



HM Revenue
& Customs

Tobacco Anti-Forestalling Restrictions

Summary of Responses

10 December 2014

Contents

1	Introduction	3
2	Responses to questions 1-3 anti-forestalling controls proposals	6
3	Responses to question 4 restrictions on businesses regardless of size	11
4	Responses to questions 5-7 Extending restrictions to other tobacco products	12
5	Next steps	15
Annex A	List of stakeholders consulted	16

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1. Introduction

Background

- 1.1 As part of the 2014 Budget the Government announced its intention to consult on options designed to tighten existing tobacco anti-forestalling controls.
- 1.2 Forestalling is a tax avoidance practice whereby tobacco manufacturers (TMs) and importers remove excessive quantities of cigarettes from duty suspended storage shortly before an expected increase in the rate of duty. By removing large quantities of cigarettes at the pre-rise duty rate this delays any revenue benefits to the Treasury. After their removal the forestalled cigarettes filter through the supply chain with the TMs and importers either profiting from the duty rate increase themselves or enabling them to keep prices down. Forestalling also creates an uneven revenue flow, as disproportionately large volumes of cigarettes are removed directly prior to the duty increase and significantly less during subsequent months.
- 1.3 The purpose of HMRC's anti-forestalling restrictions is to introduce a quota to control the amount of product that TMs and importers are allowed to remove in the months before a Budget to minimise the revenue loss and to deliver a more even revenue flow.
- 1.4 Anti-forestalling restrictions have been successfully implemented for a number of years, with little change to the nature and scope of the restrictions. However, whilst they have been successful in imposing an overall quota that is generally adhered to, in the last few years HMRC have seen a significant and disproportionate increase in the volume of product removed in March. As the quotas are intended to allow for normal business demands to be met by manufacturers and importers large clearances in March undermine the effectiveness of the restrictions which are designed to deliver a more even revenue flow. It also indicates that the current allocations are too generous for meeting ordinary business requirements.
- 1.5 HMRC therefore carried out an informal consultation over the summer on three potential controls that it identified had the potential to prevent tobacco manufacturers clearing a significant amount of product in March:
 - Option A - Changing the formula, for example by reducing or removing the 28 day uplift.
 - Option B - Retaining the same formula but introducing a monthly cap of a maximum percentage of the total allocation which can be cleared in any one month.
 - Option C - Retaining the same formula but introducing equal monthly restrictions within the overall period of the restriction.

Details of the consultation

- 1.6 HMRC launched an informal consultation with all affected tobacco businesses on 23 June 2014. The consultation specifically asked several questions on the potential three controls for change to the current anti-forestalling restrictions on cigarettes and what impacts this would have on business in terms of smoothing the pattern of clearances in the run up to the Budget, including any additional administrative burdens.
- 1.7 The consultation sought views from businesses affected to help us explore fully all the issues to inform decisions. The consultation closed on 4 August 2014.
- 1.8 The consultation set the context and the intention of HMRC's plans to provide a power in primary legislation to vary the forestalling restrictions from year to year in tertiary legislation, i.e. by public notice, issued at least 60 days ahead of the start of the controlled period specifying boundaries governing the type and extent of restrictions that could be put in place. This allows HMRC flexibility to amend the restrictions to respond to changes in patterns of clearances, but within a defined legal framework.
- 1.9 The consultation also sought responses on whether HMRC should consider extension of the forestalling restrictions to hand rolling tobacco (HRT) and other tobacco products and indicated that draft legislation would be available at autumn statement.

General Responses

- 1.10 HMRC received 12 responses from tobacco industry and health organisations. Here is a breakdown by the respondent type.

Type of respondent	Number of Responses
Tobacco Manufacturers	4
Cigarette Importers	2
Cigar Importers	1
Health organisations	5

- 1.10 During the course of the consultation, HMRC held meetings with interested parties. Feedback from these meetings has been considered as part of the consultation exercise.

