations. Mr Harra, has this now been cemented? Are you getting on better?

Jim Harra: In terms of the relationship between the organisations, certainly at a strategic level, we have been working effectively together.

Q90 Chair: Since the Vine report?

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Jim Harra: Sir John Vine made findings in relation to operational co-operation and we have taken steps both before that report and since to strengthen how we work together operationally. We will continue to do so. For example, we have recently launched a joint debriefing unit at Dover, which is a vital part of our protection against tobacco smuggling. The pattern of the smuggling is changing, for example, more to roll-on, roll-off, so Dover is critically important. We have also agreed a protocol on the referrals from Border Force to HMRC for criminal investigation, what we will do with those referrals and what feedback we give to Border Force.

Q91 Chair: He was very clear. He felt that because of this operational breakdown, large seizures of cigarettes were not being investigated and prosecuted. Are you confident, Sir Charles, that this has now been put right and you are both singing from the same songsheet?

Sir Charles Montgomery: I would just like to echo what Mr Harra has just said. One of the measures that was taken as a result of the Vine report, which I absolutely welcomed, is a much more rigorous and structured process of feedback between HMRC and my officers at the front line. So not only, as Mr Harra said, is there now a protocol in place that affects the referrals and adoptions by HMRC—I welcome that because it provides clarity to my people in the front line—but there is also a feedback loop now from HMRC to the front line that did not exist before. You can understand that it was the issue of communication rather than policy that undermined that level of confidence and to which John Vine referred. I would agree with him.

Q92 Chair: Looking at the prosecutions and convictions for 2012–13, there were 265 prosecutions for tobacco smuggling but only 159 convictions. That is quite a big gap, is it not, between the numbers you prosecute and those who are eventually sent to jail or get fined? Why is that?

Jim Harra: There is no direct correlation in time between the prosecutions in a particular year and convictions because obviously convictions can take some time to come through. What we have been doing is increasing both the number of prosecutions and achieving an increase in the number of convictions year on year. So 2012 to 2013, for example, exceeded the previous year and we are on track this year to exceed 2012 to 2013.

Q93 Chair: In 2011 to 2012 you convicted 156 people, and in 2012 to 2013 you convicted 159 people, which is an increase of three. That is not a huge increase, is it?

Sir Charles Montgomery: No, it is not. I think—

Chair: Three extra people in what is one of the biggest criminal activities in the world does not fill us with confidence.

Jim Harra: Obviously prosecutions are one element of the strategy for disrupting tobacco smuggling, together with seizures and civil action we can take, such as assessing for duty and recovering civil penalties. We have a sort of twin track approach to

criminal investigation. We investigate organised crime groups and we also investigate volume crime as well. So, for example, where we see repeat—

Q94 Chair: Sure, but organised crime prosecutions have gone down from 62 to 51.

Jim Harra: Yes, that is correct. When it comes to organised crime our key performance indicator is the extent to which we prevent revenue loss. We do that through a combination of prosecutions and convictions and seizures and other actions we take.

Q95 Chair: We will come on to that later. Just tell the Committee the loss to the revenue, to the taxpayer, of smuggling? First of all in terms of tax not paid and, secondly, those that are hand-rolled tobacco.

Jim Harra: For 2012, 2013 we estimate that the revenue loss was about £2 billion.

Q96 Chair: £2 billion?

Jim Harra: Yes, that is correct. Hand-rolling tobacco—I have the figures, I think—is £900 million and cigarettes is about £1.1 million.

Q97 Chair: That is an enormous amount of money, is it not, almost £3 billion?

Jim Harra: Sorry, it is £2 billion.

Q98 Chair: Together it is £2 billion, plus £900,000.

Jim Harra: No, together it is £2 billion.

Q99 Chair: Together it is £2 billion. That is a huge amount of money, is it not?

Jim Harra: Yes, it is. My aim is to continue reducing that. It was £3.4 billion when we started our tobacco strategy back in 2000 and in the intervening period obviously duty rates have gone up, so like for like we have reduced that from £4.9 billion to £2 billion. I am obviously not satisfied with £2 billion and I would like to see it lower.

