



HM Treasury

Small Brewers Relief

Technical consultation response

November 2021

Small Brewers Relief

Technical consultation response



© Crown copyright 2021

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at: www.gov.uk/official-documents.

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

ISBN: 978-1-911686-49-1

PU: 3177

Contents

Chapter 1	Introduction	3
Chapter 2	Summary of responses to the technical consultation	6
Chapter 3	Reforming Small Brewers Relief	14
Annex A	Respondents to the technical consultation	26
Annex B	Technical consultation questions	28

Chapter 1

Introduction

- 1.1 Since 2002, Small Brewers Relief (SBR) has provided reduced rates of beer duty for small brewers. This came after campaigns for a more progressive form of beer duty to support small brewers, which stretched back to the 1980s.
- 1.2 For over 15 years, there have been complaints from brewery groups that the scheme design is not working as effectively as it could or is unfairly distorting the brewing market. As discussed in the technical consultation, these concerns have included that:
- the SBR scheme is too generous, giving subsidy beyond the relative cost disadvantage experienced by small brewers,
 - this unfairness has increased over time, as SBR is linked to the headline duty rate and not to changes in production costs,
 - the taper is flawed, preventing growth by making expansion beyond 5,000hL extremely difficult and uneconomic, and
 - the scheme distorts normal business decision-making.
- 1.3 The Government admires the success of the craft brewing sector, which has expanded very significantly since the relief was introduced in 2002. The growth of this sector has significantly improved the diversity and quality of beers available to consumers. The Government wants to support this sector by reforming and improving the reliefs available to small brewers.

The review of SBR to date

- 1.4 In response to the concerns raised about the effectiveness of SBR, at the 2018 Budget the Government launched a review of SBR. In 2019, the Government conducted a survey of brewers to better understand their views regarding SBR and the cost structures of the industry. This received 335 responses.
- 1.5 In July 2020, the Government announced its first conclusions from the review. These set out that the Government would seek to reduce the starting taper to 2,100hL, convert the relief to operate on a cash basis (i.e. the relief would no longer be a percentage of the main rate), and consider the potential for a 'grace period' for breweries that merge.

- 1.6 Following this, the Government launched a technical consultation which ran from 7 January to 4 April 2021. This set out the Government's analysis, including that of the survey of brewers. The Government received 101 responses, which highlighted a range of views among brewers. Since then, the Government has been considering how wider changes to the alcohol duty system (as considered in its alcohol duty review) interact with SBR reform, and the impact of the different policy options on brewers.

Interaction with the alcohol duty review

- 1.7 The Government announced at Autumn Budget 2021 that SBR will be superseded by a new small producer relief, applicable on all drinks below 8.5% ABV. This includes cider and made-wines. Unlike the existing SBR scheme, this will apply to lower strength beers below 2.9% and will be applied on top of the new lower rates on draught beer.
- 1.8 The small producer relief will also differ from SBR by being based on a producer's total production across its products in hectolitres of pure alcohol, rather than on the volume of finished product for specific products such as beer.
- 1.9 As the technical consultation was started before the Government's response to the alcohol duty review and announcement of the small producer relief, the Government has chosen to respond to the technical consultation on SBR separately.
- 1.10 The terms of the small producer relief are currently the subject of a consultation, alongside the other changes to alcohol duty announced at Autumn Budget 2021. This means that the Government is not today announcing the final decisions about how reliefs for small brewers will change. These will be set out in the Government's response to the consultation on the small producer relief and other issues next year, in light of the submissions received to that consultation.
- 1.11 However, the Government has proposed in the alcohol duty review consultation that the technical terms of the small producer relief largely follow those that apply to SBR. Accordingly, the Government is in this document setting out its response to the specific questions raised in the technical consultation on SBR, to help brewers and other stakeholders understand the Government's thinking on these issues.
- 1.12 If brewers have feedback on the Government's views (set out in chapter 3), the Government invites them to provide responses to the alcohol duty consultation before 30 January 2022, via the consultation website:

<https://www.gov.uk/government/consultations/the-new-alcohol-duty-system-consultation>

Northern Ireland

- 1.13 The Government is aware that under Article 8 of the Northern Ireland Protocol of the Withdrawal Agreement, the existing EU legislation regarding alcohol duty continues to apply in Northern Ireland. The EU Directive governing the structure of alcohol duty imposes restrictions on the way in which member states may give relief to smaller producers, and how generous this relief may be.
- 1.14 Several of the proposals set out in this document depart from this body of EU legislation, such as the proposal for transitional relief for small breweries that merge.
- 1.15 Accordingly, the Government has announced in its command paper of 21 July 2021 that it is seeking a more flexible settlement regarding excise laws applicable in Northern Ireland. The Government will continue to discuss the application of these reforms to Northern Ireland with the EU.

Chapter 2

Summary of responses to the technical consultation

- 2.1 This chapter summarises the contributions made by respondents to the technical consultation. A full list of the technical consultation questions can be found at Annex B. The next chapter provides the Government's response to the consultation.

Changing the method of calculating production (Questions 1-2)

- 2.2 Generally, respondents felt changing the method of calculating production would add complexity and be administratively burdensome for small brewers, which may have fewer staff and less capacity to calculate a 12-month average. Many supported the simplicity and ease of the current method and argued that the benefits would be outweighed by the complexity.
- 2.3 A couple of respondents stated that changing to a rolling basis would better reflect seasonal differences and provide a more accurate picture of production levels.
- 2.4 The majority of respondents supported the proposal of allowing brewers to adjust their production total in-year in the event of exceptional circumstances. One commented:
- Given what the industry has been through over the past 12 months, where we have seen brewers' production fall through the floor, we believe that brewers should be able to adjust their production total in year to reflect substantial change.
- 2.5 Some respondents raised concerns about increased risk of fraud, for example, brewers exaggerating or fabricating losses to gain a tax advantage. To mitigate this risk, respondents stressed that HMRC should provide clear guidance on the definition of 'exceptional circumstance', and scrutinise evidence provided by brewers thoroughly.