Overview of comments

- 1.11 Many respondents welcomed the opportunity to comment on the proposals. The five health organisations were particularly positive about the HMRC proposals to include a power to give HMRC flexibility to introduce forestalling controls as appropriate. The general consensus from health organisations was that the current restrictions were no longer effective.
- 1.12 The tobacco industry, however, raised a number of concerns about how the changes would affect their business in terms of increased administrative

burdens, financial and time costs. A small number believed that it was not the right time to consult on anti-forestalling restrictions and commented on the number of other regulatory changes underway, such as implementation of the Tobacco Products Directive.

- 1.13 The same respondents also brought to our attention a case involving the European Commission referring Portugal to the European Court of Justice for failing to change its anti-forestalling regulations. They believed that the UK should wait until the forthcoming judgement by the European Court of Justice for Portugal, before implementing any further forestalling restrictions. However, this case is significantly different from HMRC proposals as it involves tax stamps and a requirement to sell stock within a set time period following a duty increase.
- 1.14 A number of respondents in the tobacco industry commented on HMRC proposals to include a power in primary legislation that will allow variations on year to year maximum quotas and monthly limits, 60 days before the start of the controlled period. Whilst they appreciated HMRCs desire to have a system that is flexible enough to respond to changing circumstances they advised that a minimum 60 day notice period would cause significant disruption to the business and would not allow enough time to plan accordingly. HMRC have considered the timing of this further.

2. Responses to questions 1-3 Anti-forestalling controls – potential proposals

Question 1: Explain the impact and effectiveness of the potential controls on your business in terms of smoothing the pattern of clearances in the run up to the budget, including additional administrative burdens if any?

- Option A - Changing the formula, for example by reducing or removing the 28 day uplift.
- Option B - Retaining the same formula but introducing a monthly cap of a maximum percentage of the total allocation which can be cleared in any one month.
- Option C - Retaining the same formula but introducing equal monthly restrictions within the overall period of the restriction.

There were six responses to this question.

- 2.1 A few respondents were of the view that changes designed to introduce forestalling arrangements for other tobacco products as well as cigarettes would have a significantly negative impact on their ability to launch new products during the January – March period each year, one respondent suggested that they would be disproportionately disadvantaged versus other tobacco products as their portfolio of cigars and pipe tobacco are used less frequently. Half of the respondents commented that any changes to the forestalling controls would increase their administration processes.
- 2.2 One respondent commented on the significant demand shift within their supply chain, due to retailers and distributors changing their purchasing patterns and felt that the proposals that HMRC had put forward do not take account of the changing demands or market share growth by a particular manufacturer. They strongly believed that out of stock situations would be the most likely result of the proposed new restrictions.
- 2.3 Another respondent commented on the potential of imposing financial and time costs on their business should additional restrictions be introduced. They raised concerns about anti-forestalling controls being drawn too tightly which potentially could mean that clearances during the restricted period would be effectively frozen at the same level as the year before in a way that would hinder manufacturers ability to compete for market share.
- 2.4 One respondent provided comments to questions 1 and 2 together in response to HMRC's three proposals. They were generally supportive of options A and B but they commented that option A (changing the

formula, for example by reducing or removing the 28 day uplift) must be applied consistently across the sector and suggested that if there is to be a reduction then this should be coupled with the introduction of a system for considering special or exceptional circumstances. They also commented that option B (retaining the same formula but introducing a monthly cap of a maximum percentage of the total allocation which can be cleared in any one month) would limit their sales activity for that month and suggested that the maximum cap would need to be set at a realistic level. They felt that option C (retaining the same formula but introducing equal monthly restrictions within the overall period) was unacceptable as it was too constraining as does not allow for any fluctuations in market activity and would disrupt the sales cycle. They also suggested that this could have a serious impact on competition in the market.

Government response to question 1

The consultation proposed a number of potential controls for tightening the tobacco anti-forestalling restrictions to help achieve a smoother pattern of clearances.

Responses to this question raised a number of concerns around financial and time costs to businesses, impact on smaller businesses and “out of stock” situations.

The Government has decided to proceed with the changes as they are required to prevent abuse of the current system. Extended notice will also be given by HMRC on the allowances for each year to enable businesses to plan accordingly. Furthermore, industry has been warned in the last few years that such steps would be necessary if clearance patterns remained unchanged.

