

Tackling Indirect Tax Fraud

November 2001



HM Customs and Excise

Tackling Indirect Tax Fraud

November 2001

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This document can be accessed from the Treasury's Internet Site: <http://www.hm-treasury.gov.uk>

Published November 2001

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FOREWORD BY THE RT. HON. PAUL BOATENG, MP, FINANCIAL SECRETARY TO THE TREASURY

In this year's Pre-Budget Report, the Government describes how, by maintaining the stability of the public finances, we have established the necessary foundations to continue building a stronger economy and a more inclusive society, and to make the sustainable investments required to create world-class public services and to tackle child and pensioner poverty.

At the heart of our stable public finances is a tax system based on the principle that everyone should pay their fair share. When people evade taxes, they undermine that principle.

Our commitment to tackling fraud is therefore integral to maintaining a fair tax system, safeguarding the stability of the public finances, and protecting the revenue available for investment in our public services.

The criminals engaged in fraud not only rob our public services of revenue, but also undermine honest businesses, and use the proceeds to fund other forms of organised crime.

This paper sets out the Government's strategy for tackling indirect tax fraud, summarises progress to date on the strategy for tackling tobacco smuggling announced in Budget 2000, and outlines the steps we are taking and the proposals under consideration in other areas.

We are determined to crack down on fraud wherever it occurs, and our success this year in tackling tobacco smuggling shows that the right strategies can produce real and tangible results.



EXECUTIVE SUMMARY

- The Government is committed to tackling fraud in order to protect the revenue required for investment in public services, to defend legitimate businesses, to protect its wider objectives, and to protect society from organised crime.
- Since 1997, the Government has established a new strategic approach to tackling indirect tax fraud, based on accurately assessing the size and nature of the problem, setting clear objectives and targets for tackling it, identifying the operational responses required to achieve those targets, and monitoring the delivery of results.
- The experience of the Government's *Tackling Tobacco Smuggling* strategy has demonstrated the effectiveness of this approach. Results from the first year of the strategy show that Customs have met their key target to hold smuggled cigarettes to a 21 per cent share of the market in 2000–01, and have cut the level of cross-Channel smuggling of tobacco and alcohol by more than 75 per cent.
- This strategic approach is now being applied to other areas where the Government has made estimates of indirect tax frauds, including VAT missing trader fraud, spirits fraud, and oils fraud in Northern Ireland and in the rest of the United Kingdom.
- To tackle frauds in these areas, the Government is considering a series of measures to aid in the prevention, detection and punishment of fraud, including:
 - measures to improve controls on movements of spirits and rebated fuel;
 - increased numbers of intelligence-led interceptions of illicit consignments and investigations of criminal fraudsters;
 - measures to make it easier to identify illicit goods; and
 - tougher penalties for those caught dealing in illicit goods.
- The Government will be consulting on key aspects of these proposals with a view to further announcements in the context of the Budget and next year's Spending Review.
- To accompany this paper, the Government has today placed in the House of Commons library a technical paper, setting out the methodologies used to produce estimates of fraud in relation to different indirect taxes.

A FAIR TAX SYSTEM

THE GOVERNMENT'S TAX OBJECTIVES

I.1 By maintaining stable public finances and building a stronger economy, the Government is now able to make the sustainable increases in investment required to deliver world-class public services. The foundations of these stable public finances lie in a tax system in which everyone pays their fair share.

I.2 When people evade tax, they undermine not just the stability of the public finances but the fairness of the tax system, leading to higher burdens falling on the majority of taxpayers. So in addition to creating a modern and fair tax system which encourages work and saving, and raises sufficient revenue to pay for increased investment in the public services, the Government is committed to tackling tax abuse.

Table I.1: Customs and Excise revenues, 2000–01

Tax Regime	£ billion ¹
VAT	58.5
Fuel duties	22.6
Tobacco duties	7.6
Spirits duties	1.8
Beer and Cider duties	3.0
Wine duties	1.8
Betting and Gaming duties	1.5
Customs duties and levies	2.1
Air Passenger duty	1.0
Insurance premium tax	1.7
Landfill tax	0.5
Total	102.3

Source: HM Customs & Excise, 2000/01

¹ Rounded to nearest £100m

THE IMPORTANCE OF TACKLING FRAUD

I.3 The criminals responsible for fraud, smuggling and the sale of smuggled goods are involved in the large-scale theft of revenue that would otherwise be used to support investment in public services. When the Government takes action to tackle fraud, it has a direct impact on the levels of revenue available for public expenditure.

I.4 The choice of what the Government taxes, and how it is taxed, sends clear signals about the activities it believes should be encouraged or discouraged, and about the values it wishes to support in society. However, fraud can undermine these objectives.

