



National Audit Office

**REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL**

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HM Revenue & Customs

Renewed Alcohol Strategy: A Progress Report

Summary

- 1** Section 2 of the Exchequer and Audit Departments Act 1921 requires the Comptroller and Auditor General (C&AG) to examine the accounts of HM Revenue & Customs (the Department) to ascertain that adequate regulations and procedures have been framed to secure an effective check on the assessment, collection and allocation of revenue, and that they are being duly carried out.
- 2** Excise duties on alcohol generated £9.5 billion of revenue in 2010-11, but the Department's latest estimate of the tax gap indicates that up to a further £1.2 billion is lost each year due to duty evasion, principally fraud. The United Kingdom is one of the few countries to try to make such estimates, which are inherently difficult.
- 3** In October 2008, the Committee of Public Accounts considered the Department's progress in implementing its 2005 Strategy to tackle spirits duty evasion and Committee members have since raised concerns with the C&AG about the Department's efforts to tackle alcohol duty fraud. The Department launched its Renewed Alcohol Strategy in April 2009, with implementation from 1 April 2010.
- 4** This report examines the Department's performance in implementing the revised Strategy in its first year, as well as its progress in establishing accurate figures for the value of revenue lost through alcohol duty evasion.

Key findings

Measuring the tax gap for alcohol

- 5** **The Department's latest figures indicate that the tax gap for alcohol increased to £1.2 billion in 2009-10.** The Department published its latest estimate of the tax gap in September 2011, which indicated that the upper bound estimate of losses due to alcohol duty evasion had increased significantly, from £850 million in 2008-09 to £1.2 billion in 2009-10. This pre-dates the implementation of the Renewed Alcohol Strategy.
- 6** **The Department has yet to establish a reliable estimate of the tax gap for wine and has published only an upper estimate of the tax gap for beer.** It intends to publish a midpoint estimate for the beer duty tax gap early in 2012. Although an official statistic, the brewing industry contests the Department's estimates of the tax gap for beer (the upper estimate was 14 per cent of the total market for 2009-10), and believes that the true gap is likely to be significantly lower.

7 The Department continues to seek indicators which will provide an earlier assessment of the impact of its intervention activities on the tax gap. There is an unavoidable 18-month time lag in producing the tax gap estimates. The Department attempted to develop 'proxy indicators', which should give a more immediate assessment of the impact of its activities, but it was unable to obtain the necessary data. Instead, it has developed a methodology that gives an indication of the impact of its operational interventions on the tax gap estimate.

Creating a meaningful alcohol strategy

8 The renewed strategy is a significant improvement on the Department's 2005 alcohol strategy. The Department's previous alcohol strategy covered spirits duty only, whereas the renewed strategy is more comprehensive and covers the duty payable on wine and beer as well.

9 The strategy includes some important elements but no explicit objective of increasing the Department's use of criminal sanctions (prosecutions) from its low level. The key actions within the strategy include interventions to implement legislative changes to make life tougher for criminals; to work with the alcohol industry to secure its supply chains; and to strengthen the Department's operational response to criminal activity.

Delivering the key actions within the strategy

10 The Department exceeded its key financial objective for the year. The Department set a number of key performance outcomes for 2010-11 and achieved a number of these, including its principal financial target of delivering operational outputs of £390 million.

11 The performance monitoring information used by the Department's Alcohol Strategy Delivery Group (the Delivery Group) is of variable quality. The Delivery Group is the forum where the Department determines the tactical adjustments necessary to deliver the Strategy. There is significant scope for improvement in the depth and quality of the management information provided to the Delivery Group. In particular, we found that £43 million out of £476 million reported as operational outputs of the Strategy were not defensible, because of poor quality assurance processes around reported results.

12 The Department's efforts to work with industry to secure alcohol supply chains have not reduced the volumes of beer moved duty-unpaid to the near continent and subsequently diverted back for illicit sale in the UK. Achieving a reduction in the volume of exported alcohol that is diverted back into the UK for illicit sale requires closer working with the alcohol industry, and this formed one of the key actions within the renewed Strategy. There was no evidence that the Department's efforts to work closer with the industry achieved tangible results in the period. There have, however, been discussions between the Department and key stakeholders in 2011 on the viability of fiscal marks (e.g. 'duty paid' stamps) for beer, as these have helped in countering spirits duty fraud.

13 The Department has implemented the Excise Movement Control System (EMCS) but has yet to exploit the full benefits of the system to tackle fraud. EMCS facilitates the electronic tracking of freight across the European Union, and holds valuable data on movements that can be analysed towards better targeting of interventions and investigations. The Department is not yet able to download the data within the system for detailed analysis by its Knowledge, Analysis and Intelligence units, and is also developing a risk capability to enable it to utilise the data fully.

