

Chapter 15

Revenue

Counteracting Smuggling of Tobacco Products

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15.1 In 2009, €1.2 billion¹¹⁵ was collected by Revenue in excise duty on tobacco products. 95% of this arose from duty on cigarettes. The duty collected from tobacco products in the period 2004 to 2009 is shown in Figure 78.

Figure 78 Excise Duty on Tobacco Products, 2004 to 2009

	Cigarettes		Other tobacco products ^a		Total
	Quantity 000's ^b	€m	Kgs ^b	€m	€m
2004	5,330,593	1,024	207,270	35	1,059
2005	5,514,228	1,054	183,390	26	1,080
2006	5,604,884	1,071	190,453	32	1,103
2007	5,401,702	1,155	201,858	37	1,192
2008	4,940,567	1,132	198,763	39	1,171
2009	4,607,146	1,155	285,425	61	1,216
	31,399,120	6,591	1,267,159	230	6,821

Notes:

- a Other tobacco products include cigars, fine cut tobacco and other types of smoking tobacco.
- b Excise duty on cigarettes comprises a rate of duty levied per thousand cigarettes together with a fixed percentage of the retail price at which the cigarettes are sold. All other tobacco products are charged at a rate of duty per kilogram.

15.2 Total excise duty on tobacco products increased by €45 million between 2008 and 2009. While the quantity of cigarettes on which duty was paid fell by 7%, the duty collected increased by 2% or €23 million. This is mainly due to an increase of 4% in the rate of duty in 2009¹¹⁶. There was also an increase in duty collected on other tobacco products of 56% or €22 million.

15.3 In addition to the amounts of excise duty collected, Revenue has received total payments of €2.8 million between 2006 and 2009 from two tobacco manufacturers. These payments are taken to account as appropriations-in-aid in the Vote for the Office of the Revenue Commissioners. The payments arise from legally binding agreements between the European Commission and member states on the one hand and the tobacco manufacturers on the other. The European Commission and member states have been seeking to enter into such agreements with the four major global manufacturers with the objective of instituting formal cooperation arrangements to combat cigarette smuggling.

15.4 Three such agreements have been signed to date – with Philip Morris International (PMI), Japan Tobacco International (JTI) and British American Tobacco (BAT) – and Ireland is party to all three agreements. The agreements include provision for the phased payment of an agreed sum to the members states and the European Commission over the period of the agreements as well as additional payments (known as seizure payments) to member states where genuine branded cigarettes (above a threshold of 50,000 cigarettes) of the relevant manufacturer are seized and

¹¹⁵ €168 million of this, referred to as the tobacco levy, was paid to the Health Service Executive Vote under Section 3 of the Appropriation Act 1999.

¹¹⁶ The new rate became operable on 8 April 2009.

where such cigarettes have not been released for consumption in the EU. The European Commission is actively negotiating an agreement with the other major global manufacturer – Imperial Tobacco Ltd (ITL).

15.5 The agreements commit the manufacturers to ensure that they only sell to legitimate traders, carry out due diligence checks on their customers and that they have in place ‘track and trace’ procedures to enable the source of any smuggled cigarettes to be identified.

Excise Duty Environment

15.6 With the introduction of the Single European Market in 1993, routine controls on imports from other EU member states were removed and an EU-wide control and movement system for excisable products was introduced. Under this system, the excise duty is suspended on goods moving between tax warehouses in different member states.

15.7 At the same time, restrictions on the amount of duty-paid excisable products that a person could bring into Ireland from another EU country no longer applied, provided the products are for the personal use of the person transporting them. Revenue has set indicative quantities¹¹⁷ of tobacco products (currently 800 in the case of cigarettes), which, if not exceeded, will be regarded as for personal use, provided there is no indication or suspicion of commercial activity. This is the lowest indicative level permitted.

15.8 Notwithstanding the EU Treaty provisions on free movement of goods and people, Revenue officials may carry out checks to combat smuggling of prohibited or restricted goods, including tobacco products where there are reasonable grounds for suspecting contravention of national or EU law.

15.9 Persons bringing tobacco products into Ireland from outside the EU are liable to excise duty and VAT on those products unless the quantities are below certain limits (200 in the case of cigarettes) and the products are for personal use.