Box 1.1: Health Objectives and Tobacco Smuggling

- **Smoking is the single greatest cause of preventable illness and premature death in the UK, killing 120,000 people every year.**
- **Successive Governments have increased duty on cigarettes in real terms, encouraging existing smokers to smoke less or quit and discouraging younger people from taking up the habit.**
- **Smuggling undermines these objectives by providing an unregulated supply of cheap tobacco. The Government's health objectives must therefore be protected by tackling smuggling.**

1.5 The suppliers of illicit goods also undermine honest traders. Sales of alcohol, tobacco and fuel are an important source of business for wholesalers and retailers across the country, and the Government is committed to helping these legitimate businesses operate without competition or intimidation from criminal suppliers.

1.6 There is also no doubt that fraud forms an important and highly profitable part of the activities undertaken by organised criminal networks, with the proceeds often used to fund other serious criminal activity.

1.7 Smuggling and fraud also have a debilitating effect on respect for the law by encouraging ordinary members of the public into becoming the consumers of illicit goods, and providing a source of funding for these organised criminal networks.

1.8 The Government therefore considers tackling fraud one of the central objectives for taxation, in order to protect:

- the revenue required for increased investment in public services;
- the wider objectives behind the level of taxation on particular goods;
- honest businesses from unfair and criminal competition;
- society from the scourge of organised crime; and
- local communities from the debilitating effects of criminal supply chains.

A STRATEGIC APPROACH TO TACKLING FRAUD

THE GOVERNMENT'S COMMITMENT TO TACKLING FRAUD

2.1 Since 1997, the Government has consistently demonstrated its commitment to the fight against fraud and smuggling, and the need to apply increased resources to reinforce Customs' efforts:

- in 1997, the Government cancelled the second phase of a planned cut in Customs' levels of anti-smuggling staff and ensured the continued deployment of these staff at the Customs front-line;
- in 1998, following an internal review of alcohol and tobacco fraud, the Government deployed an additional 145 staff to tackling the problem; and
- in 1999, the Government announced an independent evaluation of Customs' strategy to counter tobacco smuggling, a move that led to the introduction of a new strategic approach to tackling the problem.

THE DEVELOPMENT OF A NEW APPROACH

2.2 Over this period, Customs have been changing their approach to tackling fraud, a process that led to the development of the *Tackling Tobacco Smuggling* strategy described in Section 3.

2.3 This has entailed moving from an essentially tactical approach, where success was defined in terms of outputs, such as increased numbers of seizures, to a strategic approach based on the achievement of outcomes which have a direct and measurable impact on the problem the Government is aiming to solve.

2.4 This new approach to tackling fraud has six key components:

Estimating the size of the problem. Measuring the size of illicit activity is inherently difficult, but where possible, the Government has developed estimates for the size of fraud across a range of indirect taxes which it believes to be the most accurate available (see Box 2.1). These estimates will be published routinely on an annual basis, and revised if significant new information emerges. However, the Government sees no value in publishing estimates which are not robust, and which would therefore give an inaccurate baseline against which to measure fraud trends, or the performance of anti-fraud strategies.

Analysing the problem. Establishing the nature and economics of the fraud through the analysis of intelligence, largely gathered during individual investigations, is crucial to the development of well-targeted anti-fraud strategies. The nature of the fraud and any trends in its development need to be carefully understood before Customs can develop and deploy appropriate operational responses.

Operational responses. Customs' operational response to fraud is rooted in a careful analysis of the nature of the fraud, and the resulting assessment of the most efficient and effective means of tackling it. This can often involve a simultaneous strengthening of the enforcement effort to ensure maximum pressure at all different levels of the fraud network, from additional staff designed to improve front-line detection, to tougher penalties targeted at those involved in the supply chain.

Establishing outcomes. The Government's new strategic approach to tackling fraud is based on the establishment and delivery of ambitious outcomes, such as stopping and reversing the growth of a fraud. Each of Customs' anti-fraud strategies is designed to achieve a clear and measurable outcome in terms of its impact on the problem being tackled.

Strengthening controls. Fraud often flourishes by exploiting weaknesses in the control regime for a tax. Underpinning the operational response to each fraud is therefore an assessment of any changes required to strengthen the control regime and prevent its exploitation by fraudsters. This is essential if additional resources designed to tackle fraud are to be deployed effectively: increased numbers of staff will achieve little if there are fundamental weaknesses in the revenue control regime.

Monitoring and delivery. Customs' performance against their key outcomes is central to measuring the effectiveness of each anti-fraud strategy, and thereby to monitoring their delivery of the Government's high-level objectives. However, Customs also set lower level operational output targets (for example, relating to the number of seizures or criminal gangs disrupted), which are important indicators of whether their performance is on track to deliver the key outcome. Once established, these outcomes and targets are monitored through Customs' Public Service Agreement and the supporting Service Delivery Agreement. The first year outcomes of the *Tackling Tobacco Smuggling* strategy are reported in Section 3 of this paper.

Box 2.1: Methodologies for estimating fraud

Estimates of revenue losses from fraud and avoidance are calculated using a number of different methodologies and data sources. Most of the estimates of total fraud come from “gap analysis”.

In general, this involves:

- estimating the total size of the market;
- deducting tax paid consumption, calculated from Customs’ data on clearances of excise goods;
- deducting estimates of legitimate cross-border shopping in other EU Member States and, where possible, duty free sales from countries outside the EU; and
- assuming that the residual element (or the gap) is the illicit market share.