14 The Department has recorded increased revenue from businesses participating in its new Registered Consignee scheme, but is as yet unable to say why the growth in revenues has occurred. The Department established its Registered Consignee scheme in April 2010 to tackle concerns in the previous arrangements for registered traders receiving duty suspended alcohol from other EU Member States. As the revenue received from businesses has increased since the new scheme was launched (£1,195 million during 2010-11), there is some evidence that the scheme is encouraging traders to pay more duty than under the previous regime. The Department is currently reviewing the reasons for the growth in receipts under the scheme.

15 The Department's financial securities scheme is not effective in protecting alcohol duty revenues. Under EU law, the scheme requires traders to provide financial guarantees on alcohol movements to cover risks inherent in the movement. The Department's consultation on the scheme determined there was no scope for it to help counter alcohol duty fraud. At present, the scheme recovers very little of the duty due on goods that are diverted, as the guarantees required by the Department are far lower than the value of duty that would be due (less than 16 per cent of the duties due on invoked guarantees were recovered in the three years up to 2010-11).

16 Repayments of alcohol duty through the drawback scheme on goods that have a higher risk of being diverted illicitly on to the UK market rose by 9 per cent in 2010-11. The Department refunds duties that have been paid on goods that are exported from the UK. This arrangement was previously facilitated through the Department's Warehousing for Export scheme. When closing this scheme from 1 June 2009, the Department expected that the level of duty drawback claims often associated with alcohol duty evasion would drop by 15 per cent during 2010-11. In the event, the value of claims from small and medium-sized traders, which include the higher risk movements, rose by 9 per cent (£6.8 million).

Enforcement action to combat alcohol fraud

17 The Department has not actively pursued an increase in criminal sanctions against fraudsters. In each of the four years to 2009-10, there were convictions in six cases or fewer for suspected alcohol duties fraud.

18 In the first year of the renewed strategy, the Department increased its use of civil sanctions considerably, especially its seizures of illicit alcohol. The Department is able to impose civil sanctions on individuals and businesses that fail to comply with the law, and considers this a more effective option in some instances than pursuing criminal sanctions. During 2010-11, the quantity of alcohol seizures increased by over 61 per cent, compared to 2009-10, to almost 10 million litres.

Overall conclusion

19 The Department has achieved some of its objectives in the first year of its Renewed Alcohol Strategy, including exceeding its financial target for operational outputs. The Department has not, however, achieved tangible success in working with industry stakeholders to disrupt the supply chain for alcohol diverted illicitly on to the UK market. There is insufficient quality, depth and analysis in the performance information used to inform delivery of the Strategy. Significant improvements are needed in these areas to ensure that the Renewed Alcohol Strategy reduces the increasing level of alcohol duties lost to fraud.

Recommendations

20 The Department has yet to establish a reliable estimate of the tax gap for wine and has published only an upper estimate of the tax gap for beer.

It should therefore:

- a** devise and publish a tax gap estimate for wine as soon as possible; and
- b** work with the brewing industry to develop credible lower-bound and midpoint estimates of the beer tax gap.

21 The Department exceeded its key financial objective for the year but performance was overstated. The Department needs to improve the quality and depth of the financial and operational performance information provided to decision-makers to inform delivery of the strategy.

22 The Department's efforts to work with industry to secure alcohol supply chains have not reduced the volumes of beer moved duty-unpaid to the near continent and subsequently diverted back for illicit sale in the UK.

It should therefore:

- a** take urgent steps to exploit the data within the Excise Movement Control System to better target its interventions; and
- b** introduce new measures to improve the effectiveness of its work with industry to reduce the volume of beer at risk of diversion into illicit markets.

23 The Department has recorded increased revenue from businesses participating in its new Registered Consignee scheme, but is as yet unable to say why the growth in revenues has occurred. The Department should conclude its review of the scheme as quickly as possible to gain a timely understanding of the factors for its success and of the residual risks to revenue.

24 The Department's financial securities scheme is not effective in protecting alcohol duty revenues. The Department should ensure that the guarantee scheme provides a greater measure of revenue protection for excise goods moved under duty suspension.

25 The Department has not actively pursued an increase in criminal sanctions against fraudsters. As criminal sanctions are an important deterrent to potential fraudsters, the Department's Strategy for tackling alcohol fraud should include an objective to increase the number and impact of criminal investigations and prosecutions.