Q100 Chair: So you are doing that. Sir Charles, finally from me, on the issue of plain packaging, is plain packaging going to make your life more difficult and those of the extra staff that I know you have put in? You have put in an extra 120 staff at the borders to deal specifically with tobacco smuggling, which we warmly welcome. Is plain packaging going to make it more difficult for you?

Sir Charles Montgomery: It makes it more challenging but it is not the only thing that makes it more challenging.

Q101 Chair: Just focus on plain packaging—we will come to the other challenges in a minute with colleagues. Why is that going to make it more difficult for you?

Sir Charles Montgomery: For Border Force as a whole it probably does not make it more challenging. I think it makes it more challenging right across the piece from up country or across the border and back into in-country. It makes it more challenging in that sense. At the border, in terms of the searching regimes and of the intelligence flow, it does not make it more

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challenging in itself for Border Force, but it does make it more challenging in terms of the end to end.

Q102 Chair: Mr Harra, is it going to be more difficult for you if we have plain packaging?

Jim Harra: First of all, there is a real dearth of data that enable you to predict what the impact of standardised packaging will be on smuggling. Only one major country has introduced it—Australia. We are collaborating very closely with them to learn the lessons, even though there may not be direct parallels with the UK. Our assessment is that it is not going to create any new risks for us but it could well change the profile of the illicit market, and we would have to respond to any changes in that market in that way, but we do not think any new risk is created.

Q103 Michael Ellis: Sir Charles, let us have a look at this illicit trade and the risk of an increase by plain packaging. I think I am right in saying that the tobacco industry have argued that plain packaging will increase illicit trade, but ASH, a lobby group that opposes smoking—I think I am right in saying that—feels that illicit trade would not be increased by plain packaging. Where do you come down on this? I note what you said in answer to a question put by the Chair a few moments ago about the decrease—or I think it was you, Mr Harra—in loss to the Revenue. So in the year 2000 the loss was £3 billion in lost taxes, is that right?

Jim Harra: Yes.

Q104 Michael Ellis: Now it is closer to £2 billion. It is still a lot of money but there has been a reduction. Where do you come down effectively as law enforcement officials on the question of plain packaging? Can you be more specific?

Jim Harra: First of all the purpose of standardised packaging would be a health measure, so it would not be directly related to revenues. As I said, there is very little data to enable you to predict with any accuracy what the impact would be on smuggling. We do not believe it will create any new risks. There has been, for example, some suggestion that it might give rise to an increased risk of counterfeiting, but obviously that would displace some element of the illicit and would make no difference to revenues. It is something that we would have to monitor very carefully and respond to very quickly.

Q105 Michael Ellis: I am not talking about feasibility studies and consultancy documents and the like. What do your people on the ground who deal with these sorts of issues think about whether it is going to make their job more difficult? Have you had any feedback? Have you had any input from those people on whether plain packaging would make it more difficult for them to intercept?

Jim Harra: We certainly do gather intelligence from our front line when making our assessment of the threat. The assessment that I have given you includes that. The fact is that because there is no experience of it, it is guesswork at the front line as to what the result would be. What we have done is some futures analysis that identifies different scenarios that might come

about as a result of standardised packaging to figure out whether there are new risks in there or whether we need to make changes in anticipation of it. As I have said, the outcome of that assessment is that we do not identify any new risks.

Michael Ellis: Very well, thank you.

Q106 Dr Huppert: I am tempted ask further about standardised packaging but I think you are quite clear that there are not risks. Can I just ask about your targets? If anything, you have missed quite a lot of the targets. I have a constituent who is a heavy smoker who had some tobacco confiscated from him when he was coming from Europe. Having seen the colour of his fingers and the state of his teeth and so forth, I can well believe that he would smoke that amount. How do you make sure you do not inappropriately target people?

Sir Charles Montgomery: Our targeting at the border comes by and large in two forms. One of them is the intelligence-led targeting. There is a number of means by which we can draw on intelligence to target specific traders or individuals coming across the border. I can't comment about your constituent but he may or may not have fallen into that category.

The other, of course, is the straightforward intuition and judgment of my officers on the front line. I can honestly say, Dr Huppert, that when I have been down to see my people in the front line I am immensely impressed by the degree to which their intuition and judgment delivers real results. They do so through their experience, through very subtle questioning, which of course to the experienced officer reveals a lot about the individual. My people ask where people have come from, where they are going to and how often they have been travelling, so they can use that judgment as well. Their success rate on that basis, to my mind, is very satisfactory.

