



HM Treasury

Tobacco levy: consultation

December 2014



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1 Introduction

1.1 Autumn Statement 2014 announced that the government will consult on whether to introduce a levy on tobacco manufacturers and importers. This consultation is at stage one of the government's tax policy framework: setting out objectives and identifying options.

1.2 This consultation considers the case for, and seeks opinions on, the introduction of a new levy on tobacco manufacturers and importers. Chapter 2 seeks views on the possible design features of a levy and chapter 3 seeks views on potential wider impacts. A summary of the consultation questions is provided in chapter 4 and chapter 5 sets out the consultation process.

1.3 The consultation will run for a period of 10 weeks closing on 18 February 2015. The government will announce its next steps once the consultation has closed and all responses have been received and considered.

1.4 The government welcomes stakeholder views on the questions raised in this document. Please send responses to the consultation questions to tobaccolevy@hmtreasury.gsi.gov.uk. Please send comments by 18 February 2015.

1.5 There are 4 large multi-national tobacco companies operating in the UK. There are also a number of smaller manufacturers and importers. All of these companies benefit from selling cigarettes and/or other tobacco products.

1.6 Smoking imposes large costs on society. In addition to the obvious costs to public health, smoking also creates many indirect costs relating to productivity and other businesses losses, fire and environmental harm.

1.7 While great progress has been made in substantially reducing smoking rates since the 1960s, around 20% of adults in the UK still smoke.

1.8 The government has taken strong action to reduce smoking rates. Tobacco control measures have included banning the open display of tobacco products in large shops, advancing plans to ban smoking in cars with children and consulting on standardised packaging regulations. However, the costs of smoking to society are still high.

1.9 Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.¹ This is made up of:

- £2 billion cost to the NHS of treating diseases caused by smoking
- £3 billion loss in productivity due to premature death
- £5 billion cost to businesses of smoking breaks
- £1 billion cost of smoking-related sick days
- £1.1 billion of social care costs of older smokers
- £391 million cost of fires caused by smokers' materials

1.10 Tobacco manufacturers and importers benefit from the activity that imposes these costs on society. For this reason, the government believes it is fair to ask tobacco manufacturers and importers to make a greater contribution towards these costs.

¹ [The economics of tobacco](#), Action on Smoking and Health, November 2013.

1.11 Any levy would be based on market share. This means that those who benefit most from smoking activity would pay more of the levy.

2 How a levy could operate

2.1 This chapter sets out how a levy could operate.

How the tobacco market would be defined

2.2 Any levy would be distributed across tobacco manufacturers and importers according to market share. The tobacco market would be taken to be the market for products on which tobacco duty is paid. This means the levy would apply to all products subject to tobacco duty, including cigarettes, hand rolling tobacco, pipe tobacco, shisha, chewing tobacco and herbal cigarettes.

2.3 This would include some products that do not contain tobacco, for example herbal cigarettes. There is no evidence that herbal smoking products are any less harmful than tobacco products, though there is a duty exemption for any herbal tobacco products covered by a marketing licence granted by the Medical and Healthcare Regulatory Agency.

2.4 There is a trade-off between the tightest definition of products containing tobacco and minimising administrative burdens.

Question 1: Is it appropriate to define the tobacco market as products on which tobacco excise duty is paid?

How to determine the size of the market

2.5 The size of the market can be calculated in various ways, for example by considering profits, sales or volumes of tobacco on which excise duty is paid (these are referred to as “cleared tobacco” or “tobacco clearances”).

2.6 Basing the size of the market on profits does not appear to be the best metric for determining market share, as this would take into account the cost profile of individual participants. As a result profits do not provide an accurate way of determining total market size.

2.7 Basing the size of the market on sales would require HMRC to acquire information on sales from third parties, as this information is not readily available in the information supplied to HMRC in returns. HMRC would not be able to certify the reliability of this acquired information.

2.8 Arguably, basing the total market size upon tobacco clearances better reflects the actual activity of the tobacco manufacturers and importers. Manufacturers and importers already hold data on their clearances. HMRC also holds information on clearances and could publish a monthly estimate of total market size based on this information. As such, calculating total market size via the volume of tobacco cleared would be the least administratively burdensome option.

