

Cancer Research UK Policy Statement on Tobacco Tax and Smuggling

1. The role of taxes and price in reducing tobacco consumption

According to the World Bank, high price due to high taxes on tobacco is the single most effective intervention to prevent smoking¹. This is especially so for young people and those on low incomes². A price rise of 10% decreases consumption by about 4% in high-income countries. While price increases can have an almost immediate effect on smoking uptake, they may take some time to change current smokers' behaviour (because they are addicted to the nicotine in cigarettes). Therefore to be effective, price increases must be sustained over the long term.

2. Tax

2.1 UK taxation policy

In recent years the UK government has increased tax only by or below the level of inflation, thereby missing the opportunity to maximise the impact of a powerful public health intervention. Cancer Research UK supports above inflation year on year tax increases on tobacco as a means to reduce consumption, especially among the young and others on low incomes³.

Although increasing prices will have a greater proportionate impact on the income of low-income smokers than higher income smokers, this cannot be used as a reason to avoid such an effective public health measure. Rather, given that, in line with the overall population, two thirds of low-income smokers wish to quit, stop smoking services should be even better targeted to meet the specific needs of low-income groups.

The effect of tax increases on smoking prevalence has been weakened due to a number of moderating factors, notably smuggling of legally manufactured but non-duty paid products and of counterfeit cigarettes (illegally manufactured and non-duty paid), and the switch from machine-rolled to hand rolled tobacco (HRT) and from high to low price cigarettes. Consideration should be given to applying higher taxation levels on tobacco accessories that are used to smoke hand-rolled tobacco in order to help reduce the affordability of this type of cigarette.

The current taxation system, which allows tobacco companies to deduct marketing costs as legitimate business expenses, runs counter to public health policy to curb the marketing of tobacco. The Government should explore ways in which this deduction can be removed for the tobacco industry⁴.

¹ Jha P, Chaloupka FJ. Curbing the Epidemic: Governments and the Economics of Tobacco Control. Washington DC: World Bank, 1999

² Townsend JL, Roderick P, Cooper J. Cigarette Smoking by socioeconomic group, sex, and age: effects of price income, and health publicity, BMJ 1994;309:923-7.

³ Action on Smoking and Health. Budget Submission. ASH 2008
http://www.ash.org.uk/files/documents/ASH_681.pdf

⁴ Action on Smoking and Health. Budget Submission. ASH 2009

2.2 Draft EU Tax Directive 2009⁵

There are currently wide variations in the level of tax and price of cigarettes and other tobacco products across the EU. This not only encourages cross-border purchases, but also discourages quitting in those countries where cigarettes remain very cheap, counteracting the effects of other tobacco control efforts. A new EU Tax Directive has been proposed that addresses many of the requirements of the public health community⁶. Importantly, and for the first time at EU level, it links tax to health objectives.

The draft Directive proposes a gradual increase in the EU minimum cigarette and HRT taxation levels up to 2014, which is estimated to reduce tobacco consumption by 10% within the next 5 years. It is important to bear in mind that the draft Directive sets out the minimum rules and rates of excise duty that should be applied across the EU, while Member States are still free to determine their own higher rates.. The Directive requires the unanimous agreement of all Member States and so is likely to require substantial campaigning for it to succeed.

Among the measures proposed in the directive are the following⁷:

- The most popular price category (MPPC) concept (the basis for current taxation) will be replaced by weighted average prices (WAP) as a reference point for EU minimum tax levels. The MPPC is the price of the most popular brand in each country. As national markets are no longer dominated by one particular brand this is an outdated concept.
- Excise tax on cigarettes will be gradually increased over 5 years until it is € 90 per 1000 cigarettes and 63% of the weighted average price (WAP). The UK would be free to raise its rates but not required to, because existing excise rates are above both the monetary and the proportional EU minimum threshold.
- There will be a new tax floor for HRT, as with cigarettes – a compulsory *ad valorem* minimum tax rate for HRT that is 2/3rds of the proposed new level for cigarettes (by 2014, an excise duty of 42% of retail price and not less than €60 per kg).
- In addition, the Commission proposes to give more flexibility to Member States to fix the structures of excise duties as they wish. Member States have to apply both a specific (a fixed amount per 1000 cigarettes) and a proportional (or '*ad valorem*') excise duty on cigarettes. At present the specific component of the excise duty may not be less than 5% or more than 55% of the amount of the total tax burden resulting from the aggregation of the proportional excise duty, the specific excise duty and the VAT levied on these cigarettes (see diagram). The Commission's new proposal widens the band from 5-55% to 10- 75% of the total tax burden. This system would mean that Member States have more flexibility to determine freely the relative weight of both excise elements, taking into account the characteristics of their national