In some cases, estimates of legitimate cross-border shopping are not available, so the gap consists of the total non-UK duty paid consumption, reflecting both fraud and avoidance. In the excise sector, a number of assumptions have to be made when estimating the total size of the market. Unlike data on clearances which is collected directly by Customs, there is no direct measure of total consumption of each of the products examined.

The Government is today placing in the libraries of the Houses of Parliament a technical paper entitled *Measuring Indirect Tax Fraud*, which sets out in more detail the methodologies used to produce its estimates of fraud.

Trade bodies, academic researchers and other interested businesses, groups or individuals are invited to comment on these estimates and their supporting methodologies in order to assist Customs in further improving their accuracy.

Copies of the technical paper are available on request from Analysis Division, HM Customs and Excise, 7th Floor Central, New King’s Beam House, London SE1 9PJ, or from the Customs website (www.hmce.gov.uk).

Box 2.2: A Guide to Terminology

- **Fraud and Evasion:** activities where taxes are avoided illegally, including cross-Channel smuggling, freight smuggling, and the false description of large volumes of EU or non-EU products in order to evade UK taxes, as well as activities such as the under declaration of sales to evade VAT.
- **Avoidance:** all legal activities undertaken to reduce tax liabilities (for example, cross-border shopping and the exploitation of tax loopholes).
- **Cross border shopping:** UK citizens buying products in other Member States in order to avoid paying UK duty.
- **Revenue evaded:** the total revenue value of the fraud/evasion.
- **Revenue lost:** the sum of the actual revenue losses resulting from fraud/evasion and/or avoidance.
- **Non-UK duty paid consumption:** the sum of legal and illegal consumption of products in the UK on which UK duty has not been paid.
- **Illicit share:** the share of the total market (made up of legal consumption of tax paid products, legal consumption of non-duty paid products, and illegal consumption of non-duty paid products) that is made up of fraud/evasion.
- **Duty suspension:** all Member States are required to operate a system of duty suspension in order to facilitate alcohol trade. This allows registered traders or warehouse-keepers to produce, process, store and move goods without payment of duty, enabling them to pay the duty nearer the time when they will sell on the goods. Duty becomes payable when the goods are released for consumption or are acquired by an unregistered individual.
- **Duty suspended revenue goods:** goods, such as alcohol and tobacco, where the payment of duty is postponed until they are released onto the UK market for consumption.
- **Excise warehouses:** approved by Customs for the storage of goods without payment of excise duty (i.e. where duty is held “in suspense”). There are around 1,100 excise warehouses in the UK.
- **Outward diversion frauds:** when duty suspended goods destined for export, or for another UK excise warehouse, are diverted from an excise warehouse onto the domestic or overseas market without payment of duty.
- **Inward diversion frauds:** when imported duty suspended goods, ostensibly heading for an excise warehouse, are diverted onto the UK market without payment of duty.

IMPACT ON BUSINESS

2.5 In its efforts to tackle fraud, Customs are keen to strike the right balance between applying effective controls to protect the revenue, and ensuring both that honest traders and legitimate hauliers are not over burdened with compliance costs and that the free flow of trade is not unduly impeded.

2.6 The Roques Report on excise diversion fraud (see Box 4.1) concluded that, following the introduction of the Single Market in 1993, Customs had shifted the balance too far in favour of trade facilitation at the expense of revenue control.

2.7 Customs accept that this may have been the case, and are now bringing forward proposals which offer the scope to strengthen the underlying control regimes across a range of taxes. However, where such changes are proposed, Customs are committed to consulting widely with those affected to ensure that:

- any changes are implemented in a way which keeps additional compliance costs to the minimum required to provide the necessary controls; and that
- any additional compliance costs that do result are proportionate to the objectives of the change.

IMPACT ON THE PUBLIC

2.8 Customs are also concerned to strike the right balance between taking effective enforcement action against the criminals involved in cross-border smuggling of alcohol and tobacco, and protecting the rights of those ordinary shoppers wishing to bring back goods from abroad for their own use.

2.9 Customs seek to strike the right balance in the following ways:

- people visiting other EU Member States are permitted to bring back to the UK as much alcohol and tobacco as they wish, provided it is for their own use. Customs do not enforce any limits on such purchases.
- to differentiate between products bought by individuals for their own use and goods bought for a commercial purpose, EC law requires Member States to take into account a series of criteria including the quantity of the excise goods concerned, and sets out minimum quantities which it stipulates that Member States may use as guide levels for passengers.
- of the approximate 14 million people who cross the Channel each year, Customs stop only a small proportion. Last year, the majority of people found to have alcohol or tobacco in excess of the EC defined minimum guide levels were able to satisfy Customs that those goods were for their own use and were allowed to proceed. The minority who could not do so, representing less than 0.2 per cent of all those crossing the Channel, were smuggling and were liable to have their goods seized.