Chapter Focus

Ireland has the highest rate of tobacco taxation in the EU. This makes Ireland, despite the small size of the market, a target for the smuggling of illegitimate products into the State. Illegal importation of tobacco products represents a loss to the Exchequer and the availability of cheap products undermines health policy which aims to reduce the level of smoking. In order to address smuggling of tobacco effectively, it would be necessary for Revenue to

- ensure that there is a high level of assurance that duty levying arrangements are operated in a controlled manner
- estimate the extent of illicit activity
- target activities within an articulated strategy based on the best analysis of the nature of fraud
- implement an operational response based on such a strategy
- monitor performance.

¹¹⁷ The limits are set in accordance with Council Directive 2008/118/EC.

The audit set out to examine the extent to which each of the elements of such a strategic approach were in place.

Duty Levying – Control

15.10 Excise duty on cigarettes and fine cut tobacco ('roll-your-own') is payable by means of the purchase of security stamps¹¹⁸ which are affixed to the packet beneath the cellophane wrapper. Excise duty on other tobacco products such as cigars and pipe tobacco is payable by reference to the weight of the product.

15.11 While excise duty is payable at the time of importation into Ireland, payment is suspended until the products are released for consumption onto the Irish market. To avail of this duty suspension arrangement, tobacco products imported into Ireland but not released onto the market must be held in a Revenue approved tax warehouse.

15.12 There is a risk that tobacco products on which duty has been suspended because they are held in tax warehouses or are being moved between warehouses will be released onto the market without payment of duty. Revenue controls the duty suspension arrangements by an approval process for warehouses and warehousekeepers, assurance checks of warehouse records including supervisory visits and regular audits. There are five warehouses authorised to hold tobacco products in Ireland.

Conclusion – Duty Levying

Each of the three main companies' warehouses has been audited annually by Revenue since 2005 with no yield arising. About 700 assurance checks annually have also been carried out between 2005 and 2009 with little or no yield arising. This gives reasonable assurance that duty-levying arrangements are operating effectively.

Estimation of the Extent of Illicit Activity

15.13 A study¹¹⁹ commissioned by the EU Commission estimated that, in 2004, untaxed products accounted for approximately 13% of the EU-wide tobacco market. It estimated that this was comprised of 4% to 5% legitimate untaxed and between 8% and 9% of illegitimate untaxed products.

15.14 There is no published official estimate of the extent of evasion of duty on tobacco products in Ireland. Revenue has in recent years, in conjunction with the Office of Tobacco Control, commissioned surveys, based on market research, which attempt to estimate the scale of illicit cigarette consumption and consumption of cigarettes untaxed in Ireland but purchased legitimately abroad. The most recent survey in 2009 estimated that 20% of cigarettes consumed in Ireland were untaxed. The figure for illicit consumption was put at 14% which would equate to a loss to

¹¹⁸ The security features on the stamps, some of which are known only to Revenue control and enforcement staff, are upgraded on a regular basis to reflect current best practice. A reserve stamp is retained in the event of the existing stamp being compromised.

¹¹⁹ KPMG, *Study on the Collection and Interpretation of Data Concerning the Release for Consumption of Cigarettes and Fine-cut Tobacco for Rolling of Cigarettes*, December 2005, Commissioned by the European Commission.

the Exchequer of approximately €200 million. The balance of 6% related to legal untaxed (in Ireland) cigarettes.

15.15 In response to my enquiries, Revenue has stated that it is currently undertaking an analysis of the economics of tobacco with a view to obtaining a better understanding of the market for tobacco in Ireland. One component of this research is to create an econometric model to estimate the demand for tobacco that will identify the key determinants of the market in Ireland. The literature on this topic is well developed and there is a World Bank recommended approach that will be adopted. As part of this project, economic techniques and data from various sources will be assessed for their usefulness in estimating the scale of tobacco smuggling in Ireland.

Conclusion – Estimation of Illicit Activity

Revenue should estimate the level of illicit tobacco importation and report the results in an open, transparent manner. Doing so would help position it to formulate appropriate responses that seek to reduce the level of evasion of duty taking account of the extent and nature of the problem.

The planned research to analyse the economics of the tobacco market in Ireland offers a means of supplementing the current estimate based on market research. The risk presented by other tobacco products, for which there is no estimate of illicit consumption, should be continually reviewed particularly in light of the significant increase in the quantity of these products legally consumed.

