



Alcohol Fraud: Next Steps

Summary of Responses
16 January 2014

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Foreword

The Government is committed to taking decisive action to address alcohol fraud. It costs the taxpayer an estimated £1 billion per year, depriving the general public of revenue that could be used to fund vital public services. Alcohol fraud also poses a serious threat to the livelihoods of law-abiding businesses as they have to compete with organised criminals, and it also funds other criminality including drugs and tobacco smuggling.

In recent years there have been significant advances in tackling the illicit trade in alcohol products. In 2010/11, HM Revenue & Customs (HMRC) launched its 'Tackling Alcohol Fraud' strategy aimed at tackling alcohol fraud across all alcohol products. This was underpinned by an additional £17 million investment in HMRC enforcement work which has helped to increase the impact of our efforts almost threefold since 2010, protecting over £600 million in revenue in 2012/13 alone.

However, the level of alcohol fraud remains too high, preventing many legitimate wholesale and retail businesses from competing fairly on a level playing field. In 2012, the Government consulted on a number of legislative options to tackle alcohol fraud. The consultation confirmed that illicit products typically penetrate supply chains at the wholesale level and concluded that registration of wholesalers was the most feasible, and cost-effective means of achieving a sustained reduction in the level of illicit trade in alcohol products in the UK. This proposal had broad support across all sectors of the alcohol industry.

In 2013, HMRC consulted further on how a registration scheme for wholesalers could operate. The responses to that consultation confirm broad support for introduction of an alcohol wholesaler registration scheme across the alcohol industry as a means to protect honest businesses from illicit trading, and to reduce overall levels of tax fraud.

In the Autumn Statement, the Chancellor confirmed the Government's intention to introduce an alcohol wholesaler registration scheme. We will continue to work closely with businesses on the details of how the scheme will operate to ensure the scheme minimises burdens on legitimate businesses but is effective at driving out fraud. The Government has also announced the introduction of "due diligence" requirements for excise businesses. These are aimed at ensuring excise businesses approved by HMRC undertake reasonable and effective due diligence when entering trading relationships in the alcohol supply-chain. Many businesses already take great care to avoid supplying to, or sourcing from, the criminal enterprises behind alcohol fraud. This measure will require all businesses to put in place adequate controls and checks to protect their supply-chains against the risk of penetration by fraud.

I would like to thank the alcohol industry for the significant contribution they continue to make in tackling alcohol fraud. Working together is vital to tackling alcohol fraud effectively; I am pleased to announce the launch of the joint alcohol anti-fraud taskforce (JAAT) in January 2014. The task force will comprise senior officials from key government departments and enforcement agencies including HMRC, Home

Office, Border Force and Trading Standards with key industry stakeholders to discuss ways to combine our efforts to increase the impacts we can have on this persistent problem. I am optimistic that this collaborative effort will help to further build on the measures the Government has already announced it is taking to deal with this issue.

A handwritten signature in black ink that reads "Nicky Morgan". The signature is written in a cursive, flowing style.

NICKY MORGAN
ECONOMIC SECRETARY TO THE TREASURY

1. Introduction

Background to the informal consultation

- 1.1. Alcohol duty fraud is a serious problem in the UK. Tax losses through alcohol fraud deprive the Government of approximately £1 billion a year; money that could be used to fund essential public services like schools and hospitals. Honest businesses in the alcohol sector are also made to suffer as the organised criminals behind the fraud undercut them and deny them a level playing field.
- 1.2. The most prevalent form of alcohol fraud involves the smuggling or diversion of alcoholic drinks into the UK in large commercial quantities, duty unpaid. Organised criminal gangs do this by systematically exploiting the EU-wide duty suspension arrangements which allow excise goods to move between authorised warehouses duty unpaid until released for consumption onto the home market. Illicit product typically penetrates legitimate supply chains at the point of wholesale.
- 1.3. The Government formally consulted in 2012 on potential legislative measures to help prevent and tackle alcohol fraud and announced the conclusions from that consultation earlier this year, confirming that HMRC will:
 - implement a programme of changes now to strengthen existing legislation, policy and enforcement to tackle alcohol fraud
 - consult further on how a scheme to register alcohol wholesalers might operate, to better understand the potential costs and benefits of such a scheme
 - consult on new proposals to strengthen due diligence obligations for registered excise businesses.

Purpose of the informal consultation

- 1.4. HMRC launched an informal consultation document "*Alcohol Fraud: Next Steps*"¹ on 19 August 2013. The specific objectives of the consultation were to:
 - provide further detail on the policy and enforcement steps HMRC intends to take to increase its impact on alcohol fraud

¹ <https://www.gov.uk/government/consultations/alcohol-fraud-next-steps>

- provide further detail on how an effective scheme to register alcohol wholesalers might operate
- collect further information and data to assess the costs, feasibility and effectiveness of a wholesaler registration scheme, including from large and small/medium sized enterprises (SMEs) and any other interested parties
- understand the implications of new obligations on registered excise traders to undertake effective due diligence on their supply chains
- seek views to refine the proposed policy design of both options and inform any subsequent implementation.

Informal Consultation

- 1.5.** The consultation *Alcohol Fraud: Next Steps* was due to close on 28 October 2013 but was extended to 4 November 2013 following a request from trade representatives to allow more time to consider and collate the responses of their members.
- 1.6.** In addition to publicising the consultation, HMRC met with various business sectors and representative bodies during the consultation period to identify any areas of concern and work together with industry to reach solutions that lessened their concerns without risking revenue.
- 1.7.** The Government would like to thank all of the many stakeholders who have taken the time to respond, attend meetings and engage with officials during this consultation.
- 1.8.** In total, HMRC received 63 responses to the "Alcohol Fraud: Next Steps" consultation; 16 responses from representative bodies; 41 responses from businesses and 6 responses from other organisations.

Points consulted on

- 1.9.** The consultation requested further information on the impacts and costs of **wholesaler registration** and **due diligence obligations** for registered excise traders.
- 1.10.** It also sought industry views on options to strengthen the existing alcohol strategy; proposed legislative changes to the current provisions for granting brewery registrations and options to tighten EU legislation.