TACKLING TOBACCO SMUGGLING

3.1 The Government's approach to tackling tobacco smuggling provides the model for the application of its new strategic approach to tackling indirect tax fraud, and the initial results it has produced during 2000-01 provide a real demonstration of the effectiveness of that approach.

ESTIMATING THE SIZE OF THE PROBLEM

3.2 Initially, the problem of tobacco smuggling was largely confined to hand-rolling tobacco. However, by the mid 1990s, Customs began to detect signs that the problem was spreading and that cigarette smuggling, especially in freight containers, was also growing rapidly.

3.3 By 1999, Customs estimated that 70-80 per cent of smuggled cigarettes were being transported by freight - principally either deep sea containers or "roll on roll off" lorries. Most of the remainder was being smuggled in light vehicles through the Channel ferry ports and the Channel Tunnel: the so called "white van trade".

3.4 By March 2000, it was estimated that, if no additional action was taken to tackle the problem, cigarette smuggling would continue to grow rapidly, accounting for a quarter of the market by 2001, and more than a third by 2003 (see Chart 3.1).

ANALYSING THE PROBLEM

3.5 In the 1999 Budget, the Chancellor of the Exchequer announced that there would be an independent evaluation of the cigarette smuggling problem and the measures needed to tackle it. He asked Martin Taylor, now Chairman of W.H. Smith, to carry out this evaluation.

3.6 Martin Taylor analysed all aspects of the problem, consulting widely across government and industry, and examining each strand in the smuggling and supply chains. In November 1999, he provided advice and recommendations to the Chancellor, concentrating primarily on the need to achieve an overall reduction in the profitability (in essence, the risk/reward ratio) of smuggling.

OPERATIONAL RESPONSES

3.7 Based on Martin Taylor's analysis of the problem, the Government set out to design the most efficient and effective operational response, leading to the publication in March 2000 of its *Tackling Tobacco Smuggling* strategy. The strategy was underpinned by the need to reduce the risk/reward ratio of smuggling, by:

- dramatically increasing the proportion of smuggled cigarettes intercepted;
- making smuggled goods easier to detect;
- increasing public awareness of the criminal nature of smuggling; and
- increasing penalties for those caught smuggling or supplying illicit tobacco.

3.8 The Government believed that, beyond a certain threshold, the risk/reward ratio would begin to change significantly, and that the growth in smuggling would start to slow down and could ultimately be reversed.

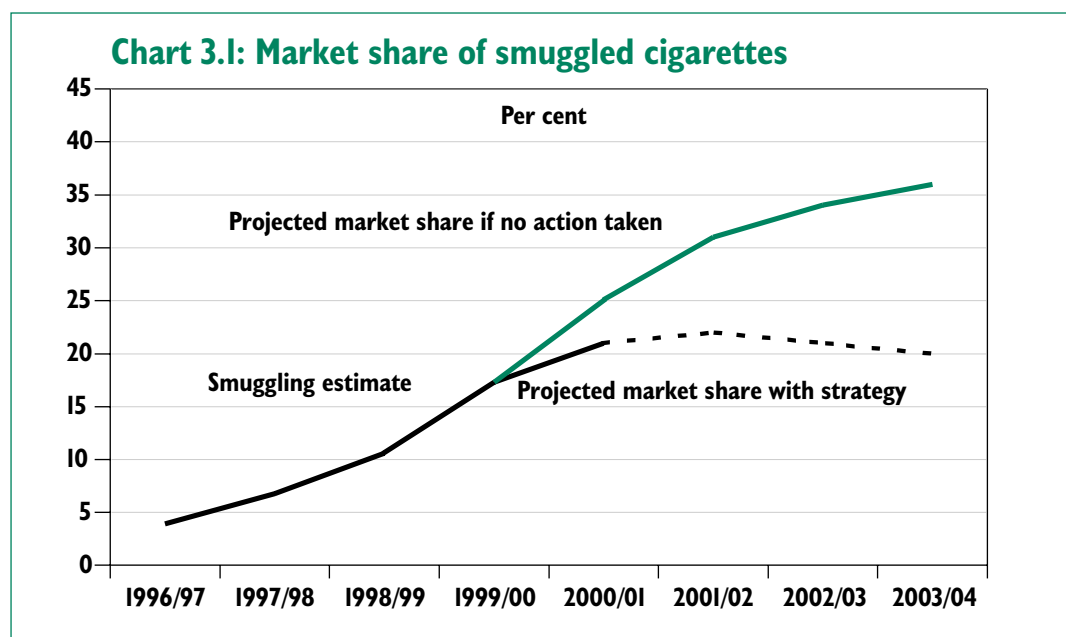
3.9 To put this strategy into effect, the Government decided on a range of measures to be implemented over a three-year period up to 2002-03, and provided £209 million for their implementation. These measures included:

- an additional 955 front-line staff and investigators: 640 deployed in the first year, with a further 175 staff to be deployed during 2001-02 and 140 more due to be deployed in 2002-03;
- introduction of a national network of x-ray scanners designed to detect large volumes of smuggled goods concealed in freight containers, with twelve scanners now in operation;
- the introduction of 'UK Duty Paid' marks on packets of cigarettes and hand-rolling tobacco, with new penalties for those caught dealing in unmarked tobacco or allowing their premises to be used for the sale of unmarked tobacco;
- a £3 million publicity campaign to remind would-be smugglers of the penalties for being caught, and to discourage ordinary members of the public from buying the illicit goods used to fund organised criminal networks.