HMRC received no evidence of additional costs to businesses but accept that additional restrictions could increase the complexity of administering the system. HMRC will continue to work closely with businesses to help ease any administrative burdens.

HMRC intend to address the out of stock concern by ensuring they provide plenty of notice before the controlled period.

In addition, HMRC wishes to re-enforce that it is in the interest of businesses to even out their pattern of clearances as this will enable HMRC to take a lighter touch with restrictions in subsequent years.

Question 2: Do you have a preference from the list of potential controls? If yes, please specify which one and give your reasons why.

There were 12 responses to this question.

2.5 Responses to this question were divided.

- 2.6 Those opposed to retaining the same formula but introducing equal monthly restrictions within the overall period of the restriction (Option C) had concerns about the constraints on their business and their ability to supply businesses.
- 2.7 Respondents with a preference for options B & C and others who made general comments regarding Option A (changing the formula by reducing or removing the 28 day uplift) expressed concern with HMRC proposals to eliminate or reduce the 28 day uplift. They were of the view that the 28 day allowance has been successfully implemented and is sufficient to manage stock, launch new products as intended. One respondent raised an interesting point, suggesting that the Government preventing such normal and necessary business conduct would be incompatible with a market economy and the aim of the UK and EU competition law.
- 2.8 One respondent was of the view that retaining the same formula but introducing a monthly cap of a maximum percentage of the total allocation which can be cleared in any one month (option B) was the most suitable option. This was based on statistical evidence that the month of March is the peak for clearances, in anticipation of annual duty rises. They believed that as long as the formula continued to be based on the previous 12 months' clearances then this was the most appropriate option.
- 2.9 Four respondents did not provide a specific preference, they recommended the primary legislation gives the Government power, by Public Notice, to introduce any of the three possible controls, or a combination of them, as circumstances require.
- 2.10 One respondent commented that they would prefer to see the 28 day uplift removed rather than the new restrictions. They did however, suggest that they could work with option b providing the max cap was set at a realistic and practical level to allow flexibility.
- 2.11 Three respondents suggested that no changes should be made to anti-forestalling controls but all three gave their default which differed for each.
- 2.12 Two respondents did not provide any preference as they strongly believed that the current restrictions should be maintained.
- 2.13 Another respondent favoured option B in principle but suggested that a monthly cap of 40% would be too low.

Government response to question 2

The consultation proposed three potential controls for tightening anti-forestalling controls. Responses to this question were divided. It is intended that HMRC is given a general power in tobacco primary legislation to vary forestalling restrictions from year to year by public notice. This will allow HMRC the flexibility to meet the conditions faced and where appropriate, the needs of the industry, without requiring legislative change for each and every change in the formula. The primary legislation will set the parameters within

which the restrictions will apply to give business appropriate certainty and reassurance. The legislation will also give HMRC the power to vary the scope of the restrictions to include other tobacco products.

The Government feel that this change is required to prevent abuse of the current system. For example, by clearing significant quantities of tobacco products immediately before an increase in the rate of duty.

The Government proposal to make a power in primary legislation to vary the forestalling restrictions from year to year in tertiary legislation, i.e. by public notice issued at least 60 days ahead of the start of the controlled period generated a number of responses regarding the timing. It was important that the Government took account of these comments before making any decisions about when the public notice should be issued. The Government have decided to publish the public notice 150 days ahead of the start of the controlled period where possible, as they believe that this enables appropriate preparation by business to plan for any supply and demand issues. For example, where a decision is taken to hold an emergency budget HMRC will not be able to provide 150 days' notice before the controlling period. HMRC will publish draft legislation on 10 December 2014.

Question 3: Do you have any alternative solutions for pre-budget restrictions which will ensure a smooth pattern of clearances in the pre-Budget period? If yes, please provide details.

There were 9 responses to this question.