Responses to the Consultation

- 1.11.** In summary the consultation confirmed that there continues to be broad support for the concept of alcohol wholesaler registration across industry, which generally believes that better regulation of this sector is necessary to safeguard against the risk of penetration by fraud. However, some sectors, particularly

the retail trade and excise registered businesses, had specific concerns around the perceived burdens of some of the detail of the scheme and discussed these with HMRC during the consultation. As a result, HMRC has modified some aspects of the proposed policy design of the scheme to address the most significant of the concerns raised regarding administrative costs, (see paragraph 2.8). An alternative approach setting out the proposed modifications to the scheme was issued to stakeholders on 21 October 2013, (see annex A).

- 1.12.** Responses to our proposals for due diligence have largely been favourable.
- 1.13.** There was broad support for the wider programme of changes to our policy and enforcement strategy announced in the consultation.

2. Responses

- 2.1. This chapter draws out the key messages from the consultation responses. Due to the number of questions, some summary paragraphs cover more than one question.

Strengthening HMRC's existing alcohol anti-fraud strategy

- 2.2. Out of a total of 63 responses, 17 specifically commented on this section.

Increasing collaboration with legitimate business and between enforcement agencies

Q1 asked what further steps the alcohol industry could take to reduce the scope and opportunity for alcohol fraud.

- 2.3. There was widespread support for the formation of the Joint Alcohol Anti-Fraud Taskforce (JAAT) from those who specifically commented on this and trade associations were keen to be involved. Suggestions to reduce the scope and opportunity for fraud included limiting drawback or restrictions to the duty suspension regime. Some respondents stated that more could be done to tackle oversupply and suggested better identification of products for export. Others suggested better use of existing sanctions and more joined up working around the administration of alcohol licences.

Tightening policy and regulations to reduce opportunities for fraud

Q2 asked if the change in criteria for brewery registrations would have any implications for industry.

- 2.4. The majority of respondents felt that the change in criteria for brewery registration would have no implications for their business. One trade association felt that the majority of their businesses would be unaffected. Another trade association supported revocation of brewery registration where fraudulent behaviour had been proven and felt further tightening of the procedure would not impact upon legitimate businesses. However, it was noted that any costs incurred were likely to be passed down the supply chain.

Q3 asked respondents if there were any other changes to the EU legal framework that they thought would be useful in addressing alcohol fraud.

- 2.5. There was a varied response to this question ranging from suggestions for changes to enforcement including mandatory checks at the border to amendments to the EMCS system and changing duty rates. One respondent advocated greater controls over the movement of denatured alcohol and also suggested the UK should oblige wine owners holding wine in duty suspension

to register under WOWGR². There was general support for a tightening up of Council Directive 2008/118/EC that deals with the holding and movement of excise goods. One wholesaler recommended that any changes requested of the EU should be dependent on what the JAAT identifies as key problems.

- 2.6.** Two respondents felt there were no changes needed to the EU legal framework at present and one trade association thought there should be more consultation before proposed changes to financial guarantee requirements, and recording vehicle details were implemented.

Registration of alcohol wholesalers

- 2.7.** Out of a total of 63 responses, 48 specifically commented on the proposal to register wholesalers. There was much support for the concept of the proposed registration scheme, but most respondents stressed that burdens on legitimate businesses should be kept to a minimum. Two specific concerns were raised: (i) who would be required to register as a wholesaler; (ii) the checks and record-keeping requirements required which would ensure businesses only trade with *bona fide* suppliers and customers.
- 2.8.** In response to the concerns raised, HMRC set out a potential alternative to some aspects of the requirements for record-keeping and checks suggested in the original proposal. This potential alternative approach was issued to trade associations for comment. The details of this alternative proposal are contained in Annex A and summarised in the relevant paragraphs below.

How would a wholesaler registration scheme help address fraud?

Q4 asked for any further data industry could provide to help assess the overall impact that alcohol fraud has on legitimate businesses.

- 2.9.** Everyone who responded to this question agreed the impacts of alcohol fraud on legitimate businesses was significant and one retail business claimed it was so far reaching that there were certain areas of the UK where honest businesses could not compete at all. Those respondents who were able to quantify losses quoted impacts ranging from lost sales of approx 40 dozen wine sales per week to a wholesale business losing approx £180m per year. The wholesale trade report a continuing decline, mainly in beer and wine sales in recent years. A major off licence chain quoted a 10% reduction in store numbers over recent years as a result of lost business to alcohol fraud.

² Warehousekeepers and Owners of Warehoused Goods Regulations 1999. This issue was consulted on by HMRC in the 2012 consultation on alcohol fraud and was addressed in HMRC's response to that consultation published on 17 July 2013.

Who would be required to register?

Legal definition of wholesale activity/who is a wholesaler

*Q5 & Q6 asked for comments on a proposed definition of “wholesale” and “wholesaler”.
Q7 asked for alternative definitions if available.*

- 2.10.** Those who responded to this section generally agreed with the proposed definitions although this agreement was for some respondents, mainly in the retail sector, conditional on a practical exemption being found for retailers making incidental wholesale sales. Some other respondents also thought the suggested definition could prove too broad. One respondent thought it should be more focused only on risky businesses whilst another considered that excise registered businesses were already the subject of stringent controls so should be excluded. Particular respondents wanted clarification of the activities that would be caught by the definition. One respondent feared that the concept of ‘dealing’ could be interpreted too broadly, for example to include people only bottling, and therefore the definition should be clarified or narrowed to avoid this and one respondent wanted further clarification of the term “sale”.
- 2.11.** An alternative definition of what is meant by wholesale was proposed based on the Income Taxes Act³. One respondent also stressed that when legislating care needed to be taken of the fact that licensing law was a devolved matter and the definition needed to take account of that. Other suggestions included introducing a de minimis level; insisting wholesale sales were to bona fide retailers or only sourced directly from the producer and including alcohol distributors both before and after the duty point.

Exemptions from registration

Q8 asked if businesses agreed there should be no exemptions from registration apart from retailers making incidental wholesale sales and whether any other exemptions were considered necessary.

- 2.12.** The majority of those who responded to this question believed there should not be any exemptions and four respondents in the retail and wholesale sectors also believed there should be no exemptions for incidental sales either. Other respondents thought low risk traders; retailers with a small proportion of wholesale sales; retailers selling to non-profit making ventures and those with excise registrations should be exempt. One major retailer thought all retailers should be excluded. Brewing associations suggested aligning or combining existing excise registrations with wholesale registration to avoid duplication. The possibility of a turnover threshold was also raised by a trade association representing small producers.