OUTCOMES AND TARGETS

3.10 To ensure that the strategy would have a genuine and measurable impact on the smuggling problem, the Government set out to achieve the ambitious outcome of slowing, stabilising and ultimately reversing the growth in smuggling by 2002-03.

3.11 To measure delivery of this outcome, the Government set key targets for each year up to 2003-04 to limit and then reduce the proportion of the total cigarette market made up by smuggled cigarettes.



3.12 The key target for the first year of the strategy was to limit the market penetration of smuggled cigarettes to 21 per cent rather than the predicted level of 25 per cent which would have been reached in the absence of the strategy.

3.13 As part of the strategy, Customs also set a number of lower level operational output targets, designed to measure the performance of different strands of the strategy and provide indications of its overall progress. These targets included breaking up 55 major excise smuggling operations, and seizing 2 billion cigarettes.

DELIVERING RESULTS

3.14 The results from the first year of the strategy give very encouraging indications that Customs are on track to deliver their key outcomes, confirming that the analysis of the problem was sound and that the operational responses have thus far been effective:

- most importantly, Customs have hit their key target to hold the market share of smuggled cigarettes to 21 per cent in 2000-01, thereby succeeding in slowing the growth in cigarette smuggling;
- in 2000-01, Customs seized 2.8 billion cigarettes: 1.9 billion in the UK and 0.9 billion en route to the UK through joint operations with overseas agencies. This represents almost a billion more cigarettes than were seized in 1999-2000, and 0.8 billion more than Customs' target for the year;
- Customs investigators have also broken up 56 major excise smuggling gangs, 43 of them involved in the large-scale smuggling and supply of cigarettes;
- Customs seized more than 10,200 vehicles used to carry smuggled excise goods, almost double the number seized in the previous year; and
- in their first six months of operation to the end of July 2001, the network of new x-ray scanners detected around 80 million cigarettes and 4.5 tonnes of hand-rolling tobacco.

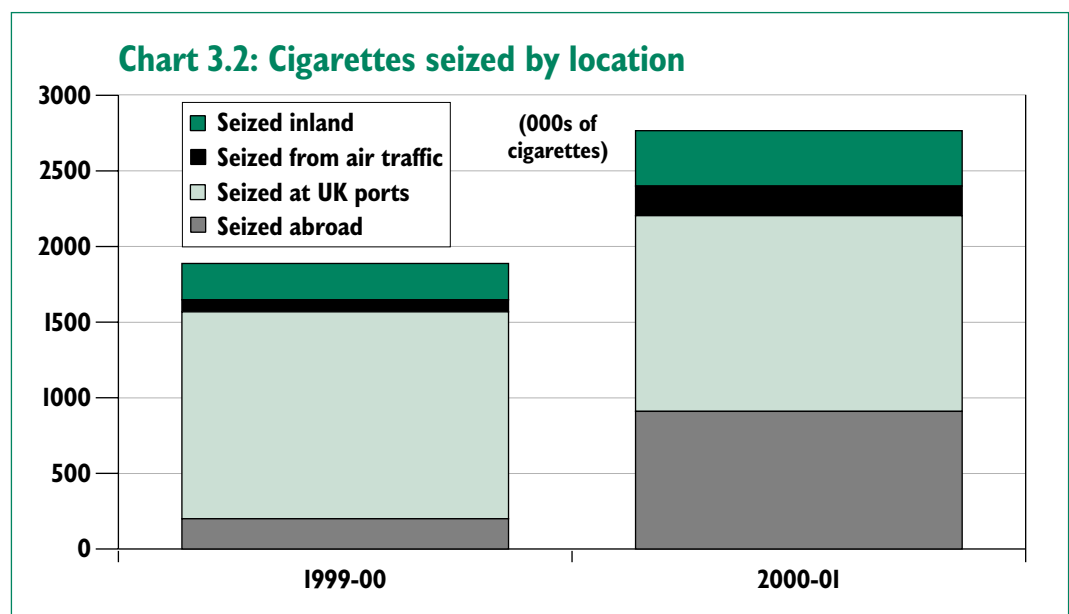


Table 3.1: Cigarette seizures by brand

Brand	Per cent of total seizures
Regal	25
Superking/Superking Blue	24
Benson & Hedges	16
All others	35

(Source: HM Customs & Excise, 2000/01). Because of the logistical difficulties involved, it is not possible to give a full breakdown of seizures by brand. However, using available data, it is estimated that between 11-17 per cent of all cigarettes seized were counterfeit and this table shows estimates of the principal seized brands amongst the remainder. Seized Benson & Hedges includes packets manufactured by both BAT and Gallaher.