Q107 Dr Huppert: What recourse does somebody have? That person and his partner smoke about a pouch of tobacco a day, which is a large amount—I am certainly not recommending it—and he had about two months' supply. What recourse do they have after this material has been confiscated, when they have been taken off the coach they were on and missed the last trip back? How do you make sure you have a proportional response, because I don't think this would have been an intelligence-led pick—it was a tobacco cruise or whatever the equivalent is called?

Sir Charles Montgomery: If the individual wishes to appeal, of course he can do—the appeal is heard by a completely independent officer from the individual who affected the seizure in the first place. Of course, there is then a process of further escalation as well. Indeed, I occasionally receive letters from the public, not just on tobacco, but on other seizures as well. In the end, I am satisfied that there is a very fair and proportionate response to enabling those who are legally bringing materials into the country to do so and to stop those who should not be from doing so.

Q108 Dr Huppert: To move on, I think both of you have not managed to hit your internal targets last year,

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in the separate organisations. How come? What more will you do beyond what you have already addressed?

Sir Charles Montgomery: Perhaps I can start from a Border Force perspective. I could start at the micro and then perhaps we could touch on the macro issue. I am not satisfied that Border Force has failed to hit its tobacco target and I am disappointed. I am disappointed not least because tobacco is the only top or high-priority target that I failed to meet last year. It sticks out as a failure to meet one target in many. I am wanting to close that gap. If I could lead into the macro and then perhaps Mr Harra could take it on.

It is important to understand that the target setting between upstream, the border and in-country is not a precise measure. You will understand immediately that there are interrelationships between the three—upstream, border and in country. There are interrelationships at play. It is our policy as part of the strategy to intervene as much as possible upstream as we can. Over half last year was taken upstream as well. That naturally impacts on the volumes crossing the border, so I think there is an end-to-end piece here, and it is quite hard to understand the dynamic. I just want to reassure you that we have responded operationally in Border Force to the changes in the modus operandi the criminals have adopted. We are seeing them bringing less volume but more frequently. We have responded to that by intensification operations and by building up our joint intelligence capability. Certainly in the last two months we have had some notable and multi-million stick seizures as a result of that. But it has been a challenge—I would be the first to admit it.

Jim Harra: Yes, just to pick up right across the strategy, Sir Charles is right. From my point of view, so long as we disrupt the smuggling and seize the product, it is not so important whether that happens at the border or further upstream. In 2012–13 we did, for example, seize more cigarettes than the previous year—about 7% more—but you are right that we fell short of the targets we had set ourselves. Like Sir Charles, I am not satisfied with that. It is right that we have stretching targets and it is right that we are driven by them to perform even better.

I think we are seeing changes in the profile of the smuggling, which is making it increasingly challenging for us to make seizures. In particular, in the past, we have seen a lot of use of the postal channel and a lot of use of large consignments through containers, which has driven large seizures. Increasingly, we are now finding the postal channel has been virtually abandoned by the smugglers and we are seeing some behaviour where they are fragmenting consignments and bringing them over the border in smaller values, increasingly through roll-on, roll-off. That is why you are seeing an increase in the number of seizures but not an increase in the actual volume of sticks seized. We are finding that our European partners in Ireland and Germany, for example, are also experiencing that pattern. I think we have to be driven to try and get one step ahead and change our intelligence and change our targeting to match.

Q109 Yasmin Qureshi: Sir Charles, may I just ask you a question in relation to the number of cases referred from the Border Force Agency to Her Majesty's Revenue and Customs? From the year 2012–13 11,839 seizures were made by the Force, but only 2,971 cases referred out to HMRC for financial penalty. Are you able to enlighten us as to why there is this discrepancy, which is quite high, and as to what can be done to improve it?