³ Section 304(3) Income Taxes Act 2007

Q9 asked for views on the proposal to include businesses that already hold a retail licence and/or excise approval in the requirement to register.

2.13. 21 respondents replied to this question and 17 supported the proposal that both retailers and excise businesses that “wholesale” should be registered. Those who supported this believed it would improve traceability through the supply chain and would avoid fraudsters exploiting loopholes. However, for some businesses, agreement was conditional on a workable exemption being included for retailers making incidental sales and potential fast-tracking of applications from businesses already registered with HMRC. Those who did oppose registration thought it was overly burdensome for businesses already holding an excise approval or retailers should be excluded as their activities were covered by their retail licence or they were not carrying out a “deliberate” wholesale activity.

Q10 & Q11 asked for views on the proposal to register importers of duty paid alcohol and whether there were any different impacts for importers when compared to businesses buying alcohol for wholesale sale in the UK.

2.14. The majority of respondents agreed with the proposal to register importers who sold duty paid alcohol to other businesses to ensure equity of treatment, close any loopholes and to allow retailers reassurance that they are dealing with an approved wholesaler. Those who did not agree believed there were already enough systems in place to track imports or could not give an opinion as the definition of importer needed clarifying as some businesses never take ownership of the goods. Others thought the impacts would be felt by UK businesses that would be placed at a disadvantage to overseas traders who would be outside UK jurisdiction.

Retailers that sell to retailers

Q12 asked whether there was agreement with the proposal to register retailers that sell alcohol to retailers/wholesalers.

2.15. Generally there was support for this proposal but some recognised there would be issues around identifying retail/wholesale customers, or support was dependent upon a workable exemption for incidental sales. One respondent supported it but thought it would be unworkable in practice and another suggested it could potentially create a burden for business without addressing fraud. A number of major retailers accepted that retailers that had a significant wholesale aspect of their business should register but felt that a workable exemption for incidental sales was vital, while one major retailer thought businesses whose trading purpose was primarily retail sales should not be caught at all. Other retailers thought those who were also wholesaling should be registered.

Examples of “wholesale” activity

Question 13 asked for any trade types which should be excluded from the examples of wholesale activity and any which have not been covered and should be included.

- 2.16.** Half of the respondents to this question confirmed they thought there should be no exclusions from the scheme although one trade association thought that existing excise approvals could be amalgamated to ease burdens on business. One retail association suggested that HMRC should ensure that sales to community events (such as village fetes) should not be caught by the requirements of the scheme. It also wanted to ensure that large sales to private individuals (for example for celebrations) should be excluded. Other respondents wanted to ensure that online/mail-order traders were included and one trade association thought it could cause unnecessary burdens for auction houses, brokers and commission agents if they were caught by the definition of “wholesale”.

Question 14 asked for further details on the potential numbers of applicants based on the proposed definition of wholesale and an initial HMRC estimate of 20,000 applicants.

- 2.17.** A number of respondents said they could not calculate this or they only had numbers applicable to their particular sector. One association suggested a source of further information. Two others suggested that numbers of applicants could be significant and potentially over double the estimated number if there was no exemption for incidental wholesaling by retailers.

Operation of the scheme: Registration

Q15 & 16 asked for views on a proposal for on-line registration and HMRC’s intention to check all applications prior to approval.

- 2.18.** Overall the majority of respondents agreed with online application providing it was not too complicated. One respondent suggested using the existing Alcohol & Tobacco Warehousing Declaration (ATWD) system and one importer thought a system with human contact was preferable.
- 2.19.** Most responses to the question regarding HMRC’s intention to check approvals were favourable. The main wholesalers’ association, and a number of other respondents were strongly in favour believing it was crucial to the success of the scheme to root out criminals. Some others agreed with the proposal although some thought it was not necessary for those already holding excise registrations. Another respondent agreed with the proposal providing there was a fall back in place to allow existing businesses to trade whilst applications were processed and there was an appeals procedure in place. However, some individual wholesalers were opposed to the proposal that existing businesses must register and questioned whether HMRC should have the right to decide who can or cannot trade.
- 2.20.** There was some concern from wholesalers, brewers and a tax consultant over what was meant by a “credible business plan”. One trade association thought

this could cause some issues for their members and suggested an alternative approach.

Criteria for registration

Q 17 asked for views on the proposed criteria for approval or refusal of applications and whether any other criteria should be considered.

2.21. Generally, those who responded to this question agreed with the proposed criteria. However, some respondents did have some reservations and thought certain criteria needed further clarification including the meaning of “any revenue non-compliance”; debts of a serious nature; satisfactory due diligence and directors/key employees. Another respondent thought due consideration should be given to the size of business and the potential level of fraud within their supply chain. A number of wholesalers suggested more definition was required around the criteria to exclude a business from the scheme.

Q18 asked if respondents agreed overall with the proposals for registration and ways to mitigate any potential problems.

2.22. Some respondents answered positively to this question whilst others did so but on condition that points they had already highlighted to earlier questions should be taken into account. Two retail businesses were concerned that they would have to identify every store that was wholesaling and register each one with associated costs and additional burdens. Another respondent thought it was essential to register every business location to avoid criminal activity at unregistered premises. Others thought they needed more detail on the scheme before they could agree to the proposals. Another respondent suggested more time was needed to properly consider all applications and for the industry to implement properly.

Obligations of the scheme – wholesalers

Q19 asked for comments regarding the means and frequency of checking registration numbers.

2.23. Initial feedback from a number of trade associations during the consultation period suggested that the purpose of the check on new suppliers was understood and accepted but some associations viewed the specification of a monthly recheck to test the registration status of existing suppliers as overly prescriptive. The need to keep specific records of the checks undertaken was also seen as too burdensome.

2.24. In response to this early feedback, trade associations were asked to additionally consider a possible alternative, aimed at reducing the nature and volume of checks required to reduce potential burdens. This alternative approach maintained that checks on the authenticity and status of suppliers of alcohol would remain essential to reduce the risk of fraud, and that a business would still be liable to sanctions if found to be purchasing from an unregistered wholesaler. However, it proposed that businesses would not be required to

establish the status of customers nor would HMRC prescribe the frequency of checks. These would be left to the judgement of businesses involved.