3.15 While the targets for the strategy remain extremely challenging, the Government fully expects that Customs will achieve the outcome of reducing the market share of smuggled cigarettes by 2003. Given the strong upward trend in smuggling before implementation of the strategy, this would be a considerable achievement.

3.16 However, as the Government stated in the *Tackling Tobacco Smuggling* strategy paper, its long term aim is to reduce tobacco smuggling below the 1999-00 level.

Box 3.1: Tackling cross-Channel smuggling

In *Tackling Tobacco Smuggling*, the Government described the law and order problems caused by the increase in smuggling of alcohol and tobacco through the Channel ports and the Channel Tunnel: the so-called “white van trade”.

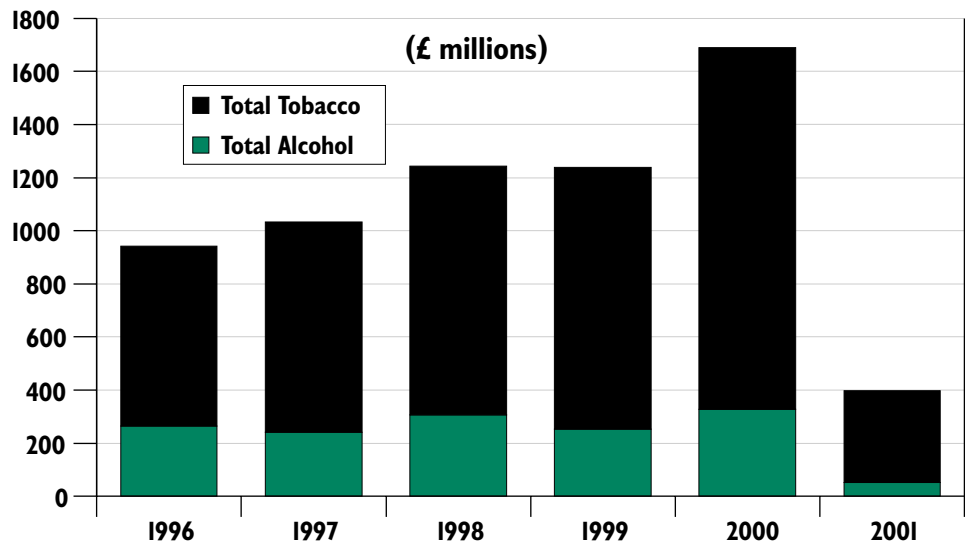
The Government set a target to reduce the revenue loss from cross-Channel smuggling by 10 per cent each year, deployed 170 additional staff specifically to this purpose, and introduced a tougher policy of vehicle seizures, to make smugglers count the cost of using their cars and vans to transport illicit goods.

The results from the first full year of the strategy show that these measures have had a dramatic impact on this type of smuggling:

- smuggling of beer has almost been eliminated, with a 93 per cent reduction in revenue lost from evasion;
- losses from smuggling of spirits and wine have been more than halved; and
- losses from smuggling of hand rolling tobacco are down 81 per cent.

Overall, the revenue lost from cross-Channel smuggling has been cut by 76 per cent, massively exceeding the key target of a 10 per cent reduction.

Chart 3.3: Revenue evaded through cross-Channel smuggling



4.1 Based on the experiences of the *Tackling Tobacco Smuggling* strategy and the early success of its implementation, the Government is now seeking to apply a similar strategic approach to tackling other forms of indirect tax fraud.

VAT: MISSING TRADER FRAUD

4.2 VAT intra-Community missing trader fraud is a systematic criminal attack on the VAT system, which has been detected in many EU Member States. In essence, fraudsters obtain VAT registration to acquire goods VAT free from other Member States. They then sell on the goods at VAT inclusive prices and disappear without paying over the VAT paid by their customers to the tax authorities. The fraud is usually carried out very quickly, with the fraudsters disappearing by the time the tax authorities follow up the registration with their regular assurance activities.

4.3 Customs became concerned about the growth of this form of fraud in 1999, and have since been working to develop an accurate estimate of the revenue losses involved. It is estimated that this form of fraud cost the Exchequer between £1.7-£2.6 billion in 2000-01.

4.4 In September 2000, Customs deployed 340 staff to tackle this type of fraud and launched a nationally co-ordinated strategy designed to halve the scale of fraud losses by the end of 2003-04. The strategy involves targeted investigation of the organised gangs perpetrating the fraud, complemented by an increased number of checks aimed at preventing fraudulent registrations or enabling their much earlier identification.

4.5 Customs are also working closely with legitimate traders in the retail sectors most affected by this form of fraud. If successful, this strategy will produce an annual saving of at least £750 million. Between September 2000 and August 2001, the strategy has already yielded a number of encouraging results:

- 1,033 suspect registrations have been refused, preventing frauds which could have cost around £1.7 billion;
- 350 missing trader registrations have been identified and cancelled; and
- Customs have secured injunctions to a value of £39 million to meet the VAT debts of missing traders.

4.6 Customs will continue to develop and refine this strategy, and will introduce new techniques to disrupt the fraudsters, with increased numbers of post-registration visits, evaluation of new legal and systems options for tackling this fraud, and a tightening of the current VAT registration procedure.