2.9 Tobacco duty is calculated per stick and by price for cigarettes and by weight for hand rolling tobacco (HRT), pipe tobacco and other tobacco products. As such, it may be appropriate to split the market into 2 distinct parts for the purposes of calculating the levy:

- cigarettes
- HRT and other products subject to tobacco duty

2.10 Total market size could be determined from the total volume of cigarettes and HRT and other tobacco cleared in the UK in the previous year. Using current year data would lead to the data being published at a much later date which would not allow industry reasonable time in

which to calculate their tax liability. Using previous year data to determine and publish total market output overcomes this problem.

2.11 HMRC could publish total market size for both cigarettes and HRT and other products subject to tobacco duty on a monthly basis.

Question 2: What would be the consequences of using volumes of tobacco cleared in the previous year in order to calculate total market size?

Question 3: Are there any other metrics that you would prefer were used to calculate total market size? If so, why?

Question 4: What are the practical difficulties in splitting the total market into 2 distinct parts:

- cigarettes; and
- HRT and other products subject to tobacco duty?

How a levy would be calculated

2.12 The government would set a revenue target for the levy. As set out in paragraph 2.9, tobacco duty is calculated in different ways for cigarettes and for HRT and other tobacco products. There could therefore be one revenue target for cigarettes and another revenue target for HRT and other products subject to tobacco duty. A company would calculate the percentage of the target for which they were liable by working out their percentage of market share in each category and applying that percentage to each category's target.

2.13 Companies would also need to calculate their share of the market. Very simply, market share would be calculated as:

$$\text{Market share} = \text{Company's tobacco clearances} / \text{Total market size}$$

2.14 It is possible to use either a company's tobacco clearances from either:

- (i) the previous year; or
- (ii) the current year

2.15 There are pros and cons to each option. Using a company's clearances from the previous year would require further rules to deal with companies entering or leaving the market. Using a company's clearances from the current year could mean the target of the levy is not reached, but it reduces difficulties around companies entering and leaving the market and may make accounting for the levy easier for companies.

2.16 After a company has calculated their market share, its levy payment calculation would be straightforward:

$$\text{Company's levy payment} = (\text{Company's share of the cigarette market} \times \text{Cigarette target}) + (\text{Company's share of HRT and other products} \times \text{HRT and other products target})$$

Question 5: Which of option (i) and (ii) as set out in paragraph 2.14 is your preferred option?

Administration

2.17 To avoid creating new administrative machinery the tobacco levy could be brought within the administration of corporation tax. This would have the advantage of allowing the existing corporation tax self-assessment (CTSA) system to be used for returns and payment.

2.18 If the levy is brought within the administration of corporation tax, it would be necessary to allow for the fact that companies have different accounting periods.

2.19 Following the approach used successfully in the bank levy, businesses within the scope of the tobacco levy would account for it in an annual company tax return. Payment of the tobacco levy would be made by quarterly instalments, as is the case for corporation tax for companies with larger profits, with the first instalment based upon estimates and the final one providing a reconciliation. A means to differentiate between corporation tax and tobacco levy liabilities would also be required.

2.20 This approach would mean that the levy would not be deductible for corporation tax purposes, and would instead be payable out of profits after tax.

Question 6: Do you agree that the corporation tax system provides the best mechanism for returning and paying the tobacco levy?

Question 7: What are the alternative approaches?

3 Possible impacts of and alternatives to a levy

3.1 This chapter seeks evidence to inform any future impact assessment of a levy.

Impact of a levy

3.2 The government is particularly interested in the impact the introduction of a levy would have on consumer prices.

3.3 The levy would be a direct tax and so would be imposed upon tobacco manufacturers and importers.

3.4 As a direct tax, potentially a levy could be absorbed in profits. Clearly, this depends on the amount the levy raises. If the levy is absorbed in profits, consumers would not see a rise in prices but the company's profits would be lower. This would affect returns to the company's owners or shareholders.