⁵ [Directive amending Directives 92/79/EEC, 92/80/EEC and 95/59/EC on the structure and rates of excise duty applied on manufactured tobacco.](#)

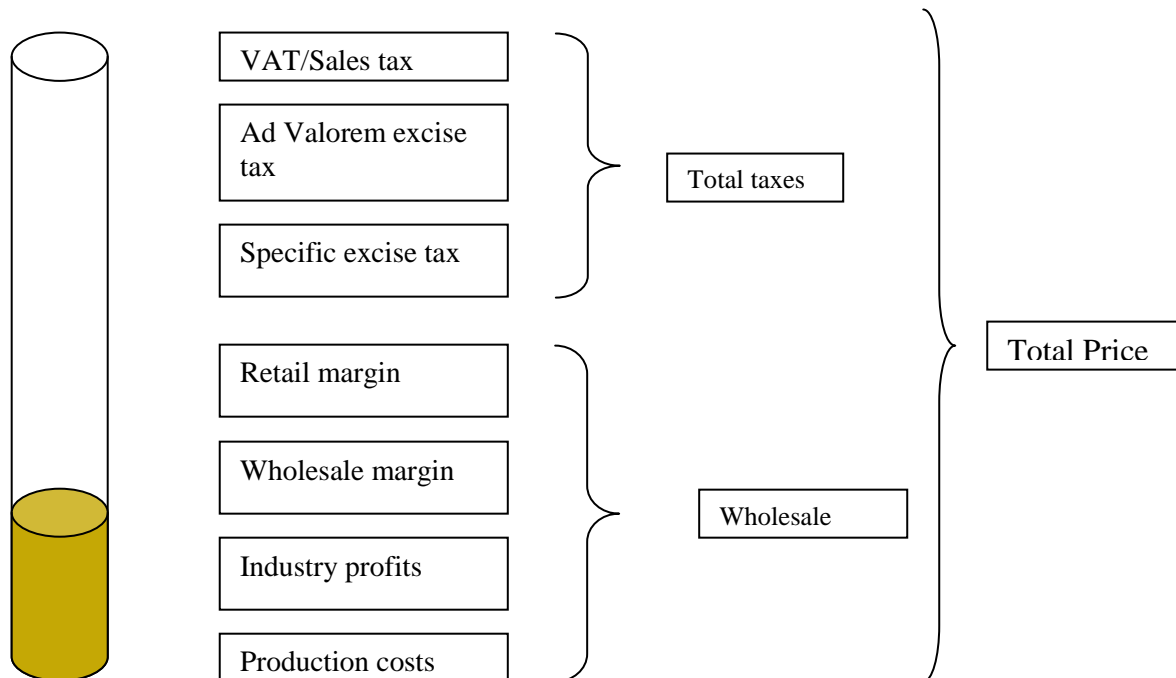
⁶ Action on Smoking and Health. Budget Submission to HMRC 2007. http://newash.org.uk/files/documents/ASH_214/ASH_214.html

⁷ Smokefree Partnership 2009. Spotlight briefing No.4 and Advocacy toolkit on EU excise duty on manufactured tobacco products. See <http://www.smokefreepartnership.eu>

market for cigarettes. Moreover, the Commission plans to allow Member States to fix minimum tax levels without any cap.

The public health community welcomes these measures, but will urge governments to go both further and faster to keep tobacco tax rises at least above inflation, and to narrow the gaps further between countries and tobacco products.

An overview of what is included in the price of a cigarette



3. Smuggling

An estimated one third of all internationally traded cigarettes are smuggled. In the UK, this rate of smuggling translated into an estimated £1.7 billion in tax revenue losses in fiscal year 2006/07 alone.⁸ There is evidence that illicit trade of tobacco products is carried out by organised trans-national criminal groups and that the money gained is used for other serious criminal enterprises.