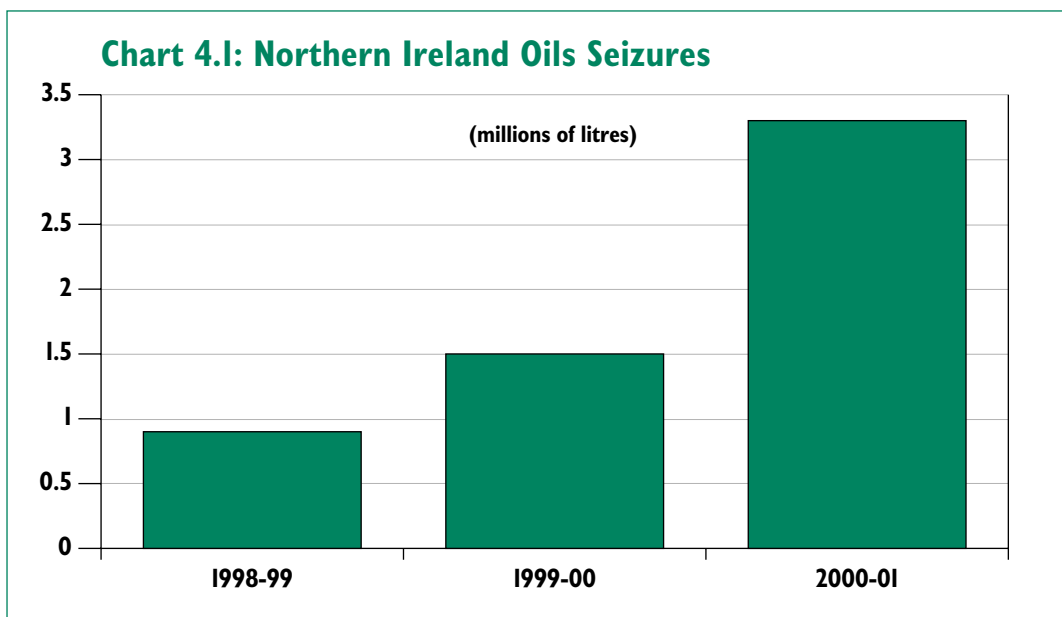
4.7 Customs are also working to develop estimates of other forms of VAT fraud and strategies to counter them, and as part of this, will be looking into other causes of VAT revenue losses, including avoidance.

OILS FRAUD IN NORTHERN IRELAND

4.8 Customs have estimated that in calendar year 2000, the revenue lost from use of non-UK duty paid petrol and diesel in Northern Ireland was approximately £380 million: £150 million petrol and £230 million diesel. A substantial element of these losses represents entirely legitimate cross-border shopping of fuel. However, there is also a large element of fraud, resulting from the smuggling of fuel from the Republic of Ireland for use in the North, and the misuse, laundering and mixing of rebated and duty free fuels.

4.9 Oils fraud forms a profitable criminal enterprise in Northern Ireland, with the proceeds often used to fund other forms of serious crime. It undermines legitimate fuel retailers, and has a debilitating effect on respect for the law by encouraging members of the public into participating in an illicit activity.

4.10 The Government has already recognised this problem and has taken action. Since April 2000, Customs have increased the numbers of staff engaged in tackling this form of fraud from 25 to more than 160. As a result, seizures of fuel have more than doubled, vehicle seizures have more than trebled, and 17 plants for laundering the chemical markers in rebated fuels have been dismantled.



4.11 While there is some evidence that this increased Customs activity has slowed the growth of the fraud, the Government believes that it remains at unacceptably high levels, and is therefore considering options for further initiatives to counter road fuel duty evasion and its associated problems in Northern Ireland.

OILS FRAUD IN THE REST OF THE UNITED KINGDOM

4.12 The great majority of oils fraud in the rest of the UK involves the misuse of rebated or low tax fuels supplied for non-road use. Compared with the main diesel duty rate of 45.82 pence per litre, red diesel (intended for off-road vehicles) is 3.3 pence per litre, and kerosene (intended for domestic heating) carries no duty at all.

4.13 Separate estimates of losses have been made for petrol and diesel. Customs has estimated that the total revenue lost in calendar year 2000 from petrol fraud and legitimate cross-border shopping of petrol represented only around 1 per cent of the market, at around £150 million. There is no evidence as yet that this figure is growing, and most of the current losses can be accounted for by legitimate cross-border shopping.

4.14 The main area of concern is diesel, where losses resulting exclusively from fraud are estimated to have been around £450 million in calendar year 2000. While this represents only 4 per cent of the market at present, Customs estimate that the fraud losses will continue to grow if concerted action is not taken to tackle the problem. Every one percentage point increase in the illicit share of the diesel market represents a revenue loss of around £125 million per year.