2.25. *Original proposal:* The majority of respondents considered that the suggested frequency for repeat checks (to test that suppliers were still registered) was too burdensome and could potentially be costly for industry to implement. A number of respondents believed that HMRC should leave to the judgement of businesses when these checks should be carried out and some thought HMRC should explore functionality to the IT system that would allow businesses to be automatically notified of registration changes. There was also a commonly held view that the need to keep comprehensive records evidencing the nature of customers could be burdensome or even impractical for supplies made at the retail end of the supply chain where the nature of the customer would often be unknown.

2.26. *Alternative proposal:* This was widely supported by those who commented.

Q20 asked for the costs and impacts of including the Unique Reference Number (URN) on invoices/purchase orders.

2.27. Responses to this question varied from some businesses who thought costs would be negligible, others thought there would be costs but they would be manageable whilst others thought costs would vary according to the size and complexity of each business and their IT provision. Some SME wholesalers were concerned by the potential for additional costs and some larger businesses thought the change could cost approx £1m to implement. One industry group suggested using the VAT registration system to verify URNs.

Q21 asked for the additional costs and impacts of maintaining specified records outlined as part of the wholesaler registration scheme.

2.28. In addition to the responses detailed above, some respondents felt there would either be no extra cost or costs would not be significant. Some excise registered businesses had concerns regarding the storage of proposed records and the additional burden of making them available for inspection. However, the proposal to record vehicle registration numbers was considered a major burden by most sectors of the supply chain. Some large retailers thought the retention of records on purchases was within current practices but thought that the original proposals for retaining records of sales were unworkable. This was echoed by large wholesalers who thought it impossible to match customer purchases to batch codes unless it was done manually.

Q22 & Q23 asked whether current business records differentiated between wholesalers, retailers and members of the public and if not how much it would cost to introduce such a system.

2.29. Two respondents out of a total of 35 had records that currently differentiate between customer types. Many trade associations thought this would be a major cost for businesses and many thought the requirements could prove impractical for retailers due to the nature of their business activities. Some SME businesses thought they would not be able to afford the cost of introducing

such a system, others thought they would not be able to capture the information accurately or could cost up to £100,000 per business depending on individual requirements.

- 2.30.** A number of associations and businesses responded that the difficulties and costs attached to identifying every single customer, and keeping associated records gave particular concern. In response HMRC offered industry stakeholders a potential alternative proposal to consider. The alternative proposal removed the suggested new offence of selling to an unregistered wholesaler and also accepted that the specific checks and record keeping requirements outlined in the consultation to verify the nature of all customers would not apply. Instead suppliers would be expected to simply carry out reasonable due diligence (see paragraphs 2.49 onwards) on their customers where there could be a reasonable threat of duty fraud or sales being made to a wholesaler that should be registered. All respondents that offered a view on this alternative proposal indicated preference to this rather than to the original proposal.

Q24 asked about the costs and impacts of keeping records of checks on registration numbers.

- 2.31.** Similar concerns were raised in response to this question as were raised in responses to questions 19, 22 and 23. Some respondents thought that keeping a record of checks on registration numbers would not cause any significant costs or be too burdensome. But many others, while believing the check on new suppliers was reasonable, thought that the further repeat checks on suppliers and also records of checks on customers would be highly costly or, in the latter case, even impractical. Some respondents, particularly from parts of the retail sector, thought the costs of retaining records of monthly checks could be significant and in some cases prohibitive and outweigh the benefits of the scheme. For example, one set of estimates offered for small retail stores suggested the administrative cost could be as low as £12.60 per store per year if only new suppliers needed to be checked but this would increase to more than £200 per year if repeat checks on suppliers were required. Other responses that offered costs for the original proposals in the consultation document varied greatly depending on the size and type of business ranging from £10k pa for additional staff to upwards of £100k. Others were unable to quantify but thought they would be substantial.

Q25 asked how stock records could be improved to allow reconciliation of purchases to sales.

- 2.32.** There were a number of suggestions put forward including only allowing wholesalers to buy direct from the manufacturer; applying the URN to pallets to identify the source; using original bottle and case markings (but recognised as a massive undertaking) and track and trace solutions although these would be prohibitively expensive. Other respondents thought any additional stock keeping would be burdensome or beyond the capabilities of a lot of businesses.

Q26 asked for the costs and impacts of requesting stock returns.

- 2.33.** The consultation made clear that there is no current proposal to introduce a requirement for businesses to provide periodic stock declarations (i.e. returns)

to HMRC, but information on possible costs would inform any consideration of introducing returns in the future. The relevance of requesting stock returns was questioned by some respondents and the majority thought it would create additional burdens and cost. Only some larger businesses offered actual monetary costs on this question, and these responses varied widely from £20,000 for additional staff to possibly £250,000. One trade association suggested the impact could be onerous for their members due to the scale of activity and number of locations that a business might need to consolidate in one return. They consequently suggested that if a returns requirement were ever adopted it should be considered for high risk operators only.

Obligations of the scheme - Retailers

Q27 asked retailers who would have to register what they thought the costs and impacts would be of complying with the obligations of the scheme.

- 2.34.** Similar to points raised to earlier questions, respondents felt the main costs and impacts on retailers would lie with the obligations to check suppliers/customers and additional record-keeping. Responses ranged from minimal impact on their business providing there was an exemption for incidental wholesale sales to a substantial burden particularly for small retailers. Others thought the requirement to check customers would be unworkable. One respondent thought effective prosecution, better intelligence and joined up action was preferable to more regulation.

Q28 asked if it was agreed that retailers making only incidental wholesale sales should not have to register.

- 2.35.** The majority of respondents agreed that retailers making incidental wholesale sales should not have to register. One respondent thought that strict criteria were also vital and another thought records must be kept to substantiate these sales. Two respondents thought there should be no exemptions.

Q29 asked for criteria to determine incidental sales.

- 2.36.** There were a number of suggestions proposed for a suitable level including using: a fixed monetary level per transaction; a volume limit similar to the EU minimum indicative levels; a percentage of total sales or basing on the excise duty level rather than the value of the product. Some respondents thought the proposed £250 limit was too low and would be too onerous to track sales above this limit or could cause a loophole for fraudsters to exploit.

Q30 asked what other approach HMRC could take to mitigate the impact on retailers who make occasional wholesale sales.

