

Figure 1: Total tax revenue losses to the illicit market – upper estimates

Item	2010-11 (£m)	2011-2012 (£m)	2012-13 (£m)	2013-14 (£m)	2014-15 (£m)	Five year total (£m)
Spirits						
Upper estimate	580	580	500	750	1,160	3,570
Central estimate	270	200	90	280	650	1,490
Beer						
Upper estimate	1,050	1,100	850	1,300	1,500	5,800
Central estimate	700	750	650	850	950	3,900
Wine						
Upper estimate	1,110	600	540	630	630	3,510
Central estimate	710	250	130	200	200	1,490
Cigarettes						
Upper estimate	1,700	1,600	1,900	2,000	1,400	8,600
Central estimate	1,200	1,000	1,300	1,400	900	5,800
Hand Rolling Tobacco						
Upper estimate	900	1,000	1,100	1,200	1,100	5,300
Central estimate	700	800	900	1,100	900	4,400
Diesel						
Upper estimate	1300	1160	840	770	770	4,840
Central estimate*	470	230	119	99	99	1,017
Total, upper estimate (£m)	6,640	6,040	5,730	6,650	6,560	31,620
Total, lower estimate (£m)	4,050	3,230	3,189	3,929	3,699	18,097

*NI estimate of “<£50m” considered as £49 million

The estimates for previous years in each Measuring Tax Gaps report are revised as more information becomes available. Upper and lower estimates are published, but the global scale of the illicit trade – and the figures in the tables below showing huge underestimates being revised up annually – mean that upper estimates have been used for this analysis.

Figure 2: Illicit market share of spirits, cigarettes, hand rolling tobacco and diesel

Item	2010-11 (%)	2011-12 (%)	2012-13 (%)	2013-14 (%)	2014-15 (%)
Spirits					
Upper estimate	13	11	10	14	20
Central estimate	6	4	2	6	12
Cigarettes					
Upper estimate	14	13	15	15	12
Central estimate	10	8	10	11	7
Beer					
Upper estimate	17	17	14	20	22
Central estimate	12	12	11	14	15
Wine					
Upper estimate	18	9	8	9	9
Central estimate	12	4	2	3	3
Hand Rolling Tobacco					
Upper estimate	46	43	43	44	40
Central estimate	39	37	37	40	35
Diesel, GB only					
Upper estimate	6	5	3	3	3
Central estimate	2	1	<1	<1	<1
Diesel, NI only					
Upper estimate	15	16	14	11	11
Central estimate	12	13	11	8	8

Revisions to previous calculations

In addition to making a yearly calculation of its tax gap, HMRC also makes revisions to its previous years' calculations. Significant revisions in either direction are common. For instance in the 2013 report the tax gap for beer in 2011-12 was estimated to be £750 million. However by the time of the 2016 report, the figure for 2011-12 had been revised up by more than 45 per cent to £1.1 billion. For GB diesel, the 2014 estimated the tax gap for 2012-13 at £1.25 billion, a figure that was reduced by 40 per cent to £750 million in the 2016 version of the report.

Conclusions

Analysing successive editions of *Measuring Tax Gaps* clearly shows that HMRC tends to underestimate the amount of tax revenue lost to the illicit trade each year in alcohol and tobacco products, most of all in beer and cigarettes. Given that demand for these products is relatively inelastic, punitive proposals based on higher duties and prices are likely to exacerbate this problem over time.

Figure 3: Underestimates of the losses of tax revenue from the illicit trade in beer

Financial year	2013 report	2014 report	2015 report	2016 report	Difference between first and last estimates (£m)
2011-12	750	1,150	1,150	1,100	350
2012-13	1,000	1,000	900	850	-150
2013-14	-	-	1,150	1,300	150

Figure 4: Underestimates of the losses of tax revenue from the illicit trade in cigarettes

Financial year	2013 report	2014 report	2015 report	2016 report	Difference between first and last estimates (£m)
2011-12	1,500	1,500	1,500	1,600	100
2012-13	-	1,700	1,700	1,900	200
2013-14	-	-	1,700	2,000	300

Research has found that there is no demonstrated link between high taxation, high consumer prices and overall consumption and alcohol-related harm.² This means that when the Treasury considers increasing duties on these products they risk boosting the illicit trade and losing the Exchequer revenue without meeting public health objectives.

Plain packaging for cigarettes is also worrying because it will make it far more difficult for consumers and shop keepers to identify illicit products. It may be easy for officials to identify authentic products, but the same would not necessarily be true of smokers themselves, or shopkeepers.

Of further concern are proposals for a “Minimum Excise Tax” (MET) which would set a minimum level of duty on a packet of cigarettes. Currently, tobacco duty is comprised of two elements:

- a) A per unit element currently charged at £196.42 per 1,000 cigarettes
- b) An “ad valorem” element charged at 16.5 per cent of the retail price

While METs are common in countries where the duty structure is dominated by an ad valorem element, the UK’s duty structure is more weighted towards a unit tax. Applying a MET would effectively increase the unit element further, increasing the price of cheaper brands while having little or no effect on the price of premium brands. A MET set above the level of the price of illicit sales, typically around £4 for a packet of 20, will therefore increase demand for illicit cigarettes, most acutely amongst low income, more price sensitive consumers.

HMRC has clearly been unsuccessful at claiming these duties for some time and therefore it needs to take decisive action, not introduce policies that make it worse. It is unfair that higher taxes for ordinary families are often used to make up the shortfall. The loss of £31.8 billion in revenue over a five year period could have funded a 1.5p cut in the basic rate of Income Tax. Not only would this have helped millions of ordinary families, but it would also have had a big impact on the jobs market, which is particularly important at this time.

² *Getting the facts right on alcohol taxation, pricing, and alcohol-related harm*, CEPS (the European Spirits Organisation and the European Forum for Responsible Drinking, May 2011