Sir Charles Montgomery: Thank you very much indeed. There is, of course, a discrepancy but I will try and explain it. We now have a clear protocol between HMRC and Border Force on when referrals will be made from Border Force to HMRC. We have a protocol which sets out when they will be adopted for further action. I would just like to make clear, therefore, two things on why there are significantly fewer referrals as opposed to the seizures. First of all, of course, that is against the requirements of that protocol and, secondly, those people who we do stop at the border do not get away scot-free—their contraband is seized by Border Force. We do interview and we do get a lot of intelligence from those interviews, so the criminal does not get away scot-free. They lose quite a lot and we get a lot of intelligence.

To go back to our point earlier about the degree to which we have been able to achieve between us so much upstream seizure in the last few years—as I said, 50% of the seizures are now out of country—that has largely been as a result of the intelligence that we have gleaned at the border. Much of it is from seizures that do not in the end get referred or become adopted by HMRC.

Q110 Yasmin Qureshi: Can I then ask the next question? I want to ask this very carefully because I am not going to try to imply anything. From what you have just said, effectively you are saying that from low-level seizures—little criminals—you often get the information to get the big people, and therefore in return, the little person is allowed to go away?

Sir Charles Montgomery: No. It is about a proportionate response. Yes, you are absolutely right that that intelligence allows us to form a bigger picture and enables us at times to target the bigger people rather than the smaller people. It is also the case that some of those smaller seizures may be from repeat offenders and, of course, the little people do in the end get prosecuted.

Q111 Paul Flynn: What new sanctions do you think we should apply for the big criminals—the major tobacco companies who quite significantly overproduce and send to countries where there is no demand for certain brands of cigarettes and certainly no demand for the amount they send out? They are possibly produced here—produced legitimately with no tax being paid—and those companies know when they send them abroad they will not be consumed in the country of their destination but will be smuggled back here. What can we do to deal with those?

Jim Harra: Oversupply of brand cigarettes overseas with the intention of it being smuggled back into UK has historically been a problem and it remains a

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problem. We do have sanctions with a fine of up to £5 million available to us.

Q112 Chair: Sorry, a fine of what?

Jim Harra: There is a fine of up to £5 million for any tobacco manufacturer that does not take adequate steps to manage their supply chain. In addition, there are enforceable agreements with the EU where, if their product is seized, they have to pay a duty fine. For example, last year HMRC received £8 million from those manufacturers in response to seizure across the EU that were related to that.

The aim of the £5 million fine, obviously from my point of view, is to enforce compliance with supply chain management, so success for me is not that I gather in £5 million fines but that those manufacturers toe the line and manage that chain effectively. We have seen them respond to that. For example, exports by those manufacturers to what we regard as high-risk countries have fallen by 20% since we introduced that. We have one manufacturer at the moment who is in receipt of a statutory warning letter. Under the statute, I have to give them six months' warning to improve before I can impose the fine and one of the four main—

Q113 Chair: Who is that?

Jim Harra: I am afraid I am not able to disclose who that is.

Q114 Paul Flynn: You can tell us. You are among friends.

Jim Harra: I am under a statutory obligation not to do so.

Q115 Paul Flynn: Do you think they might have been the sort of people who come here with some fairy story about how we must not have plain packaging and other self-interested types? It would be useful to know if they are the same people that are feeding the illicit market.

Jim Harra: There are only four major tobacco manufacturers and I dare say at one time or another you have met them all.

Q116 Paul Flynn: How many have been fined? Presumably nobody has been fined £5 million, and you say that 80% of the trade remains untouched.

Jim Harra: No, sorry, there have been no fines under the legislation as yet.

Paul Flynn: Why?

Jim Harra: Because, as I said, the purpose of the legislation is to incentivise them to improve their supply chain management and we are seeing them do that. There is the potential for—

Q117 Chair: Sorry, you are telling us that the purpose of legislation passed through this House is just to encourage people to improve their supply chain, as opposed to ensuring that those who break the law go before the courts and are fined. That is the point Mr Flynn is making. You have this legislation but it seems to be just there to kind of provide you with a good climate.

Jim Harra: I will not hesitate to seek a fine—

Q118 Chair: When was this legislation brought in, Mr Harra?

Jim Harra: I am sorry. I do not have that information to hand but I will get it to you if you just bear with me one moment.

Chair: Roughly, which year? It is a key bit of legislation, is that not right?

Jim Harra: It was 2006.