Mergers and acquisitions (Questions 3-5)

- 2.6 Respondents supported introducing a transitional relief for brewers who choose to merge, to allow brewers time to adapt to the changed level of SBR entitlement.

- 2.7 There were a range of views over how long the transition should last. Several suggested a two or three-year period, while others suggested phasing the relief over a longer timeframe e.g. five years, as they felt three years was insufficient.
- 2.8 Respondents raised concerns that a transitional relief could enable and incentivise larger brewers to buy up smaller ones. Some worried this would lead to larger brewers gaining an unfair tax advantage. They expressed concern that this could restrict consumer choice and stifle innovation in the industry, by putting smaller brewers at an unfair disadvantage. Some also raised that it might be time consuming and burdensome for HMRC to administer.
- 2.9 However, other respondents disagreed, stating that as long as appropriate safeguards were put in place, brewers would not be in a position to exploit this relief.
- 2.10 Respondents suggested a number of rules to protect this relief from abuse, including:
- Qualifying brewers must already be entitled to SBR before the merger takes place, and relief must not be inherited by larger breweries not entitled to SBR.
 - Relief should be based on calendar years for ease of administration and monitoring.
 - If the acquired brewery closes or its annual volume drops below 10% of the average volume, then the relief should end at the end of the calendar year.
 - Brewers should not qualify for more than one relief over the transition period.
 - The acquiring company should not claim any relief if they have had control of more than 30% of the equity of the acquiree company at any point in the previous three years.
 - HMRC should request evidence that a genuine merger or acquisition has taken place and not a corporate rearrangement to avoid duty.
- 2.11 There was a strong consensus that the operation of these rules should be reviewed regularly, e.g. every five years, to ensure the relief does not cause unintended consequences or create new market distortions.

Adjusting SBR for the strength of the beer produced (Questions 6-8)

- 2.12 There were mixed views on this proposal. Some respondents supported capping the amount of SBR claimable, to ensure relief is a function of both strength and volume combined. They argued that the higher alcohol content of craft beers could be attributed to the financial advantages of SBR, and that by linking relief entitlement to

strength, this could incentivise all brewers to produce lower strength beers.

2.13 One brewer also made the point that lower and higher strength beers tend to command higher retail prices relative to mid-strength beers, and so this proposal was unlikely to lead to new market distortions.

2.14 Some respondents opposed this proposal entirely. They argued that SBR did not incentivise brewers to produce at a higher strength and introducing a cash cap would be unnecessary. Among these respondents, many cited the average strength of beer (4.2% ABV) to defend their point. Some also stressed that higher strength craft beers remain a relatively small segment of the market and should not be unduly penalised for being more alcoholic.

2.15 Brewers also raised concerns that introducing a cash cap would harm innovation. One brewer commented:

We produce what our customers ask for and if this is higher strength ABV beers and this reduces the volume we can sell before hitting the SBR cap, then how can we build that into our business model?

2.16 In terms of an appropriate ABV on which to base a cash cap, several supported using the national average strength of beer (4.2% ABV). One commented that this would help make Government expenditure more predictable, stating:

Pegging the cash cap to per cent ABV national average has the benefit of more closely aligning the relief with the headline excise rate.

2.17 Others raised concerns that basing the cash cap at 4.2% ABV may stifle innovation at the upper end of the market, particularly among craft brewers producing stronger ABV products. They proposed basing the cash cap at a higher level. One respondent suggested using an individual brewer's average ABV of products, so as not to put craft brewers at a disadvantage.

2.18 Respondents' views on including all beers (above 7.5% and below 2.8%) in this proposal were mixed. Some respondents supported taxing beers above 7.5% ABV an additional excise, to encourage responsible drinking and support reformulation of lower strength beers. Conversely, a number of brewers argued that taxing higher ABV products additional duty (and lower strength products less), would create artificial hurdles to growth and may benefit larger, industrial brewers, who could produce lower ABV beers more easily.

Converting to a cash basis (Question 9)

2.19 A number of respondents supported converting to a cash basis, to allow the SBR rate to more accurately reflect production costs and economies of scale, and ensure the relief is not too generous to certain brewers. One respondent commented:

Those getting 50% relief have disproportionately increased their benefit against those who pay full duty, which has increased punitively over the same period. Converting to a cash basis removes this anomaly.

- 2.20 A couple of brewers stressed that relief should be reduced to levels typically provided in other beer markets, and felt moving to a cash basis would make this possible. However, they made clear that the rate should not be increased regardless, but rather, there should be progressive, incremental withdrawal of relief.
- 2.21 Conversely, some respondents argued SBR should remain connected to, and fluctuate with, the rate of duty in percentage terms. Among these respondents, several worried converting to a cash basis would result in smaller brewers receiving less SBR than before, as the Government could adjust the rate of relief provided. One respondent commented:

Such a move could result in the SBR cash rate remaining frozen while the top rate of duty changes, resulting in the relative value of SBR support being automatically eroded away over time.

Technical issues with reforming the SBR Taper (Questions 10-13)

- 2.22 The two leading options among respondents were option 4 (marginal bands) and option 5 (a non-linear taper).
- 2.23 Among respondents who preferred option 4 (marginal bands), many stated that this would be the simplest to understand and easiest to modify. They also noted that jumps in marginal costs could be phased over a wider range, helping to reduce steep increases in duty past certain production levels.
- 2.24 There were mixed views on where thresholds for bands should be set. While some argued the 50% reduction should be retained up to 5,000hL - with the relief withdrawn gradually in small incremental steps - others suggested increases of 10% of the marginal duty rate e.g. brewers pay 60% of the marginal rate between 2,100-5,000hL, 70% between 5,000-10,000hL, and so on.
- 2.25 Other respondents preferred option 5 (the non-linear taper) as they felt it better addressed market distortions. They argued that while it may appear more complex, this was no longer a real-world issue, due to the increased use of digital technology.
- 2.26 Among respondents who preferred the non-linear taper, a common response was that this should mirror option 5D in the technical consultation, with the rate at 5,000hL set at 65% of the duty rate, and the cash cap at £250,000 instead of £280,000. A couple of brewers felt option 5D provided the best catalyst for growth, while one brewer commented that option 5A reflected the costs of brewing small quantities of beer in multiple microbreweries.