- 2.37.** One retailer thought this should not be a concern if the scheme has a major impact on fraud. Others thought a simplified registration process was required and a workable level for incidental wholesale sales. One respondent thought all retailers should be excluded from the scheme whilst another retail trade association suggested that retailers making a small amount of wholesale sales were regulated via their retail licence rather than new regulations.

Penalties and Offences

Q31 asked for industry's views on the proposed new sanctions and penalties.

- 2.38.** Some respondents to this question agreed with the proposed sanctions and penalties, others thought the penalties were too lenient and suggested alternative levels. Generally, there was a view that the steps leading up to the imposition of a penalty or other sanction should be made clear and penalties should be used against those deliberately engaging in illicit activity and not be used to penalise businesses making honest mistakes. A number of wholesale businesses thought an appeal to the tribunal was not an effective remedy when a business has their licence revoked and suggested fast-tracking appeal hearings and allowing businesses to continue trading until the appeal decision.

Q32 & Q33 asked industry what other action HMRC could take as an alternative or in addition to the proposed sanctions and whether there were any other features of the scheme that should have a right of appeal.

- 2.39.** There were a number of suggestions from industry regarding potential alternatives or additions to the proposed sanctions including referral to the licensing authorities, losing the right to trade, and in some cases, a life-time ban; imposing assessments for duty for the past three years; business education to make it easier for businesses to get it right and making directors personally responsible and liable in the event of any sanctions.
- 2.40.** The majority of respondents were content with the proposals and did not think there was anything else that needed to be included. One respondent thought the basis for appeal had not been properly set out.

Summary of Impacts

Q34 asked whether industry agreed with the impact assessment.

- 2.41.** Responses to the consultation varied greatly on possible costs to industry with some often similar businesses believing costs would be negligible while others claimed these could be significant. A few respondents agreed with the impact assessment but some agreed on the proviso that the burden on small retailers must be taken into account or felt fiscal marks for beer and wine were also essential to address duty fraud. Others disagreed on the basis that they did not believe costs for wholesalers would be negligible as indicated and other costs such as systems development, record-keeping and administration should also be included.
- 2.42.** Some **Wholesalers** who commented thought there would be little or no cost as they already maintained the records requested. However those who commented on the proposed monthly checks thought the associated costs could be prohibitive. One respondent indicated ongoing costs of £100k for recording vehicle registrations. Some SME businesses thought costly system changes could be unaffordable if the original proposed scheme was introduced

and other wholesalers indicated costs would be dependent on the size of business but could be up to £25k per trader.

- 2.43.** Comments from **Retailers** mainly indicated costs could be significant. The main costs appear to lie in making one-off changes to systems to include a wholesaler registration number and adapting systems and processes to record checks and details of customers on an ongoing basis. A retail trade association indicated a cost of approx £8m across their membership if the checks on customers suggested in the consultation document were introduced. However, another retail respondent indicated they believed the costs of introduction to be minimal.
- 2.44.** Associations representing **Excise Registered Businesses** also indicated a range of costs from negligible to £100,000 depending on the final requirements of the scheme. The highest costs indicated were around recording vehicle registrations which both small and large beer producers thought could be prohibitive, suggesting it could cost millions to introduce.

Q35 asked what impact the industry thought the wholesaler registration scheme would have on fraud.

- 2.45.** The majority of respondents believed the scheme would have a positive impact on fraud to a greater or lesser extent. The wholesalers' association and some smaller retailers underlined that significant regulatory action was vital to stem the losses caused by fraud to the legitimate trade. One respondent believed it could halve the current estimates of fraud. Others saw the benefits in terms of greater transparency of illicit supply chains and likewise saw financial benefits for legitimate businesses and the taxpayer. Others could see the benefits but with reservations. One respondent thought that fraud would still persist on a significant scale and another emphasised the scheme itself would have no impact unless extra resources were provided to police it. Two responses suggested there would be little impact on fraud but that the scheme would tie up legitimate businesses in additional administration.

Q36 asked if there were any other impacts that should be taken into account.

- 2.46.** There were several responses to this question. Two trade associations requested that any additional costs and compliance burdens should be risk based and proportionate and two other respondents mentioned the potential impacts on the consumer. Another trade association representing excise registered businesses said there were controls already in place to check movements of duty suspended stock but there would be costs of introducing checks on duty paid supplies. Finally, another respondent thought the impacts of HMRC refusing or revoking a registration should be considered where an incorrect decision has been made.

Q37 asked small businesses to comment on the costs and impacts of the measure on their business.

- 2.47.** Only one association chose to directly answer this question as responses on costs and impacts tended to be embedded in other parts of the consultation

response. The association that responded, which represented smaller drinks' producers, thought additional costs should be low if the scheme was appropriately targeted and suggested that if a turnover threshold could be used for registration, the impact could be negligible.

Excise due diligence condition

2.48. Out of a total of 63 responses, 41 specifically commented on due diligence.

2.49. Generally, the due diligence proposal was supported by representatives of businesses in the alcohol supply chain including producers, wholesalers and some retailers. Some felt the proposal would improve the confidence of businesses and have a positive impact on fraud as long as checks were rigorous and robustly policed. A few businesses responded that, depending on the exact checks introduced, they may incur extra costs. Many businesses stated they already carry out such checks so any additional costs should be minimal. A couple of businesses said they would incur no extra cost, highlighting the increased profits they would receive through trading on a more level playing field.

Q38 asked if a due diligence condition would have any positive or adverse effects on business, and if so, what would be those effects.

2.50. Generally there was a positive response to this question especially if it helped to drive out fraud. One trade association believed businesses should undertake due diligence on their immediate supply chain and another trade association thought the removal of a registration was a powerful enforcement tool. Others responded that they already had these systems in place and one respondent thought existing Memoranda of Understanding (MOU) with HMRC already covered this proposal. Some wholesalers thought a due diligence condition is unreasonable if they were being asked to verify the whole supply chain.

Q39 asked if a due diligence condition would help improve confidence in the sector and help businesses make more informed decisions on those businesses they trade with.

2.51. Generally, those who responded to this question believed this would improve confidence in the sector and sent out an important message to those turning a blind eye to illicit activity. One trade association thought that it would help their members identify potentially illicit customers when introduced alongside the wholesaler registration scheme. Others thought the condition would only have marginal effect as most businesses were doing this already. One association said they believed a MOU they already have with HMRC gave them sufficient confidence. One respondent believed it would only result in significant impact if it accompanied robust pre-registration checks and enforcement and another suggested "know your customer" procedures should be a critical part of due diligence.