Smuggled tobacco products not only undermine price increases as a means of reducing smoking prevalence, but also exacerbate health inequalities, and may discourage younger smokers from quitting. Recent research reveals that 12% of smokers from higher socioeconomic groups admit to buying smuggled tobacco, but among poorer smokers the figure rises to 22%.⁹

Her Majesty's Revenue and Customs (HMRC) has in recent years introduced measures to control smuggling, including additional Customs officers, more dedicated investigators and intelligence staff, additional X-ray scanners, tougher sanctions and penalties, and a public awareness campaign¹⁰. Covert security

⁸ HMRC/UK Border Agency. Tackling Tobacco Smuggling Together. Nov 2008. The Stationery Office Ltd. ID5978977

⁹ The Smoking Toolkit Study (2006) Commissioned by ASH and part-funded by Cancer Research UK.

¹⁰ Joossens L, Raw M. Progress in combating cigarette smuggling: controlling the supply chain. Tobacco control 2008; 17:399-404

markings on cigarettes and HRT were introduced in October 2007 and October 2008 respectively. Also, in October 2006 new legislation came into force whereby manufacturers could be fined up to £5m for failing to control their supplies of cigarettes and HRT to non-UK markets.⁴ These have helped to reduce the market share of smuggled cigarettes and the government has met its target of 13% by 2006/07 (down from over 20% in 2000).

However it is estimated that approximately 22% of all smoked tobacco products in the UK (non-duty paid cigarettes, hand-rolled tobacco, and counterfeit cigarettes) are still smuggled, and that elimination of smuggling could lead to a 5% decline in cigarettes smoked resulting in 4,000 fewer deaths pa in the longer term¹¹. In particular, the market share of illegal HRT (counterfeit and genuine) remains high at 56%.

3.1 Counterfeit cigarettes and HRT

Counterfeit cigarettes, illegally manufactured mainly in Eastern Europe and China, are a growing phenomenon and now represent a quarter of the smuggled cigarette market in the UK. Recently there has also been an increase in counterfeit HRT. A tracking and tracing system that could effectively identify smuggled tobacco products (see Section 5) would help to eliminate counterfeit tobacco products. Annual estimates of the scale of counterfeit market also need to be made and published in order to ensure that resource and activity are being appropriately directed.

Cancer Research UK wishes to see a reduction in the availability of counterfeit tobacco products because they are cheaper than legal ones, (and do not therefore provide a motivation for smokers to quit, compared to the more costly legal products) not for any spurious concerns that they may be more harmful. All cigarettes and HRT are extremely dangerous, killing one in two long-term users irrespective of whether they are legally produced or counterfeit.

3.2 Integrated Strategy of HM Revenue and Customs and the UK Border Agency.

Cancer Research UK welcomes the HMRC/UK Border Agency integrated strategy published in November 2008 but urges the government to go further. Among other provisions, the strategy commits the agencies to:

- ensure sharing of intelligence and data
- introduce new technology and IT for better detection
- review sanctions and penalties
- develop a cross-governmental communications strategy designed to change public attitudes to illicit tobacco products
- take a lead in international negotiations and
- continue negotiations with the EC regarding the anti-smuggling agreement between the EU and certain tobacco companies (Philip Morris and Japan Tobacco International –owners of Gallager).

However the strategy could and should be stronger in certain areas:

¹¹ West R, Townsend J, Joossens L, Arnott D, Lewis S, 2008. Why combating tobacco smuggling is a priority. *BMJ*. 2008 Oct 9;337:a1933. doi: 10.1136/bmj.a1933.

Targets. The proposed targets have either already been met - 13% of market share for smuggled cigarettes which was achieved in 2006/07 - or are old, unmet targets - a 20% reduction in the illegal market share of HRT (counterfeit and genuine).

The public health community has called for the following, stretching targets¹²:

- for illegal cigarettes (counterfeit and genuine) - no more than 8% of the total market share by 2010 and no more than 3% by 2015
- for illegal HRT (counterfeit and genuine) – 45% of total market share by 2010 and 33% by 2015.