- 2.27 Some brewers opposed all options for change and argued that the current scheme should remain as is, to support brewers at the smaller end of the scale.
- 2.28 There were mixed views on how relief between 2,100hL and 5,000hL should be set. Among brewers producing up to 5,000hL per annum, the vast majority felt the current 50% reduced rate should be retained. One brewer commented:
- We do not believe that there is any reason why the 50% duty relief threshold should be reduced below 5,000hL. To do so would have a negative impact on at least 150 small breweries and will also restrict those below 2,100hL looking to expand.
- 2.29 Other respondents were more neutral. One brewer stated:
- We do not have a view on this but propose that the new regime should be cash-neutral at the time of it being adopted and then the new limits phased in over three years, in order to allow brewers to plan their businesses accordingly.
- 2.30 Among respondents who supported reducing the starting taper, some suggested taxing brewers at the smaller end of the scale around 60% of the marginal duty rate would strike a balance between supporting small brewers, while ensuring the scheme was not unfairly generous. One stakeholder commented:
- We very strongly request that the threshold is not moved any higher as it would really make the whole exercise of SBR reform pointless, based upon all of the evidence submitted to the Treasury as part of its overall review.
- 2.31 A sizeable number of respondents supported extending the taper past 60,000hL. Their main arguments were that economies of scale no longer end at 60,000hL, that the existing thresholds were arbitrarily set, and that the UK should match the maximum threshold available in the EU (200,000hL) to put it on a more competitive footing. One brewer commented:
- Even at 120,000hL brewers are disadvantaged compared to the larger brewers who are brewing in excess of 1,000,000hL, and so this would be a good catalyst for growing UK brewers to a larger size than has been the case since SBR was first introduced.
- 2.32 Conversely, some brewers felt only the smallest brewers (e.g. those producing up to between 30,000-60,000hL per annum) should qualify for SBR, and opposed extending the taper past 60,000hL.

Technical paper on economies of scale experienced by small brewers

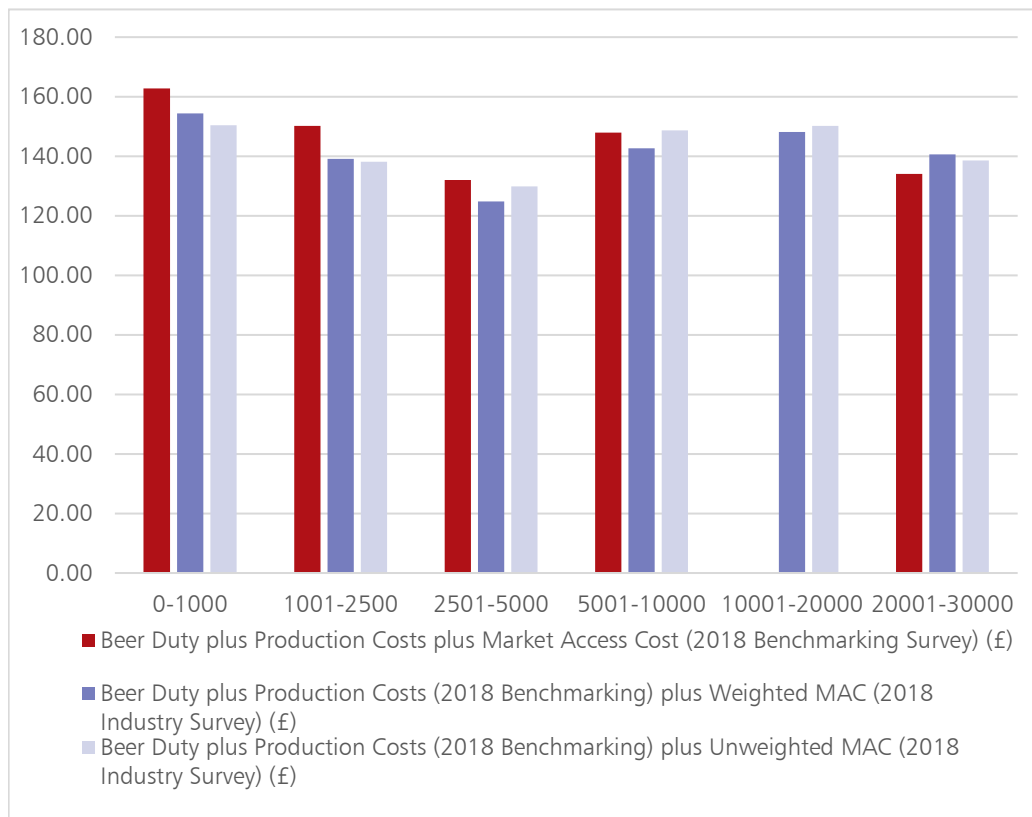
- 2.33 Along with feedback from brewers, the Government also received a paper from Geoff Pugh and David Tyrrall, the economists whose previous work on SBR was discussed in the technical consultation

document. While produced independently, the paper was endorsed by SIBA and attached to their response.

- 2.34 The paper conducted an analysis of small brewers' production costs based on the 2018 SIBA benchmarking survey and 2018 SIBA industry survey. The paper attempted to analyse the effect of incorporating a 'market access cost'.
- 2.35 The results of their analysis are summarised in the chart below (which was included in the paper). The conclusions are very similar to those found by the Treasury in its analysis of the 2019 HMT survey of brewers, in that production costs (when combined with duty) are higher for those above 5,000hL compared to brewers in the 2,500hL range. As the authors concluded:

Our calculations from the 2018 Benchmarking Survey responses do not support the contention that breweries in the 2501-5000 hl category are much advantaged compared to the larger breweries in the sample (especially not in comparison with those in the 20,001-30,000 hl category). Yet ... by combining the production cost and duty data from the 2018 Benchmarking Survey with Market Access Costs calculated from the 2018 Industry Survey responses, our estimates again could give the impression that the 2501-5000 hl category is over-compensated by beer duty relief for its production cost disadvantages vis-à-vis the larger 5001 – 20,000 competitors immediately above it.