Q119 Chair: So it came in in 2006 and in the last eight years no company has been fined, even though you have said to Mr Flynn in answer to his very pertinent question that you believe there is oversupply?

Jim Harra: You are right. There has been no fine to date. Our aim is to use the threat of a fine to force those companies to improve their supply chain management. We have seen them respond positively to that. In one case where we had not been satisfied, we have issued them with a statutory warning letter, which is a pre-cursor to a fine.

Q120 Paul Flynn: We are talking about companies who come and give evidence to us as respectable members of society, whereas their business is to sell a killer addictive drug at a very low price to young people. We have had a law for eight years that has been ineffective in at least 80% of the cases, and the nonsense goes on. We are producing the goods here, avoiding tax and sending them overseas knowing that they are coming back to our markets.

Jim Harra: I don't believe it has been ineffective. There are high-risk countries that we regard as being oversupplied and we have seen the supply to these countries reduce—

Q121 Chair: Which ones?

Jim Harra: Countries like Andorra, for example.

Chair: Andorra. What is the population of Andorra, Mr Harra?

Jim Harra: I don't know the population of Andorra but in effect the high-risk countries are EU countries with very low duty rates because—

Q122 Paul Flynn: Can you compare the tobacco retail industry in Andorra with the Ukraine or Bulgaria?

Jim Harra: Sorry, can you repeat the question?

Paul Flynn: What would you say it was? Has Andorra more than a 0.1% of the tobacco retail industry that the Ukraine has or Bulgaria has?

Jim Harra: I do not think it is valid to do a comparison on the size of population because one of the key legitimate reasons for exporting branded cigarettes is to supply legitimate cross-border shopping. If British tourists visit there to buy cigarettes to bring home, which they are entitled to do, then that is entirely legitimate, but we do believe that that industry has been oversupplied and we continue to work to get that oversupply down.

Q123 Paul Flynn: But we are making no progress. This is the main source of the illicit tobacco coming in, the main reason why we lose £2 billion, and the

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main reason why our children are exposed to very cheap addictive drugs.

Jim Harra: First of all, I think we are making progress, but it is also important to say it is not, we believe, the main source of the illicit tobacco that is smuggled into the UK. The main source of illicit cigarettes, for example, is foreign brands, which we call illicit whites, rather than the UK market.

Chair: It would be very helpful in answer to Mr Flynn's questions, which were very pertinent, if you could let us have the percentage breakdown of how much you regard as being oversupplied as opposed to foreign brands entering the country, and let us know what that £2 billion figure you gave us represents. Just for your record, the population of Andorra is 78,000, which I think is about the same as Northampton North, Mr Ellis, or even Rochester and Strood, where we will now go for the next question.

Q124 Mark Reckless: Are you on course to meet your target of reducing the amount of revenue lost from fraud by 30% by 2015? Do you expect to hit that?

Jim Harra: Yes, I very much hope we will. We have obviously got a year and a bit to go on that, but the revenue losses prevented are so far are running ahead of target up to the end of 2012–13. We are on track to exceed 2013–14 as well.

Q125 Mark Reckless: Ultimately, can you deal with the issue that taxes on tobacco are so much higher in this country than in many of the other countries exploited for this trade. Is there not something inevitable about the losses in this trade?

Jim Harra: UK duty rates on tobacco are among the highest in the world and they are the highest in the EU. That does mean that the price of legitimate product in the UK is very high compared with other countries in the EU, so that does contribute to UK being a target for smuggling. I think what the evidence shows, however, is that year on year we have been able to increase the amount of revenues we collect from tobacco duties. Over the period of the tobacco strategy, we have been able to reduce the size of the illicit market both in absolute terms and as a proportion of the overall tobacco market, so it definitely contributes to the scale of the challenge. That is a challenge I face but it is one we have been able to count.

Q126 Mark Reckless: If the Chancellor were to make your task more challenging by, say, increasing tobacco tax by a further 10%, what impact do you think that would make on smuggling? How much of the expected revenue would be lost to greater smuggling than would otherwise be the case?

Jim Harra: I can't quantify what a 10% increase would do, but certainly since 2011 we have had an escalator on tobacco duty where it increases at above the rate of RPI. During the same period, we have managed to reduce the duty losses and reduce the illicit market share, so I think most assessments would say that we have not reached an optimal point in terms of maximising the revenues that you could get from tobacco.