Q40 asked respondents if they thought the condition would have a positive impact on fraud and reduce overall risks in their trading sector.

2.52. The majority of respondents thought this condition would have a positive impact on fraud including reducing secondary wholesaling of illicit stock and making fraud more difficult. However, a minority thought it would either have no impact on fraud, could be undermined by fraudsters using a wholesaler registration as a cover, or push fraud further underground if legitimate suppliers refused to supply certain customers.

What HMRC will check

Q41 asked industry if they agreed with the proposed due diligence checks.

2.53. Generally, respondents agreed with the checks included although a couple of respondents thought they would not have any results or were excessive. Others stressed it was impossible to check beyond immediate supplier/customer citing competition issues or it was difficult to prove duty had been paid on a product. One respondent agreed with the checks but thought illicit businesses would not carry them out.

Q42 asked if businesses agreed that carrying out these checks would help them identify fraud.

2.54. Some respondents expressed strong agreement to this especially when checking out new customers. Others thought their supply chain was low risk as they bought direct from the manufacturer or it would not help them at all. One trade association commented it could only work if all companies carried out due diligence to the same level. One respondent suggested businesses should be made to buy direct from the producer to eliminate major fraud.

Q43 asked industry if there were any further checks they would like to see published.

2.55. Those who responded to this question generally thought the level of checks outlined were sufficient. An independent retail chain suggested the proportion of purchases which are bought direct from the producer could be indicative evidence of a lower risk supply chain. One wholesale respondent suggested targeted checks on brands susceptible to fraud and cross-checking volumes of sales to wholesale customers.

Q44 asked if respondents would prefer to see checks published in a dedicated excise due diligence notice or in a regime specific notice.

2.56. Responses to this question were inconclusive. Those who responded to this question thought either some form of guidance was necessary, some preferred a dedicated notice, or others thought it should be regime specific. The remainder either thought it should be both or one suggestion was to include in a notice and issue with each registration certificate.

Penalties and Offences

Q45 asked for views on the proposal to impose proportionate sanctions on those businesses who fail to carry out appropriate due diligence.

- 2.57.** Generally, respondents agreed with the imposition of sanctions providing they were proportionate and reasonable. Some responses advocated strong action including removal of registration. Others thought sanctions should only be imposed where there were deliberate attempts to avoid due diligence obligations or where there had been a clear failure to pay duty.

Summary of Impacts

Q46 asked industry if carrying out reasonable due diligence checks would provide benefits to business.

- 2.58.** The majority of responses to this question thought there would be benefits from due diligence for the supply chain as a whole in terms of reducing fraud and securing supply chains. One respondent thought turnover could increase by 20% if due diligence meant their business could compete on a level playing field.

- 2.59.** However, some respondents thought there would be limited benefits for individual businesses that already carry out these checks.

Q47 & Q48 asked whether due diligence checks would create extra costs and administrative burdens for industry.

- 2.60.** Responses to the question of additional costs varied widely from negligible impact to approximately £1m for one trade association's members to introduce "know your customer" checks. Others thought it would result in a small amount of additional administration or that costs could vary significantly depending on the level of auditing that HMRC proposed to carry out.

- 2.61.** Most respondents to the question on additional burdens thought there would be some but one retail chain emphasised that these were acceptable if the measure helped to drive out fraud. One respondent thought their records should already be at an acceptable standard but another thought they would have to formalise current procedures and this would involve additional burdens.

Q49 asked small businesses to comment on the potential costs and impacts for their business.

- 2.62.** There was one response to this question. One trade association whose membership was largely composed of small businesses thought it was impossible to quantify costs and impacts as there was a massive variation between their members in terms of size, production turnover and complexity.

3. Next steps

- 3.1. The Government is grateful for industry's constructive engagement during the consultation period.
- 3.2. After fully considering the responses, the Government announced at Autumn Statement 2013 its decision to introduce a wholesaler registration scheme and that it would also proceed with the proposals to introduce a new due diligence condition. The reasons these conclusions were reached are as follows.

Registration of alcohol wholesalers

- 3.3. Responses to the previous consultation held in 2012 - *Alcohol Fraud: Legislative Measures to tackle existing and emerging threats to the UK alcohol duty regime* – had indicated there was broad support across industry for the concept of a wholesaler registration scheme. However the responses to that consultation also reinforced that in order for such a scheme to be worthwhile it would need to be introduced with a high level of controls and robust enforcement. Furthermore, more detailed consultation on scheme design was necessary to establish in greater depth the potential impacts on industry.
- 3.4. *Alcohol Fraud Next Steps* gave industry the opportunity to consider a more detailed scheme design and understand more fully the implications a new wholesaler registration scheme would have for businesses. It also gave a further opportunity to consider the potential impact such a scheme could have on fraud.
- 3.5. The responses underlined that businesses directly suffering the most from fraud tend to believe that new measures are necessary to help stem the problem. The consultation responses also reaffirmed that there is still a high level of support for the concept of registering wholesalers in recognition that better regulation of this sector is required, as the point in the supply-chain at which illicit products are frequently distributed. Although not a universally held view, responses also confirmed that most in the alcohol industry believe that a properly enforced wholesaler registration scheme could have a significant impact on the overall levels of fraud.
- 3.6. We are encouraged that responses generally supported our proposal that wholesalers would need to meet certain standards before being approved to demonstrate they are fit and proper to trade wholesale in alcohol. We believe this is a key design element of the scheme to allow HMRC to test the bona fides of a business before granting approval and to give other businesses greater certainty around the legitimacy of who they trade with. We note some of the concerns raised particularly regarding the actual criteria that should be used and will work with industry to refine the detail over the coming months.
- 3.7. We have also noted that many responses emphasised that adequate HMRC resource would be needed to enforce the scheme properly. A rigorous approval process and strict enforcement of compliance with the obligations imposed by

the scheme is essential to achieving the expected benefits in helping reduce the current level of alcohol fraud. The scheme will be supported by new teams of staff dedicated to conducting full, rigorous checking of registration applications and policing compliance with the scheme once it is introduced.