Collaboration. Better collaboration is also needed between HMRC, the UKBA and the Department of Health and local authorities to ensure the new strategy is delivered effectively.

3.3 EU anti-smuggling agreements

All EU countries have now signed these agreements, under which two major tobacco multinationals agree to pay a range of penalties (depending on the quantities seized) for their products if they are found to be smuggled¹³. The UK Government signed the agreements on 20 April 2009.

3.4 Framework Convention on Tobacco Control (FCTC) Protocol on Illicit Trade

In order to effectively tackle the illicit trade in tobacco, international collaboration is essential, as outlined in the global public health treaty, the FCTC.¹⁴ Proposed measures include:

- tracking and tracing systems whereby cigarettes and HRT packs are marked so they can be traced along the whole path from manufacturer to seller. The manufacturer would have a duty of care to ensure arrival at final destination, and would be liable to heavy fines for products identified as smuggled;
- licensing schemes for participants in the tobacco business;
- 'know your customer' laws, which oblige participants in the tobacco business to identify their customers and keep records of transactions;
- anti-money laundering laws;
- criminal and civil sanctions that are sufficient to deter individuals and entities from participating in illicit trade;
- programmes to enhance the capacity of law enforcement bodies to combat illicit trade;
- programmes to increase cooperation and technical assistance with respect to the investigation and prosecution of offences and the sharing of information.

An Intergovernmental Negotiating Body has been charged with drawing up a protocol on illicit trade, to be reviewed at the next FCTC Conference of the Parties in November 2010.

¹² ASH/BHF/Cancer Research UK. Beyond Smoking Kills. October 2008

¹³ It is left to the companies to identify whether the products seized are legal or counterfeit, however.

¹⁴ FCA Illicit Trade in Tobacco Products: why it is a problem and what should be done about it. Framework Convention Alliance <http://www.fctc.org>

3.5 Involvement of the Tobacco Industry in Smuggling

If introduced globally, the above measures should help to reduce the large-scale smuggling that has gone on over past decades, often with the knowledge of the manufacturers¹⁵. Evidence of direct and indirect involvement of the tobacco industry has become increasingly clear in recent years, based largely on its own internal documents¹⁶. Also in July 2008 two tobacco companies in Canada pleaded guilty to involvement in evasion of tax duties and were ordered to pay Can \$1.15 billion⁶.

4. Summary of what the public health community wants the UK government to do

- Re-introduce an annual above-inflation price escalator for tobacco products
- Consider applying higher levels of taxation on tobacco accessories used in smoking Hand Rolled Tobacco (HRT)
- Consider removing the tax relief currently available to tobacco companies on marketing costs
- Develop a fully-resourced local, national and international strategy to control tobacco smuggling and the sale of illicit tobacco, with the following 2015 targets:
 - reduce illegal cigarettes (counterfeit and genuine) to < 8% of total market share
 - reduce illegal Hand Rolled Tobacco (counterfeit and genuine) to 33% of total market share
- Ensure better collaboration and coordination of roles between HMRC, the UKBA, the Department of Health and local authorities
- Support the proposed measures in the EC draft Tax directive 2009:
 - abolition of the Most Popular Price Category in favour of the WAP
 - application of minimum taxation
 - allowance for higher levels of the specific tax element
 - increase in cigarette tax (in value and %)
 - increase in tax for HRT (in value and %)
- But to go further and faster as implementation is not due until 2014 and by then inflation is likely to have eroded health gains. Also HRT would still be taxed at a lower level than cigarettes, which could lead to smokers switching rather than quitting. Tax levels for HRT need to be increased to the equivalent tax levels of cigarettes as quickly as possible and taxes on both cigarettes and HRT need to keep up at least with the level of inflation
- Support a strong protocol on illicit trade within the Framework Convention on Tobacco Control.

April 2009

¹⁵ eg Lee, K and Collins, J. "Key to the Future": British American Tobacco and Cigarette Smuggling in China. PLOS Med 2006 July; 3(7): e228

<http://www.pubmedcentral.nih.gov/articlerender.fcgi?artid=1502159>

¹⁶ eg LeGresley E, Lee K, Muggli M et al. British American tobacco and the 'insidious impact of illicit trade' in cigarettes across Africa. Tobacco Control 2008; 17:339-346.