- 2.14 Only one respondent proposed an alternative solution for pre-budget restrictions. This was the introduction of 'cash smoothing' e.g. making excise payments regular as opposed to the clearances themselves.
- 2.15 Four respondents were strongly opposed to voluntary arrangements and agreements with tobacco industry and commented that the solution to forestalling is to apply appropriate legislation, backed by appropriate penalties for non-compliance.
- 2.16 One respondent commented that HMRC proposals would not ensure a smooth pattern of clearances in the pre-budget period and would lead to out of stock situations and consumers who would be unable to purchase the products they wish to consume.
- 2.17 One respondent felt that option B was likely to be an effective solution to ensuring a consistent pattern of clearances.
- 2.18 One respondent commented that they want to fully cooperate with all stakeholders associated with their business and would welcome the opportunity to working more closely with HMRC to help manage the expectations of current, pending or future regulation.
- 2.19 Another respondent commented that cigarettes and hand rolling tobacco together makes up the majority of the tobacco duty collected each year and therefore proposed that only these two categories are

included in any future forestalling schemes. This is covered below at question 5.

Government response to question 3

As per question 2 the Government has decided to proceed with the proposal for HMRC to be given a general power in tobacco primary legislation to vary forestalling restrictions from year to year by public notice. Following responses to the consultation exercise under the general power HMRC would be able to adapt the formula to:

Change aspects of the current formula regarding the calculation of the total quantity of tobacco product involved with a minimum allowance specified as a proportion of annual clearances;

Introduce a cap of a maximum percentage of the total allocation which can be cleared in any one month with minimum percentage restrictions for a month specified in primary legislation; or

Introduce equal monthly restrictions within the overall period of the restriction.

HMRC did not consider the proposal about the introduction of ‘cash smoothing’ as it does not meet the Government’s objective which is to achieve a smoother pattern of clearances during the controlled period.

HMRC will address the out of stock concern by providing plenty of notice before the controlled period and as with current restrictions HMRC may be able to adjust the limits in a year.

HMRC will continue to work closely with the tobacco industry to ensure any changes meet their needs.

3. Responses to question 4 restrictions on businesses regardless of size.

Question 4: Should the same restrictions apply to all businesses who remove cigarettes for home use regardless of the size of the business?

There were 10 responses to this question.

- 3.1 Almost all respondents were of the view that the same restrictions should apply to all businesses who remove cigarettes for home use regardless of the size of the business to ensure consistency and fair competition for all manufacturers and importers.
- 3.2 One respondent did not consider that the same restrictions should apply to medium, small and micro businesses who remove cigarettes (or other tobacco products) for home use because of disproportionate administrative burdens and greater volatility in such businesses.
- 3.3 One respondent commented that it felt unfair that as a small business they should be penalised when they clearly have not been abusing the system.
- 3.4 A further respondent recommended that the restrictions are means tested on the basis of business size and the volume of cigarettes sold in the UK.

Government response to question 4

Responses to this question are generally positive. However, responses also highlight understandable concerns about the disproportionate administrative burdens to smaller businesses.

The Government has decided to apply the same restrictions to all businesses who remove cigarettes for home use regardless of the size of the business.

This will ensure consistency and fair competition for all manufacturers and importers and avoids the potential for creating a potential loophole in the legislation.

4. Responses to questions 5-7 extending restrictions to other tobacco products.

Question 5: Should restrictions be extended to any other tobacco products e.g. hand rolling tobacco (HRT), cigars, pipe tobacco and chewing tobacco?

There were 12 responses to this question.

- 4.1 Half of the respondents felt that all tobacco products should be extended to the forestalling restrictions. One of the six respondents suggested that any proposal to introduce restrictions for other tobacco products (especially HRT) should be specifically consulted on and agreed with industry in advance as the original restrictions were in 2000/2001.
- 4.2 Three respondents felt very strongly against cigars, and pipe tobacco being included in the tobacco anti-forestalling restrictions. They commented that this would have a detrimental effect on their business in terms of increased administrative burdens. Two of the three respondents could understand why HRT was being considered.
- 4.3 Two respondents commented that forestalling controls should apply to cigarettes and HRT only.
- 4.4 One respondent suggested that the focus should be on cigarettes only, as they felt the volumes for other tobacco products was relatively immaterial compared with cigarette volumes. However, they did comment that once the formula has been agreed for a longer period then, in principle, they would be open to considering an extension to other tobacco products, if the need arose.