Registration

- 3.8.** Drawing specific conclusions around all potential costs to industry has proven difficult as some similar businesses have indicated potential costs of the scheme as negligible whilst others thought costs could be significant. Some have also highlighted that at least in some cases costs to legitimate industry could be recuperated through increased sales due to the prevention of fraud. Nevertheless, using established HMRC models to estimate costs (regulatory compliance burdens) for customers, our initial estimate is that the process of registration and approval itself is likely to lead an industry wide cost of £5m (on average £250 per wholesaler but exact costs will not be identical per business). Additional to this will be the costs of adding registration numbers to relevant commercial documentation such as invoices. The costs offered on this point fluctuated significantly with a number of respondents believing they would be negligible while others insisted they would be significant due to systems changes. There was no consistent pattern in these responses and we will continue to work with stakeholders to refine these estimates prior to implementation of the scheme.
- 3.9.** A theme of some responses was that, while the general concept of a wholesaler registration scheme was accepted as a necessary step to address fraud, the overall burdens of registration to industry could be mitigated. This potential mitigation could be through introduction of exemptions from the requirement to register, or possibly simplified procedures, for industry sectors such as retailers making only incidental wholesale supplies and businesses that already hold other excise approvals.
- 3.10.** We believe that it is essential to the success of the new scheme that registration is required for all businesses who routinely conduct wholesale activity. Consequently, we do not intend to introduce an exemption for businesses that wholesale but hold other excise approvals. However, we will continue to work with relevant industry stakeholders that have concerns over the potential burdens for their businesses to see to what extent these concerns can be mitigated.
- 3.11.** The original scheme design confirmed that an exemption would be necessary for licensed retailers that make only incidental wholesale supplies. This was in recognition that it would be onerous to insist that a retailer that makes only unintended, very occasional, low levels of wholesale supplies (such as sales of a few bottles to the local restaurant that has run out of wine, sales to the annual village fete) should be obliged to comply with the requirement to register as a wholesaler. This continues to be our view and we have noted that it is supported by a large number of stakeholders. However, responses to the consultation indicated differing views as to how this exemption should work (for example, level of threshold). We will continue to work with industry

stakeholders to determine the exact nature and threshold to define incidental sales.

Checks and records on suppliers and customers

- 3.12.** While many other aspects of the scheme design appeared to be broadly accepted, serious concerns were raised by a significant number of stakeholders around certain obligations of our original proposals including checking suppliers/customers on a regular basis and associated record-keeping. Responses to the consultation showed potential costs of £8.2m per annum for the convenience retail industry carrying out regular checks on suppliers and we acknowledge the practical difficulties there could be for retailers carrying out routine checks on their customers.
- 3.13.** As explained at paragraph 2.8, discussions with stakeholders early in the consultation prompted an alternative design for the checks required by the scheme, specifically the expectation on businesses to check the credentials of suppliers (but not customers) to lessen burdens on legitimate businesses but without jeopardising the scheme's integrity. This alternative proposal was broadly welcomed and we consequently intend to proceed with this revision to the scheme design. Our initial estimates, based on costings for those parts of industry that we did receive, are that this would reduce costs across the industry to approximately £1m per annum. We will work with stakeholders to refine these estimates to inform a detailed impact assessment ahead of implementation.
- 3.14.** A number of stakeholders also highlighted that the specific requirement to keep records of delivery vehicles might prove onerous or particularly costly for their businesses. We will therefore revisit this issue and seek further detail from these respondents before making any decision as to whether we proceed with this requirement in the final design of the scheme.

Penalties and sanctions

- 3.15.** We noted that most respondents agreed with the penalties and sanctions laid down in the consultation document but that a number of respondents believed that a £5000 penalty was not a sufficient deterrent to the most serious criminals to stop illicit trading. We understand this point of view. Before legislating we will therefore consider again what scope there is for the introduction of penalties of increased severity for the most serious and persistent offences, while recognising that any solution will need to satisfy the test of proportionality when compared to sanctions for similar offences in other parts of the justice regime.

Next Steps

- 3.16.** In summary, the consultation has helped to confirm that introduction of a wholesaler registration scheme is an appropriate next step to take if we are to make a significant impact on the current unacceptably high levels of fraud. It will introduce new compliance requirements and give enhanced visibility to HMRC to a part of the alcohol supply-chain where tax unpaid products are

often distributed. The new approval requirements will make it more difficult for those prepared to trade in tax unpaid products to continue trading in alcohol. It will also help to give more transparency to those trading with wholesalers as to whether the businesses they are trading with are legitimate. These factors should combine both to reduce tax revenues currently lost to fraud and help to create a more level playing field for legitimate businesses.

- 3.17.** It is planned to legislate for the scheme at Finance Bill 2015. Subject to legislation being made to that timetable, we will invite applications to register from early 2016 to allow HMRC to conduct rigorous pre-registration checks on all existing businesses wholesaling alcohol. The scheme will be implemented in 2017.
- 3.18.** In the meantime we will continue to work with industry stakeholders to settle the final detail of the scheme ahead of producing draft legislation for consultation in 2014.

Due Diligence

- 3.19.** There is broad support for a due diligence condition and we have noted industry's general belief that it would have a positive impact on fraud, particularly if introduced alongside wholesaler registration.
- 3.20.** We believe this proposal will help to tighten and increase transparency of alcohol supply chains and consequently will make it more difficult for fraudsters to source and distribute their products. As a result we intend to proceed with implementation of this proposal. However, some of the concerns raised by industry have been noted, in particular the extent of the checks and the burdens on business if excessive. We intend to carry on a dialogue with key industry representatives to help overcome their concerns and finalise the detail with a view to implementation in early 2014.

Strengthening HMRC's existing alcohol anti-fraud strategy

- 3.21.** We noted the positive response to the establishment of the Joint Alcohol Anti-Fraud Taskforce (JAAT) and more generally to the range of policy and enforcement measures announced in August. The inaugural meeting of the Taskforce will be held early in 2014 and will comprise key industry representatives and government agencies involved in tackling all forms of alcohol related harm including HMRC, UK Border Force, Home Office, Trading Standards and the Police. This will be followed in 2014 with the establishment of expert working groups to progress areas of concern highlighted through this consultation and at the JAAT.
- 3.22.** Responses were supportive regarding the proposed changes to the criteria for brewery registration. HMRC will continue to make the necessary changes to the Beer Regulations 1993 with a view to implementation in early 2014.