Chart 2.A: Analysis of small brewers' production costs



Source: Submission to the technical consultation by Geoff Pugh, David Tyrrall and John Wyld

2.36 Turning to the policy implications for the design of the taper, the authors made a number of points:

We return again to the question of the overall 'fairness' of the current duty and relief structure, i.e. whether and to what extent any tax relief should attempt to bring the average production cost curve across the size bands to the horizontal. Putting it differently: what is the role of the duty relief? Is the role of duty relief an ambitious aim of re-levelling a playing field by counter-acting arguably 'natural' economies of scale? Or does it have the rather more limited aim of simply reducing the tax burden on the lower earning tax payers?

It seems reasonable to argue that at inception the introduction of the relief was somewhat of a mixture of the two, but that any goal of levelling the playing field was limited in target towards the smaller players, i.e. this was not an attempt to change any 'natural' economies of scale across the sector, but rather to allow for the development of a niche in which the craft beer sector could not only survive, but thrive and indeed grow – a result which [the Treasury] and [our previous research] find to have occurred. If there really is a bulge in the population of breweries at the 1000 – 5000 hl class, for which the evidence is at best mixed, then this could simply be regarded as the natural outcome of the policy goal - i.e. to create a niche for such breweries.

2.37 The authors also cautioned:

[The variation in the results] suggests that the data available from these cost of production surveys, although highly indicative regardless of the source, may not be sufficiently robust to support any major change in public policy regarding the Beer Duty relief, for example an attempt to 'horizontalise' the total average cost curve (production cost plus market access cost plus beer duty) across the size categories of small breweries.

Our analysis suggests that the role of relief from beer duty should continue to have a more modest and targeted aim, of enabling and indeed encouraging development at the lower size end of the sector.

Chapter 3

Reforming Small Brewers Relief

- 3.1 This chapter sets out the Government's response to the questions raised in the technical consultation.
- 3.2 As discussed in the first chapter, the Government has announced that SBR will be superseded by a new small producer relief, applicable on all drinks below 8.5% ABV. This will differ from the current SBR scheme in several ways, as discussed further below.
- 3.3 As mentioned, if brewers have feedback on the proposals below, the Government invites them to provide responses to the alcohol duty consultation before 30 January 2022, via the consultation website:

<https://www.gov.uk/government/consultations/the-new-alcohol-duty-system-consultation>

Method of calculating production

- 3.4 At present, SBR is calculated on a brewery's total production in the previous calendar year. Following suggestions from brewers, the Government considered changing the method of calculating production as part of the consultation process.
- 3.5 Having discussed this proposal with industry, the Government does not intend to change the method of calculating production. While this would provide a more accurate picture of brewers' production throughout the year, the Government believes it would add unnecessary complexities to the SBR scheme.
- 3.6 The technical consultation also sought feedback on allowing brewers to adjust their production total in year, in the event of exceptional circumstances. Currently, there is no legal mechanism for brewers to adjust their production calculation in year, an issue which was brought to the fore by the COVID-19 pandemic.
- 3.7 Having considered the responses to the consultation, the Government intends to allow brewers to adjust their production levels where these have been materially affected by an exceptional event, and are reasonably expected to be affected for the remainder of the year. The adjustment would only be allowed up to three months before the end of the current production year.
- 3.8 This would mean that production would not be recalculated in the event of flooding which affected facilities for a fortnight, because the

brewer could reasonably be expected to recover from this setback by the end of the year. However, a storm or fire that destroyed part of the brewery, requiring extensive reconstruction, would qualify.

- 3.9 The recalculation would be based on the brewer's estimate of their production for the remainder of the year, which could be informed by data on their production. The brewer would need to provide evidence to HMRC to support their application. Once the year had ended, SBR entitlement would be recalculated on actual production levels for the period after the event (adjusted for the length of this period) in the usual way.
- 3.10 HMRC will also be given discretion to adjust a brewer's production levels to ensure fairness for the following year. If an event happened very close to the end of the production year, this might make the previous year's production figures unrepresentative of the brewery's future production. For example, if a fire destroyed part of a brewery one month before the end of the year, the brewer would be able to apply for an adjustment to its production for the following year based on the anticipated impact. Again, such an event would have to be more than a temporary impairment and the application would need to be backed by evidence.
- 3.11 The Government will further develop the definition of an exceptional event that permits brewers to recalculate their production in-year as it drafts the legislation necessary to implement the conclusions of the SBR review. It will also further consider what protections would be needed to prevent possible fraud.
- 3.12 The Government believes these changes will benefit the craft brewing sector by giving HMRC greater flexibility to address adverse events that brewers may face. In this way, craft brewers can more quickly see their duty bill adjusted to reflect their true business circumstances. It will also potentially provide a form of economic support to help brewers recover from major setbacks.

Mergers and acquisitions

- 3.13 In July 2020 and in the technical consultation, the Government proposed introducing a transitional relief for breweries that merge. Brewers have complained that the current system of SBR disincentivises mergers and acquisitions because the entitlement to SBR is recalculated immediately upon completion of the merger. For example, if two breweries each producing 5,000hL merge together, they must immediately recalculate their production on the basis of 10,000hL total production. This means that their SBR discount drops from 50% to 25% at once.
- 3.14 Having considered the responses to the consultation, the Government proposes to introduce transitional relief for brewers that merge, to help them adapt to large changes to SBR over time and avoid the tax system distorting business decision-making.

3.15 The Government intends that the relief will be phased over a three-year period:

- From the point of the merger until the next production recalculation, the newly merged brewer will base its SBR calculation on the production of the larger of the two original brewers.
- At the next reproduction calculation (the beginning of the second year), a calculation will be made of the difference in duty between the combined total production of the merged brewer and the production of the larger of the two original brewers.
- For the second year, the merged brewer will pay the SBR level applicable to the larger of the two original brewers, plus one-third of the difference to the SBR level applicable to its total production.
- For the third year, the merged brewer will pay the SBR level applicable to the larger of the two original brewers, plus two-thirds of the difference to the SBR level applicable to its total production.
- At the end of the third year, the merged brewer will then pay SBR on its total production, as currently happens immediately after a merger.