4.15 To tackle this form of fraud, Customs have therefore:

- initiated a number of intelligence-led operations tracking duty-rebated supplies from the point of production through the distribution system, designed to detect and disrupt illicit consumption; and
- increased the number of resulting investigations, targeting the organised criminal gangs involved in large scale diesel frauds.

4.16 The results from this initial work have been encouraging. Detection rates for Customs' intelligence-led operations have been about ten times higher than the traditional random checks, demonstrating the value of this new operational response.

4.17 However, the Government is concerned that diesel fraud could continue to grow rapidly, with serious implications for revenues, the competitiveness of legitimate retailers and hauliers, and for the environment. Customs have therefore been asked to develop further their strategy for tackling this form of fraud. Some of the key elements under consideration include:

- authorisation schemes for the distributors of tied oils and rebated fuels;
- a simultaneous strengthening of the obligations on distributors to take reasonable steps to check that sales of such fuels are made only to customers who intend to put them to an approved use;
- improved chemical and colour marking of rebated fuel to deter misuse;
- increased numbers of intelligence-led checks and investigations;
- tougher penalties against those engaged in the supply of fuels for illicit purposes, or for those found using such fuel in road vehicles; and
- a targeted publicity campaign designed to highlight the danger of fuel misuse and the penalties for people caught misusing.

4.18 Before coming to a final decision on these proposals the Government will conduct a consultation exercise with affected businesses and other interested bodies, with the aim of devising measures which protect the revenue but avoid imposing disproportionately heavy burdens on legitimate traders.

ALCOHOL FRAUD

4.19 The great majority of alcohol excise duty comes from beer, wine and spirits. The illicit market for beer and wine is relatively small and has traditionally resulted from cross-Channel smuggling of duty paid goods from other EU Member States. However, as described in Section 3, activity at the Channel ports is already having a tangible impact in reducing smuggling of beer and wine. The Government therefore believes that the next major challenge lies in tackling large-scale spirits fraud.

4.20 The principal feature of spirits fraud involves the diversion of duty-free goods moving between excise warehouses for consumption on the domestic market. These goods are mostly manufactured in the UK and distinguishing between legitimate and illicit spirits at the retail stage is difficult. Customs estimate that about half of all illicit spirits are sold to consumers through retail outlets at legitimate retail prices. Fraudulent traders therefore make a huge mark-up on the fraud by exploiting consumers who are often unaware that they are purchasing illicit goods.

4.21 Spirits fraud is estimated to have cost up to £450 million in revenue losses in 1999-2000, equivalent to 15 per cent of the UK market.

Box 4.1: The Roques Report on excise diversion fraud

- **In June 2000, the Paymaster General and the Chairman of Customs commissioned an independent investigation to look into Customs' handling of a series of excise diversion frauds which occurred between 1993 and 2000, headed by John Roques, an ex-senior partner of Deloitte and Touche.**
- **The Roques Report was published in July 2001, making a total of 65 recommendations designed to strengthen the excise holding and movements systems, improve controls on investigations and establish clearer lines of accountability for revenue issues at senior levels within Customs.**
- **The Government has accepted 62 of these recommendations, and 44 of them have already been implemented.**

4.22 To tackle spirits fraud, and in particular the problem of inward diversion, Customs have so far:

- established a specialist team to check and “discredit” the paperwork covering the movement of duty suspended goods in freight consignments;
- implemented a tougher HGV seizure policy, targeting those hauliers who fail to conduct simple checks to ensure they are not caught up in fraud;

- commenced the redeployment of an additional 146 assurance officers to strengthen the excise holding and movements system;
- started a review of all warehouse approvals; and
- increased the resources deployed to excise intelligence and research.

4.23 The Government believes that further action will be necessary to reduce revenue losses from spirits fraud and to reduce the competitive disadvantage suffered by legitimate wholesale and retail traders. The Government has therefore decided to press ahead with the next stage of the strategy which involves:

- increasing the rate of checks carried out on spirits consignments when they enter the UK under duty suspension;
- applying improved intelligence to help target additional checks on suspicious consignments, helping to limit the impact on legitimate traders and hauliers;
- strengthening the controls on bonded warehouses within the UK;
- consulting widely on the costs, benefits and practicalities of introducing a tax stamps system for spirits, designed to assist in the identification of smuggled products; and
- if it is decided to proceed with the tax stamps system, introducing new sanctions for those found to be dealing illegally in un-stamped goods.

4.24 A key issue in the consultation process will be the development of a system which keeps compliance costs for legitimate businesses as low as possible, consistent with the aims of the strategy.

4.25 To measure the impact of this strategy, the Government will set Customs the objective of achieving gradual reductions in the market share of illicit spirits over the next three years.

CONCLUSION

4.26 The Government's commitment to tackling fraud is integral to maintaining a fair tax system. Consultations will shortly begin on key aspects of the alcohol and oils strategies outlined above, with a view to further announcements in the context of the Budget and next year's Spending Review, and which – depending on the outcome of these consultations – will be taken forward next year with resources drawn from within Customs' existing allocation. The aim will be to put in place measures which tackle fraud and secure the revenue necessary to safeguard the stability of the public finances, and protect investment in the public services.

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