Strategic Targeting of Operations

15.16 In order to target Revenue activities designed to combat evasion of duty as well as preparing regular estimates of the extent of the problem there would need to be

- an analysis of the nature of the problem including the sources of supply, the profile of the population that uses the products and the trends over time
- an operational response based on that analysis designed to tackle the problem in an efficient manner
- the establishment, monitoring and regular review of goals and outcomes
- regular review of the control regime employed and applied by Revenue designed to identify gaps that could be exploited
- a performance-reporting regime designed to provide information on the extent of achievement in terms of goals and outcomes.

15.17 Revenue regions and the Investigations and Prosecutions Division (IPD) are responsible for implementing the actions designed to counteract smuggling.

15.18 While Revenue has a strategic aim of minimising the size of the illicit cigarette market, it does not have a high level strategy that targets specific achievements in terms of outcomes. It employs operational strategies that envisage an effective response to cigarette smuggling through targeting distribution outlets and a 50% increase in the seizure of smuggled cigarettes. Revenue also targets improved compliance by applying sanctions for non-compliance and, in particular, increasing the number of prosecutions.

15.19 One of Revenue's key priorities for 2009 sought "to increase the use of intelligence-based operations to combat the smuggling of goods, including drugs and tobacco products". The priorities for 2010 included "tackling the social and fiscal menace of tobacco smuggling to prevent it undermining government finance and public health policy".

15.20 Revenue has stated that organised crime is centrally involved in the illicit cigarette market. Revenue has access to international resources and expertise, including the World Customs Organisation and the European Anti Fraud Agency (OLAF)¹²⁰.

Conclusion – Strategy

While Revenue has set a target for seizures and acknowledging that other factors such as the after-tax price of cigarettes, the general state of the economy and the EU legal framework would have to be taken into account, it has not developed a strategy based on the regular generation of estimates of the size of the problem and which targets the achievement of specified outcomes designed to reduce or contain the problem.

Operational Response

15.21 Revenue's actions to counteract tobacco smuggling fall into a number of categories

- tackling, using a multi-agency approach, large-scale smuggling which usually involves organised criminal gangs. In this regard, Revenue receives assistance and co-operation from OLAF which also plays a role in facilitating follow-up investigations in countries from which seized cigarettes were shipped
- the identification of suspect consignments by means of risk profiling, intelligence gathering, sharing of information with other customs services and, where appropriate, using X-ray scanning technology to detect contraband.

15.22 Certain programmes and operations are coordinated by IPD, particularly multi-agency operations. Other than in the case of these centrally coordinated operations, intelligence sourced by IPD is passed on to the relevant Revenue region for action. A National Freight Intelligence Unit (NFIU), which is part of IPD, profiles and sources intelligence on third country traffic¹²¹. Targeting reports are produced which help operational units identify high risk traffic. Figure 79 sets out details of seizures of tobacco products as a result of reports issued by NFIU to operational units for the period 2007 to 2009.

¹²⁰ OLAF's mission is to protect the financial interests of the European Union and to fight fraud, corruption and any other irregular activity. It promotes cooperation between the Member States in order to coordinate their activities and provides them with the necessary support and technical knowledge to help them in their anti-fraud activities.

¹²¹ Goods imported into Ireland from outside the European Union are known as third country traffic.

Figure 79 Seizures of Tobacco Products arising from NFIU Profiling, 2007 to 2009

	Number of Cigarettes Seized m	Quantity of Hand Rolled Tobacco Seized kg
2007	6.4	1.4
2008	51.7	–
2009	17.9	2.5

Role of Revenue Regions

15.23 Revenue regions participate in national and international coordinated operations and undertake local operations aimed at points of importation and at distribution outlets. ‘Operation Downstream’ is an ongoing operation which targets the sale of illicit products at various retail points including shops and markets and by street traders. Acting on intelligence generated within Revenue and received from industry and other sources this operation has resulted in 424 seizures totalling over 17 million cigarettes between December 2007 and December 2009.

15.24 Revenue also deploys staff on a permanent basis at a number of key locations in each region and operations are conducted in regions based on risk profiling. In addition to the profiling of third country freight provided by the NFIU, regions also profile EU traffic. Because of the free movement of goods provisions within the EU, limited information is available in relation to EU freight and care is applied in detaining any for examination.