Box 3.A: Worked example of the transitional relief

Two breweries, Brewery A and Brewery B, merge to form a new venture, Brewery AB.

Brewery A produces 10,000hL.

Brewery B produces 15,000hL.

Currently, Brewery AB would receive SBR based on 25,000hL production immediately. Under the new relief, SBR would be received as follows:

- **Step one:** calculate SBR based on the production of the larger brewery (in this case Brewery B)

Using the existing SBR taper, Brewery B pays 83.3% of the main duty rate, and so pays £15.90 per hL%.

Under the transitional relief, this will continue to be the duty rate for Brewery AB immediately after the merger until the next time production is recalculated.

- **Step two:** calculate SBR on the total combined production of brewery AB.

Under the existing SBR taper, Brewery AB would pay 90% of the main duty rate, and so would pay £17.17 per hL%.

This is the rate Brewery AB will pay after the transitional relief is concluded.

- **Step three:** calculate the difference between the start and end rates.

In this case, this is $£17.17 - £15.90 = £1.27$ per hL%

- **Step four:** calculate the rates for the second and third years by increasing the rate by one-third of the difference each year.

Y2: $1/3 * £1.27 + £15.90 = £16.32$ per hL%

Y3: $2/3 * £1.27 + £15.90 = £16.75$ per hL%

Accordingly, the rates per hL% will be as follows:

- From the merger to the beginning of the next year: £15.90
- From the recalculation, for the rest of the second year: £16.32
- For the third year: £16.75
- From the end of the third year onwards: £17.17

- 3.16 If brewers were to experience a change in their production level during the three-year period, an adjustment would be made to reflect this. This would apply if the brewer grew or shrank over the period.

Box 3.B: Worked example of adjustments for changes in production

Consider the example of brewery AB, as set out above.

This time however Brewery AB grows over the transition period. At the beginning of year 2, its production rises from 25,000hL to 30,000hL, and likewise at the start of year 3 it rises further to 35,000hL.

While the first step of the calculation would remain the same (i.e. the SBR entitlement would remain based on the original 15,000hL production of brewery B), the remaining steps would be recalculated based on Brewery AB's higher production.

Year 2 calculations

- Step two would now result in a duty rate (under the existing taper) of 91.6% or £17.49 per hL%.
- Accordingly, step three would create a difference of £1.59.
- Therefore, the second year rate calculated in step four would rise to £16.43.

Year 3 calculations

- Step two would now result in a duty rate (under the existing taper) of 94% or £17.94 per hL%.
- Accordingly, step three would create a difference of £2.04.
- Therefore, the third year rate calculated in step four would rise to £17.26.

This principle would also apply in reverse, if the merger was not a business success and the brewery declined in production over the transition period.

- 3.17 If the merger meant that the two breweries (when production was combined) exceeded the maximum threshold for SBR (currently 60,000hL), the transitional relief would apply, but would be phased down to zero. However, if the larger brewer exceeded the maximum threshold before the transaction, the combined brewery would not be eligible for any SBR.
- 3.18 The Government does not intend to set out a definition of what constitutes a merger in order to qualify for the transitional relief. Instead, brewers who are assessed by HMRC as cooperating under the existing SBR rules (and are therefore required to calculate SBR under their combined production) will be able to apply for the transitional relief.
- 3.19 Therefore the existing conditions around connectedness and control to define the economic independence of a small brewer will continue to apply.
- 3.20 The Government is aware of the risk that transitional relief could give rise to avoidance opportunities or distort the brewing sector. The Government would not wish a multinational brewer to be able to acquire a small brewery, and then channel millions of hectolitres of mass-produced beer through that brewery at SBR rates. To prevent this, all brewers must qualify for SBR before the merger transaction to benefit from transitional relief.
- 3.21 If brewers undertake further mergers while the transition is in operation, the transition period will be reset. Further transitional relief will be available, but only on the basis of the additional merger. Any outstanding transitional relief from the original merger would be lost.

Box 3.C: Worked example of effect of additional merger

Consider the example of Brewery AB as set out in Box 3.A.

During the first year of the transition (i.e. when Brewery AB is paying £15.90 per hL%), Brewery AB agrees to buy Brewery C (5,000hL) to form Brewery ABC.

Following successful completion of the second merger, the original transition will end. Brewery ABC can apply for transitional relief instead on the merger of Brewery AB with C.

In this case, SBR entitlement is calculated on the transition between Brewery AB's 25,000hL production and the 30,000hL production of Brewery ABC.

The rates would therefore be:

- From the merger of A and B to form AB until the next year end: £15.90 (as calculated in Box 3.A)
- From the merger of AB with C (occurring before the first year end): £17.17
- Year 2 after the second merger: £17.28
- Year 3 after the second merger: £17.38
- From the end of the third year: £17.49

Because the second merger in this case occurred before the beginning of the second year, the overall transition is the same length. However, if the second merger happened at a different point, the transition point would reset in length.

For example, if the merger happened halfway through the second year of the first merger transition, the second transition would run at first year rates until the next year end, when it would then run at second year rates. In this situation, Brewery AB would benefit from 18 months of transitional relief after the first merger, and then Brewery ABC would benefit from transitional relief for 2.5 years after the second merger.

3.22 The Government has developed a model for mergers and acquisitions around the case of two entities merging. However, the Government is aware that more complex transactions are possible and would welcome feedback from industry groups on other scenarios (e.g. where three or more brewers merge). It will consider these points further as it develops the legislation necessary to implement the transitional relief for mergers and acquisitions.

3.23 Although necessarily sophisticated to reflect the diversity of circumstances in which brewers may merge, the Government believes that the transitional relief will help small brewers. By adjusting relief

more gradually, small brewers can properly consider mergers with fellow small brewers, without the tax system unfairly distorting their business decision-making. This may, for example, make it easier for brewers who wish to retire to sell their business to a fellow small brewer.