Government response to question 5

The consultation raised a number of questions on proposals to tighten tobacco anti-forestalling restrictions and responses to this question were again divided. Half of the respondents felt that all tobacco products should be extended to the forestalling restrictions.

HMRC recognises that the HRT segment has seen a significant growth over recent years and the new power will include the option to extend restrictions to HRT.

HMRC will also continue to monitor the situation and potential consequences on the illicit trade of doing so.

Should the Government decide that restrictions will apply to other tobacco products, beyond HRT in the future, HMRC will consult the tobacco industry on the details well in advance of any extensions to the forestalling restrictions being made.

Question 6: What impacts would extending the scope to other tobacco products have?

There were 11 responses to this question.

- 4.5 Four respondents commented on the increased administrative burdens that extending the scope to other tobacco products would have on their business.
- 4.6 Three respondents commented on the significant growth of hand rolling tobacco (HRT) over the last few years. They were of the view that it was appropriate that HRT had a similar managed approach as cigarettes.
- 4.7 Four respondents suggested that extending the scope to other tobacco products would increase tax revenue and would also maximise the public health benefits of tobacco tax rises.

Government response to question 6

HMRC are committed to reducing administrative burdens on businesses and will work closely with businesses in administering the system should anti-forestalling restrictions be extended to other tobacco products.

Question 7: If restrictions were to be extended to other tobacco products, should there be any exclusions and, if so, why?

There were 11 responses to this question.

- 4.8 One respondent did not provide a specific response but commented that they support an effective and efficient anti-forestalling system that is clear, transparent and enables robust competition in the market place.
- 4.9 One respondent suggested that HMRC does not extend anti-forestalling controls to other products that are neither factory made cigarettes nor HRT other tobacco products.
- 4.10 Two respondents strongly recommended that cigars and pipe tobacco are not included in the restrictions.
- 4.11 Six respondents felt that there was no justification for excluding tobacco products legitimately sold in the UK market from anti-forestalling measures.
- 4.12 Another respondent believed that cigars should be excluded from any restrictions due to the severe adverse impact such restrictions would cause e.g. administrative burdens, lost sales and potentially lost customers.

Government response to question 7

Although the majority of respondents felt that there was no justification for excluding tobacco products legitimately sold in the UK market from anti-forestalling measures the Government agrees that to apply restrictions to cigars and pipe tobacco would be unnecessary at this time due to the small size of the market and the potential impact of imposing financial and time costs on these businesses.

Due to the significant growth in the HRT segment over recent years the Government will consider whether to include HRT in the run up to the Budget 2016 restrictions and in subsequent years.

HMRC will continue to monitor the situation and will liaise with relevant businesses should there be a change in circumstances.

5: Next steps

- 5.1 This consultation generated many helpful, informative and constructive responses.
- 5.2 The Government has taken these responses on board, as well as the outcomes of meetings with stakeholders, to design its response as detailed in this document and the next steps it plans to take with regards to the proposals suggested.
- 5.3 The proposals with regards to anti-forestalling controls (questions 1 -3), whether restrictions apply to all businesses who remove cigarettes for home use regardless of the size (question 4) and; if restrictions should be extended to other tobacco products (questions 5-7) are now at a stage where, thanks in part to the consultation responses, they can be taken forward by the Government.
- 5.4 The Government is now exploring legislative options for these specific proposals and will publish draft legislation on 10 December 2014. It is likely that the legislation would be introduced to Parliament in 2015/16 at the earliest.
- 5.5 The Government can confirm that the new powers will be influenced by previous clearance patterns once they have been made legal.

Annex A: List of stakeholders consulted

British American Tobacco
Imperial Tobacco Limited
Phillip Morris Limited
Japan Tobacco International
The Chancellor Tobacco Company
Bull Brand Limited
Davidoff Distribution (UK) Ltd
Scandinavian Tobacco Group
TOR Imports Ltd
Karelia Tobacco Company
Cancer Research UK
ASH (Action on Smoking and Health)

We also received a response from an importer of cigars who was a member of the Imported Tobacco Products Advisory Council (IPAC) and three further health organisations.