15.25 Regions use profiling and a presence on the ‘high street’ to combat sales of illicit tobacco products. Checks on the internet followed by reviews of Revenue information systems are used to profile premises where illicit products are potentially being sold. Revenue officers have a right of entry to commercial premises. A warrant is required for private premises. For example, in the Dublin Region there were a total of 24 such warrants requested in 2009, warrants were granted in all of these cases which resulted in seizures in 13 cases and 13 prosecutions. Test purchases in commercial premises are also used to identify illicit trade and all of these cases are referred for consideration with a view to prosecution.

Scanning of Consignments

15.26 An aid to identification of illicit tobacco products is X-ray scanners. X-ray scanners can identify illicit goods in containers and vehicles. The scanner takes an X-ray image of the container and officers interpret that image based on training and experience. Revenue first acquired a scanner in 2006 and a second one was acquired in late 2009. One scanner operates in and around Dublin Port and the other, while based in Rosslare, is available to other regions as required.

15.27 It is only possible to scan a small percentage of the containers that arrive each week in Dublin Port (approximately 10,000). Revenue requires a significant amount of port space to operate the scanner for both radiological protection reasons and to accommodate freight that is to be scanned. It aims to avoid unduly delaying freight traffic moving through ports while scanners are in operation. Details of seizures of tobacco products which were identified using the X-ray scanner in the period 2007 to 2009 are shown in Figure 80.

Figure 80 Seizures of Tobacco Products from use of X-Ray Scanner 2007 to 2009

Year	Number of cigarettes seized	Quantity of other products seized	Value of tobacco products detected
2007	15 million	–	€6,337,500
2008	13 million	12.5 kgs	€5,492,500
2009	22 million	6,490 kgs	€11,295,000

Conclusion – Operations

Much of Revenue's operations are based on intelligence. Revenue has suggested that it is becoming more difficult to identify suspect consignments because smugglers increasingly use the tax registration details of legitimate traders as a cover.

There has been limited success in using X-ray scanners to detect contraband cigarettes. A comparison of the number of scans and the detection rate per scan with that achieved by tax authorities in other countries would be a useful approach for Revenue to assess the performance of its scanners and whether they could be deployed to better effect. Revenue informed me that it plans to conduct a study in 2011 that will compare the detection rate achieved with that achieved by tax authorities in other countries.

Performance Reporting

15.28 Revenue has not set performance targets in terms of outcomes. Its monitoring is focused on its actions including those designed to

- profile and assess risk
- target outlets that are distributing illicit products
- increase the number of intelligence based operations
- increase seizures
- increase the number of prosecutions.

15.29 Other than the aim in Revenue's Strategy Statement to increase seizures by 50%, quantified targets have not been published for these activities. Regions set targets for the number of seizures and the quantity to be seized as well as the number of cases to be referred for prosecution but these are not published or included in performance reports to the Revenue Board. Details of actual prosecutions and seizures are published in the Revenue Annual Report. Revenue has stated that seizures are analysed as a matter of course.

15.30 Figure 81 sets out the details of all seizures of cigarettes by Revenue in the period 2007 to 2009.

Figure 81 Cigarette Seizures, 2007 to 2009

	2007	2008	2009
Number of Seizures	15,481	10,191	10,610
Number of Cigarettes Seized	74.5m	135.3m	218.5m
Number of Counterfeit Cigarettes Seized	n/a ^a	62m	127.6m
Retail Value of Cigarettes Seized	€25.6m	€54.4m	€92m
Duty and Tax	€20.5m	€39.5m	€73.2m

Note:

a Figure not available.

15.31 While the number of cigarette seizures has fallen by about 30% since 2007, the actual number of cigarettes seized has increased from 74.5 million in 2007 to 218.5 million in 2009. One seizure in 2009 accounted for over 120 million cigarettes. Given the size of this seizure and the brands seized, it is unlikely that these cigarettes were destined for the Irish market.

15.32 Figure 82 sets out details of seizures of other tobacco products for the period 2007 to 2009.

Figure 82 Tobacco Seizures, 2007 to 2009

	2007	2008	2009
Number of Seizures	763	1,100	1,171
Quantity of Tobacco Seized	1,516kgs	3,083kgs	10,451kgs
Retail Value of Tobacco Seized	€0.4m	€1.1m	€3.7m
Duty and Tax	€0.3m	€0.7m	€2.9m

15.33 The number of seizures of other tobacco products increased by over 50% between 2007 and 2009 but there was a seven-fold increase in the quantity seized.