Adjusting SBR for the strength of the beer produced

- 3.24 The Government acknowledges that the way SBR is currently calculated means brewers producing strong beer receive more relief in absolute cash terms, although this is a constant proportion of the duty rate paid.
- 3.25 Following concerns raised by some stakeholders that this may incentivise brewers to increase the strength of their products, the Government raised the possibility of introducing a cash cap in the technical consultation. This would result in small brewers receiving SBR relief up to a certain amount in cash terms, such as the £200,000 currently claimable on 5,000hL of 4.2% ABV beer.
- 3.26 Since then, the Government announced at Autumn Budget 2021 that it will supersede SBR with a new small producer relief. This is intended to apply to all products that producer may make (below 8.5% ABV) and is therefore based on a producers' total combined production, expressed in pure alcohol terms. That means that rather than calculating entitlement based on hectolitres of finished product, the relief will be calculated in reference to the hectolitres of pure alcohol produced.
- 3.27 Accordingly, the Government does not intend to introduce a specific 'cash cap' mechanism, as the concerns around higher strength beers will be addressed by converting SBR to a pure alcohol basis method of calculation.
- 3.28 The Government is consulting on the small producer relief design through its alcohol duty review consultation. As part of this, the Government is considering the appropriate levels and thresholds for the relief in hectolitres of pure alcohol.
- 3.29 The Government has not made a final decision on how to translate the proposed SBR thresholds (discussed further below) into a pure alcohol basis. The national average for beer brewed in the UK is around 4.2% ABV, but the Government is aware that some small brewers may brew at a higher average ABV, such as 4.6% or 4.8%.
- 3.30 If brewers have feedback on how to convert the current SBR thresholds of hectolitres of finished product into hectolitres of pure alcohol (e.g. what average ABV should be used), the Government invites them to respond to the consultation on the new alcohol duty system, as discussed in the first chapter.

Converting to a cash basis

- 3.31 The Government announced in July 2020 that it would seek to convert the value of SBR to a cash basis, with its value subject to regular review.
- 3.32 As part of the technical consultation, the Government sought feedback on what method the Government should use when considering whether to adjust the SBR amount – either a broad-based index of general price changes such as CPI or RPI, the Beer Producer Price Index (reflecting wholesale beer prices) or a custom index using beer industry costs.
- 3.33 The consensus amongst brewers was that adjustments to the SBR amount should use a broad measure of prices such as CPI or RPI. The Government proposes to continue to use RPI until 2030 as the basis of uprating alcohol duties more widely. This means that when considering whether to adjust the SBR amount, the Government will take into account what changes have occurred to RPI. However, the Government will also consider other indicators such as CPI and the Beer PPI, as well as other evidence about the wider economic circumstances, when making decisions.
- 3.34 The Government intends this cash basis will be used as part of the new small producer relief, which will extend to other categories of product.
- 3.35 The Government believes the conversion to a cash basis will help ensure that small brewers receive a fair offset for their diseconomies of scale, that keeps pace with inflation and therefore maintains its value in real terms over future years.

Design of the taper

- 3.36 In the technical consultation, the Government reviewed five options for a new taper design for SBR, and invited suggestions from brewers for alternative taper designs. The consultation asked specifically how the new taper should affect brewers producing between 2,100hL and 5,000hL, and whether the taper should be extended beyond 60,000hL.
- 3.37 Reform of the taper is a highly complex issue. The Government has extensively analysed the available evidence to develop options for a new taper, which it considers will significantly address most of the concerns raised around the current scheme.
- 3.38 As noted earlier, the Government has now announced a new small producer relief which will supersede SBR. This is subject to consultation and so the Government is not in this document setting out its final decisions on the taper that will apply to small brewers in future. However, to help explain the Government's thinking and help brewers and other producers respond to the separate consultation on the new alcohol duty system, the Government is setting out its

conclusions on the questions raised in the technical consultation around the SBR taper.

The Government's working model for a new taper for small brewers

- 3.39 The Government considers that while the non-linear options (Option 5 in the consultation) had some technical advantages, they were excessively complex, inflexible and hard to interpret. While computers and ready reckoners could be used to address the difficulties of calculating relief entitlement, the Government believes the marginal bands scheme is inherently easier to explain, and the effect of its parameters can be more readily understood.
- 3.40 For that reason, the Government proposes that it would be better to adopt the marginal bands scheme (Option 4 in the technical consultation document) as the basis of a new taper design.
- 3.41 Option 4 in the consultation provided a specific example of a marginal bands scheme involving a five banded system, with marginal rates of 50%, 60%, 80% and 100% before the relief was withdrawn.
- 3.42 However, the Government considers – based on the consultation responses – that a different scheme would provide better overall results.
- 3.43 Firstly, the Government proposes to adjust the start point of the taper from 2,100hL to 2,500hL.
- 3.44 Secondly, the Government proposes to reduce the marginal rate from 60% to 55% for the first section of the taper. This will provide brewers with a gentler introduction to the start of the taper. This represents a less dramatic increase in duty for growing brewers and means that a brewer at 5,000hL would pay an overall rate of 52.5% rather than 50% as now.
- 3.45 Thirdly, the Government proposes to divide the taper between 5,000-30,000hL into three bands. The marginal duty rate would be 75%, rather than 80% between 5,000-10,000hL. Rather than immediately moving to 100%, the Government proposes this should be lowered to 85% until 20,000hL, and then return to 100% until 30,000hL.
- 3.46 Fourthly, the Government believes that the marginal tax as the relief is withdrawn rate should not change significantly from its current level of 108.3%. The three changes above make the scheme more generous than now, and so the marginal tax rate would have to increase for the taper to end at 60,000hL. Accordingly, the Government proposes that the taper should extend up to 100,000hL, with a marginal tax rate of approximately 107.3%.
- 3.47 The marginal rates and overall rates of the scheme can therefore be summarised in the tables below.