3.5 If a levy were to be passed through to consumers, the price of tobacco would rise. A rise in prices is likely to lead to a reduction in sales, so the overall impact on a company's profits is unknown.

Question 8: The government welcomes views on the expected impacts of the levy on consumer prices.

Question 9: Would the levy have any other impacts on consumers that have not been considered in this document?

Question 10: Would the levy have any other market impacts?

The illicit market

3.6 If the levy is passed onto consumers through higher prices, then this could mean that some stop smoking, some smoke less or smoke cheaper brands, and some move to the illicit market.

3.7 The government remains committed to tackling the illicit market. Since 2000, the strategic approach to tackle illicit tobacco has reduced the illicit market for cigarettes from 22% to 10% and the illicit market for hand rolled tobacco from 61% to 39%. HMRC will publish a refreshed strategy in the spring in order to tackle the new and diversifying risks of illicit and smuggled tobacco.

Alternatives to the levy

3.8 The government believes it is right that tobacco manufacturers and importers make a greater contribution to the societal costs of smoking.

3.9 An alternative option to ensure tobacco manufacturers and importers make a greater contribution would be to change their tobacco duty liabilities, but experience suggests that a duty rise would be passed on in full to consumers, meaning the tobacco manufacturers and importers would not bear the costs themselves.

3.10 There has recently been a consultation on the introduction of a minimum excise tax. The government is still considering responses received and will respond in due course.

3.11 Another alternative to the levy could be a corporation tax surcharge. A corporation tax surcharge would be more complex to design and operate. This complexity could lead to additional administration and compliance costs for HMRC and additional burdens for taxpayers.

Question 11: The government welcomes views on an alternative to a levy that would enable tobacco manufacturers and importers to make a greater contribution.

4 Summary of consultation questions

4.1 This chapter provides a summary of the questions asked in this document.

Question 1: Is it appropriate to define the tobacco market as products on which tobacco excise duty is paid?

Question 2: What would be the consequences of using volumes of tobacco cleared in the previous year in order to calculate total market size?

Question 3: Are there any other metrics that you would prefer were used to calculate total market size? If so, why?

Question 4: What are the practical difficulties in splitting the total market into 2 distinct parts:

- cigarettes; and
- HRT and other products subject to tobacco duty?

Question 5: Which of option (i) and (ii) as set out in paragraph 2.14 is your preferred option?

Question 6: Do you agree that the corporation tax system provides the best mechanism for returning and paying the tobacco levy?

Question 7: What are the alternative approaches?

Question 8: The government welcomes views on the expected impacts of the levy on consumer prices.

Question 9: Would the levy have any other impacts on consumers that have not been considered in this document?

Question 10: Would the levy have any other market impacts?

Question 11: The government welcomes views on an alternative to a levy that would enable tobacco manufacturers and importers to make a greater contribution.

5 The consultation process

5.1 This consultation is being conducted in line with the tax consultation framework. There are 5 stages to tax policy development:

- Stage 1 – Setting out objectives and identifying options
- Stage 2 – Determining the best option and developing a framework for implementation including detailed policy design
- Stage 3 – Drafting legislation to effect the proposed change
- Stage 4 – Implementing and monitoring the change
- Stage 5 – Reviewing and evaluating the change

5.2 This consultation is taking place during stage 1 of the process. The purpose of the consultation is to seek views on the policy design and any suitable possible alternatives.

How to respond

5.3 A summary of the questions in this consultation is included at chapter 4.

5.4 Responses should be sent by email to tobaccolevy@hmtreasury.gsi.gov.uk or by post to:

Tobacco levy consultation
VAT and Excise
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

5.5 All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

5.6 When responding please say if you are a business, individual or representative body. In the case of representative bodies, please provide information on the number and nature of people you represent.

Confidentiality

5.7 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1988 (DPA) and the Environmental Information Regulations 2004.

5.8 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

5.9 HM Treasury will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation principles

5.10 This consultation is being run in accordance with the government's consultation principles.

5.11 If you have any comments or complaints about the consultation process, please contact:

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Budget Team
HM Revenue & Customs
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Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

HM Treasury contacts

This document can be downloaded from
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format or have general enquiries about
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