- 3.23.** HMRC has noted the suggested responses regarding tightening existing EU legislation regarding the holding and movement of goods in duty suspension. In particular, the UK has pressed for changes to the EMCS system to ensure that we make full use of the system and its data in order to reduce fraud. To that end, the UK recently responded to the EU Commission's EMCS Strategic and Tactical Plan to push for a range of potential enhancements aimed at tightening controls within the system and proposing that the Commission incorporates risk management into the EMCS Strategic and Tactical plan.
- 3.24.** In *Alcohol Fraud: Next Steps*, we also reported on the development of an EMCS risk functionality to allow HMRC to improve targeting and risk assessment of illicit alcohol movements. HMRC are on target to deliver this enhanced risk capability in April 2014.

Annex A: Alternative approach

Note to industry stakeholders 21st October

Checks on registration status of alcohol suppliers

The published consultation document proposes at paragraph 3.45 and 3.58 that businesses should check the registration details of all new suppliers against an on-line HMRC database, and for regular (ongoing) suppliers these checks should be refreshed at least once a month. The consultation also suggests at paragraph 3.51 and 3.59 that businesses should keep records of these checks.

The initial feedback we have received from associations suggests that the purpose of the check on new suppliers is understood and accepted but some associations viewed the specification of a monthly refresh as overly prescriptive and the need to keep specific records of the checks undertaken as too burdensome.

As a result of this feedback, although checks on the authenticity and status of wholesaler registration numbers would remain essential to reduce the risk of fraud, we are considering how this aspect of the scheme could be made less burdensome for businesses.

Consequently, when responding to Question 19, besides the proposals contained in the consultation document, we would also like you to cost a possible alternative approach which does not prescribe any frequency to the checks on registration status of alcohol suppliers.

This would mean in practice that:

- **if a business is caught sourcing alcohol from an unregistered supplier they would still be liable to the penalties and sanctions outlined at paragraph 3.65 of the consultation, but**
- **it is for each individual business to understand the risks in their supply chains and use their own 'best judgement' when to carry out checks in order to avoid sourcing illegally from an unregistered operator.**

Checks on nature of your customers

The majority of concern we have received so far regards the checks 'forward' in the supply-chain to customers, with most respondents stating that the checks outlined at paragraph 3.52 of the consultation aimed at identifying the nature of customers and the associated record-keeping requirements would be too burdensome and difficult to practically implement.

We are therefore considering whether we could change the scheme design to reduce potential burdens caused by this aspect of the scheme. In consequence, we are

considering the possibility that the penalty suggested at paragraph 3.65 for buying from, or selling to, an unapproved wholesaler should only be introduced for “buying from” and not “selling to”: Instead of a new absolute offence for supplying unregistered traders we could simply require that suppliers exercise reasonable due diligence and we would not expect this to go beyond what is reasonable. For example, while we would expect suppliers higher up the supply-chain to carry out adequate due diligence checks where they are selling to wholesalers, we would not prescribe the nature of checks or record-keeping requirements for sales made. In cases where HMRC believed that adequate due diligence had not been exercised by registered traders, sanctions could be considered in line with those proposed at chapter 4.12/4.13 of the consultation document (i.e. possibly civil penalties or revocation of an approval).

In summary, under this alternative proposal, for sales that you make:

- **there would be no absolute offence for selling to an unregistered trader (because of the practical difficulty and costs of identifying the status of every single customer), and**
- **the specific checks and record keeping requirements outlined in the consultation to verify the nature of all customers would not apply, but**
- **suppliers would be expected to carry out reasonable due diligence on their customers where there could be a threat of duty fraud or sales being made to a wholesaler that should be registered.**

Consequently, while we would still ask that you respond to, and cost, the proposal at paragraph 3.52 in the consultation document, when responding we would ask that you also consider and cost this alternative approach.

Recording the checks you undertake

We are also considering the possibility of developing a database functionality that could give HMRC a log of any interrogations of the system made by businesses (which businesses and HMRC could refer to in any cases where scrutiny of the checks undertaken is necessary). If such functionality could be developed, it might provide an alternative to requirements for businesses to keep specific records of database interrogations they have carried out.

Consequently when responding to Questions 24 and 27, we would therefore like you to comment and cost not only on the consultation document proposal to carry out a monthly check but also an alternative suggestion that does not prescribe a need for you to keep records to evidence interrogations of the on-line database that you have carried out.

Annex B: List of stakeholders consulted

A G Parfett & Sons Ltd
AKZ (UK) Ltd
Aldi
Alpi UK Ltd
Arjowiggins Ivybridge Ltd
ASDA
Association of Convenience Stores (ACS)
Bargain Booze
Best Price Cash n Carry
Bonded Warehousekeepers Association (BWA)
Bristol City Council
British Beer and Pub Association (BBPA)
British International Freight Association (BIFA)
British Association of Ship Suppliers (BASS)
Cellar Trends Ltd
CellarVino
Center for Alcohol Policy
CO-OP Retail Trading Group
Divus DFL International SL
Domaine de Palejay
Durham Drinks Company Ltd
Euro Choice Ltd
Federation of Wholesale Distributors (FWD)
Flaxley Ltd
George Hill Ltd of Loughborough
Global Distributors Ltd
Golden Harvest Wholesale Ltd
Good Wine Online.co.uk
H & W Wholesale Ltd
Hobsons Choice Stores Ltd
House of Townend
John Lewis
Lanchester Wines
Litigaid Law
M9 Cash & Carry
Marlborough International
Matthew Clark Wholesale Ltd
MRRJ Ltd
Musgrave Retail Partners
National Association of Cider Makers (NACM)
National Beer Wholesalers Association (NBWA)
National Federation of Retail Newsagents (NFRN)
New Claire Wines Ltd
Northern Ireland Drinks Industry Group (NIDIG)
Price Waterhouse Coopers
Public Action Management PLC
Raiken Wholesale Ltd
RM Wholesalers Ltd
Road Haulage Association (RHA)
Sainsbury's
Scotch Whisky Association (SWA)
Society of Independent Brewers (SIBA)

Soho Cash & Carry
Tanners Wines Ltd
Tesco
Tidechain Ltd
Tradium Ltd
UK Travel Retail Forum (UKTRF)
UK Warehousing Association (UKWA)
Universal Brand Ltd
Watford Distributors Ltd
Wine and Spirit Trade Association (WSTA)
Wine and Spirits Wholesalers of America