Table 3.A: Marginal duty rates

Production (hL)	Marginal duty rate (new model)	Marginal duty rate (current scheme)
0-2,500	50%	50%
2,500-5,000	55%	50%
5,000-10,000	75%	100%
10,000-20,000	85%	100%
20,000-30,000	100%	100%
30,000-60,000	107.32%	108.33%
60,000-100,000	107.32%	100%
100,000+	100%	100%

Table 3.B: Duty rates (percentage of the main rate)

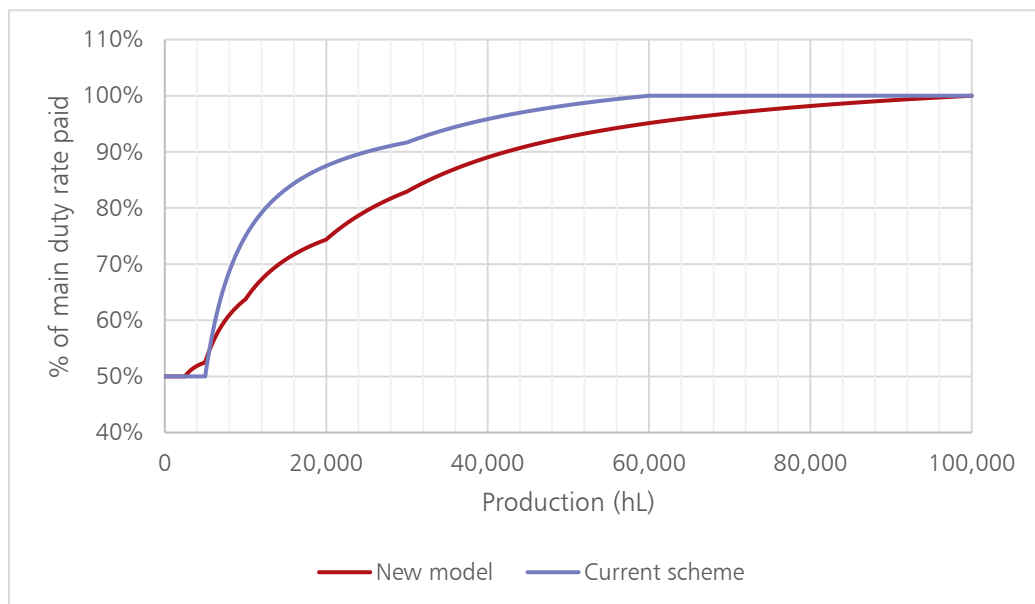
Production (hL)	Duty rate (new model)	Duty rate (current scheme)
1,000	50%	50%
3,000	50.8%	50%
5,000	52.5%	50%
10,000	63.8%	75%
15,000	70.8%	83.3%
20,000	74.4%	87.5%
25,000	79.5%	90%
30,000	82.9%	91.7%
40,000	89.0%	95.8%
50,000	92.7%	98.3%
60,000	95.1%	100%
70,000	96.9%	100%
80,000	98.2%	100%
90,000	99.2%	100%
100,000	100%	100%

3.48 The marginal rates and overall rates can also be graphed as follows.

Chart 3.A: Marginal duty rates

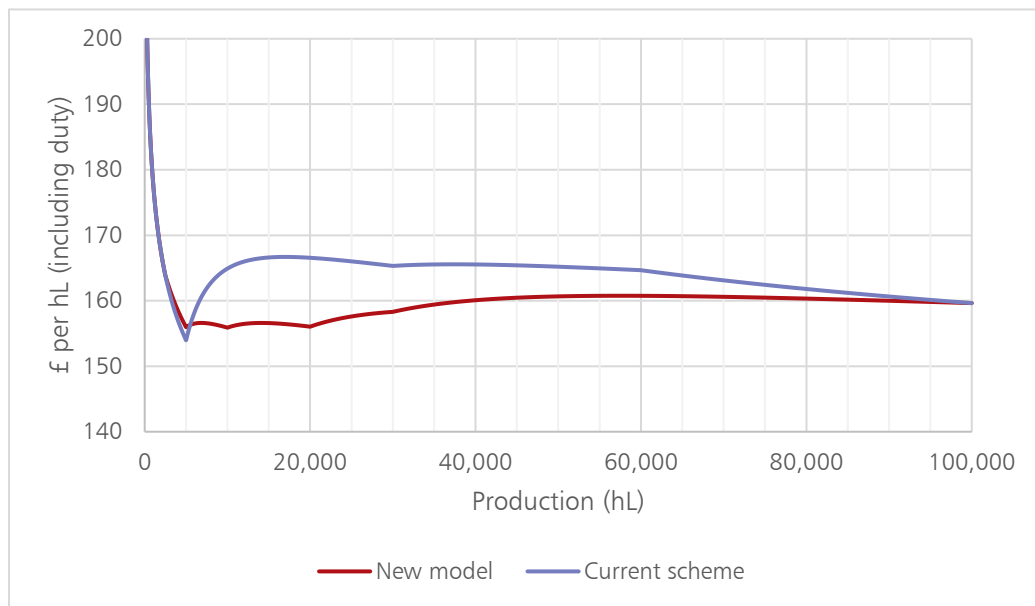


Chart 3.B: Duty paid relative to the main rate



- 3.49 As can be seen in both charts, the new model provides for a much more gradual withdrawal of relief than at present. The Government believes this will substantially address the current issues that brewers currently experience when they try to expand above 5,000hL. In this way, the Government believes that this policy will further stimulate growth and expansion in the craft brewing sector.
- 3.50 The effect of the new model for the taper on the overall economies of scale affecting a brewer can be illustrated in the chart below. The effect of reduction in SBR as a brewer grows is combined with the modelled average production costs for that brewer (based on the data from the 2019 HMT survey of brewers). This modelling was discussed further in the technical consultation document.