Q127 Mark Reckless: So are you saying the current tax rate is sub-optimal?

Jim Harra: No, I am saying that I will rise to whatever challenge Ministers want to give me, but my assessment would be that it is still possible for tobacco duties to rise, as indeed they will under the escalator, and to continue to bear down on the illicit market and get more revenues.

Q128 Chair: Can we just check what happens to all this stuff that is seized—all the cigarettes and other illegal items? Where does it all go? Is there a ritual burning of these cigarettes or are they kept in some warehouse?

Sir Charles Montgomery: The answer is both. It is taken to a Queen's warehouse where it is preserved in secure accommodation unless or until there is a decision for a prosecution, but in the end every bit of it gets burnt.

Q129 Chair: Is that under your control?

Sir Charles Montgomery: It is under my control.

Q130 Chair: How much of these items do you have under your control, for example, today?

Sir Charles Montgomery: I am very happy to give you a reply by return.

Chair: By tomorrow? That is fine.

Sir Charles Montgomery: Whenever you would wish it.

Q131 Chair: Tomorrow would be fine because they are figures you could get to. So you have all these items, you do not destroy them until you decide on a prosecution, and then there is a mass bonfire?

Sir Charles Montgomery: Yes.

Q132 Chair: Where is that bonfire held?

Sir Charles Montgomery: Again, I am sorry, Chair, I do not know, but of course there are a number of Queen's warehouses around the United Kingdom.

Chair: On days other than 5 November cigarettes are just burnt.

Sir Charles Montgomery: Contraband more widely is destroyed. Yes.

Mr Winnick: The Chair wants to witness it for himself.

Chair: I was going to say Mr Flynn.

Paul Flynn: I think the Chair wants to volunteer for the champagne that comes in that has to be disposed of.

Q133 Chair: Anyway, the Chair has not said any of those things. Can I place on record our appreciation to you, Sir Charles, and your organisation—in particular your chief of staff, Dan O'Mahoney—for the way in which we are treated when we ask to visit any of your facilities? It is quite unlike any part of the Home Office. You say yes immediately and you facilitate our visit—as you did recently, when we were most grateful. That helps the Committee understand effectively how things are going. We are most grateful for that.

On the issue of dogs being used, has there been any reduction? We were very impressed with the way in

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which dogs are deployed to find illegal activity on the very big lorries that come over from the Continent.

Sir Charles Montgomery: There has been no reduction on my watch.

Q134 Chair: Mr Harra, we are very worried. We would not say it is complacent yet, but we are worried by the fact that nobody has yet been prosecuted under legislation that has been on the statute book for eight years, and that it is used more as a threat than as something that brings people to justice. At the end of the day, we would be very keen to have further information from you as to how there has been an improvement in the supply chain for those companies that you have had communications and discussions with. You presumably engage with foreign countries to try and stop them sending this contraband into our country. There is engagement with foreign countries, is there?

Jim Harra: Yes. Quite apart from engagement from the UK, we have a network of foreign crime liaison officers who are embedded in the highest-risk countries around the world. They work with local law enforcement agencies and local policy agencies to get those countries to help us with the upstream procedures.

Q135 Chair: With respect to the only country you mentioned to us today, Andorra, who do you engage with there?

Jim Harra: Our foreign crime liaison officers will often be embedded in one country but cover a region. So, for example, we have one in Madrid who will cover that country.

Q136 Chair: It covers Andorra?

Jim Harra: Yes.

Q137 Chair: Right, because we understand that Andorra is run by the President of France and Bishop of Urgell and we wonder how you engage with those two.

Jim Harra: I don't know how we engage with those people personally. Our FCLOs will usually engage with custom authorities, tax authorities and law enforcement agencies. They are key to making sure that intelligence flows both back to the border and from the border to the agency.

Q138 Chair: Of course, but could we have a note on your foreign engagement, because obviously stopping things coming in is better than seizing them when they are at the border?

Jim Harra: Absolutely, and that is where the majority of cigarettes—

Chair: We are most grateful. Thank you both very much for coming in today.

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