Chart 3.C: Total average production cost curve, including duty (4.2% ABV)



Source: HM Treasury analysis

- 3.51 As can be seen, under the existing scheme there is a very sharp rise in duty once a brewer exceeds 5,000hL, leading to the existence of a 'growth trap' where brewers in the 2,500-5,000hL range enjoy lower production costs than brewers both larger and smaller than themselves, once duty is included. Under the new scheme, this phenomenon is eliminated, with brewers in the 5,000-20,000hL range experiencing flat unit costs.
- 3.52 Under the new model, above 20,000hL, average costs gradually rise and peak at around 60,000hL. However, this effect is much less than experienced at present between 5,000-15,000hL and occurs much more gradually. Total average costs in this range will be lower than at present in any case. Overall, the disparity between the highest and lowest cost caused by the withdrawal of relief above 5,000hL is very significantly diminished.
- 3.53 The Government therefore believes this new model for a relief taper will provide a fairer basis of competition between small and medium brewers of different sizes, as the relief more accurately reflects the economies of scale present at this brewing scale.
- 3.54 The Government also considers that the new model will encourage brewers to consider expanding, because they now face lower marginal duty rates as they grow past 5,000hL.

Annex A

Respondents to the technical consultation

1	A T Leisure Ltd	52	Graham Murray
2	Adnams plc	53	Grahame Morris MP
3	Allendale Brew Company Ltd	54	Hackney Brewery Ltd
4	Andwell Brewing Company	55	Hall & Woodhouse Ltd
5	Anspach & Hobday	56	Hambleton Brewery
6	Arundel Brewery	57	Hogs Back Brewery
7	Bank Top Brewery	58	Husk Brewing Ltd
8	Bedlam Brewery	59	Hybrid Brewing
9	Bexley Brewing Limited	60	Ilkey Brewery Co Ltd
10	Billericay Brewing Company	61	Iron Pier Brewery Ltd
11	Bingley Brewery	62	Ivo Brewery Ltd
12	Black Country Ales	63	James Newman
13	Black Sheep Brewery	64	John McGrath
14	Bollington Brewing Co	65	JW Lees & Co Brewery
15	Brass Castle Brewery	66	Lincoln Green Brewing Company Limited
16	Brewhouse and Kitchen	67	Marble Beers
17	British Beer and Pub Association	68	Milton Brewery
18	Bryn R Pass	69	Moorhouse's Brewery
19	Calverley's Brewery	70	Neptune Brewery
20	CAMRA	71	Olivia Blake MP
21	CAMRA Ayrshire and Wigtownshire	72	Orbit Brewing Limited
22	CAMRA Birmingham	73	Peak Ales Ltd
		74	Pheasantry Brewery

23	CAMRA Brighton and South Down	75	Rebellion Beer Company Ltd
24	CAMRA Bristol and District	76	RedWillow Brewery Ltd
25	CAMRA Burton-on-Trent & South Derbyshire	77	Richard Bottoms
26	CAMRA Derby	78	Rooster's Brewery Ltd
27	CAMRA Durham	79	Saltaire Brewery
28	CAMRA Hinckley & Bosworth	80	Shepherd Neame Ltd
29	CAMRA Keighley and Craven	81	SIBA (The Society of Independent Brewers)
30	CAMRA Liverpool and Districts	82	Small Brewers Duty Reform Coalition
31	CAMRA Trafford and Hulme	83	Stephen Pugh
32	Castle Eden Brewery	84	Summerskills Brewery
33	Chantry Brewery	85	Surrey Hills Brewing Ltd
34	Cloak+Dagger Brewing	86	T&R Theakston Ltd
35	Common Rioters Beer Limited	87	The Great Newsome Brewery Ltd
36	Cullercoats Brewing Limited	88	The Ramsgate Brewery
37	Dancing Duck Brewery	89	Three Brothers Brewing Company
38	Daniel Thwaites plc	90	Tim Saker
39	Darwin Brewery Ltd	91	Timothy Taylor & Co Ltd
40	David Holliday Limited T/A the Norfolk Brewhouse	92	Tirril Brewery
41	Dawkins & Georges Ltd	93	Titanic Brewery Co Ltd
42	Double Maxim Beer Co Ltd	94	Tommy Sheppard MP
43	Elusive Brewing Ltd	95	Tyne Bank Brewery Ltd
44	Exe Valley Brewery Ltd	96	Utopian Brewing Ltd
45	Exmoor Ales Ltd	97	W.H. Brakspear & Sons Ltd
46	Ferry Ales Brewery Limited	98	Weetwood Ales Limited & Weetwood Distillery
47	Frederic Robinson Ltd	99	Wells & Co
48	Fuller Smith & Turner PLC	100	Wensleydale Brewing Ltd
49	Fyne Ales	101	Wishbone Brewery Limited
50	Geoff Pugh and David Tyrrall		
51	Goddards Brewery Ltd		

Annex B

Technical consultation questions

Changing the Method of Calculating Production

- B.1 Would you support changing the method of calculating production from the previous calendar year's total to a rolling 12-month average?
- B.2 As an alternative, would you support brewers being able to adjust their production total in-year? Would any protections be needed to prevent this provision from being abused?

Mergers and Acquisitions – Transitional Relief

- B.3 If relief is put in place, over how many years (and at what rate) should SBR be withdrawn for breweries that merge?
- B.4 Do you foresee any issues if such a relief was put in place?
- B.5 What rules would be needed to protect this relief from abuse? Should there be a maximum size that breweries can be to benefit from transitional relief?

Adjusting SBR for the Strength of the Beer Produced

- B.6 Would you support capping the amount of SBR claimable in cash terms? This would reduce the production volume that would be eligible for reduced rates produced for higher strength beers while increasing it for lower strength beers.
- B.7 If so, what would be the appropriate ABV on which to base the 'cash cap'?
- B.8 Would you support the inclusion of the additional excise on beers above 7.5% ABV, and the reduced rate for beers below 2.8% ABV, in this system?

Converting to a Cash Basis

- B.9 What method would you prefer the Government uses when considering whether to update the SBR amount?

Technical Issues with Reforming the SBR Taper

- B.10 Which of the five options for a scheme design do you consider the most attractive?
- B.11 How would you set the parameters of your preferred design?
- B.12 What would the amount of relief at 5,000hL (and therefore the rate of withdrawal between 2,100-5,000hL) be under this new scheme?

B.13 Would you support a more gradual rate of SBR withdrawal from 30,000hL, to e.g. 100,000hL, in the context of a reformed scheme?