Conclusion – Performance Reporting

There is no performance reporting in terms of outcomes designed to highlight Revenue's impact on the illegal importation problem and performance against operational targets is limited to reporting the level of seizures.

The extent of seizures does not necessarily indicate whether the level of illicit trade is being impacted upon. The success of the measures that Revenue is taking to reduce the level of evasion of excise duty on tobacco products can ultimately only be measured in terms of their effect on reducing the incidence of evasion. This requires estimating the level of evasion over time, analysing the nature of that evasion and targeting actions accordingly. The market research commissioned by Revenue in conjunction with the Office of Tobacco Control is a first step in this regard.

Variations in seizures underline the need for Revenue to identify the factors that give rise to changes in the level and nature of seizures. Isolating the causes of variations would be valuable in determining whether they are as a result of better targeting by Revenue, changes in the nature of smuggling or other factors. Analysis and reporting of seizures in terms of whether the products were destined for the domestic market or for elsewhere would be useful in this regard. A planned review of seizure policies should provide valuable information on the effectiveness of the approach.

Sanctions and Penalties to Deter Smuggling

15.34 Under excise law it is an offence to do anything (hold, remove, transport, deposit or conceal) in relation to excisable products on which duty has not been paid with the intention of defrauding the State of the duty. It is also an offence to be involved in the evasion or attempted evasion of excise duty. The penalties are as follows

- on summary conviction a fine of €5,000 and/or up to 12 months in prison¹²²
- on conviction on indictment a fine not exceeding €126,970 or up to three times the value of the goods where their value is greater than €250,000 and/or up to 5 years imprisonment¹²³.

15.35 Section 125 of the Finance Act 2001 also provides for the forfeiture of the products, any goods packed with or used to conceal them and any conveyance used to transport them. Offences relating to tobacco stamps are set out in Section 78 of the Finance Act 2005. There is also provision for a court fine (€5,000) and forfeiture for failing to comply with the warehousing requirements and the EU control and movement provisions.

¹²² Section 119, Finance Act 2001 (as amended)

¹²³ The penalties on indictment were increased to this level by Section 99, Finance Act 2010. Previously, the fine was the greater of €12,695 or three times the value of the goods (section 119, Finance Act 2001).

15.36 Details of prosecutions by Revenue in relation to tobacco offences for the period 2007 to 2009 are set out in Figure 83.

Figure 83 Prosecutions for Tobacco Offences 2007 to 2009

	2007	2008	2009
Summary Prosecutions			
Number Prosecuted	120	82	159
Number of Convictions	120	82	159
Number where Custodial Sentence Imposed	14	5	28
Number where Fines Imposed	n/a ^a	78	143
Value of Fines Imposed	€43,710	€41,259	€93,510
Prosecutions for Serious Offences			
Number Prosecuted	1	3	6
Number of Convictions	1	3	6
Number where Custodial Sentence Imposed	–	1	5
Value of Fines Imposed	€7,500	–	€300

Note:

a Figure not available.

15.37 Revenue has stated that its policy is to prosecute wherever possible. As prosecution is dependent on the availability of quality admissible evidence, neither minimum nor maximum targets are set. Cases are analysed for their intelligence value and to extract the lessons learned.

15.38 Figure 84 sets out details of other sanctions imposed in relation to tobacco offences in the period 2007 to 2009.

Figure 84 Other Sanctions Imposed for Tobacco Offences 2007 to 2009

	2007	2008	2009
Number of Vehicles Seized	59	110	130
Cash Seized	€7,000	–	€312,338
Ship Seized	–	–	€250,000

Conclusion – Prosecutions

In-depth analysis of the effectiveness of deterrence, in terms of the type of prosecution case taken, the resultant sentences and the other sanctions imposed would be useful to assess its effectiveness as a deterrent.

Recent Developments

15.39 In recent years, Revenue has signed Memoranda of Understanding with two of the main cigarette manufacturers, ITL and JTI, to further cooperation in relation to the illicit tobacco trade. Samples of all major seizures are sent to manufacturers to establish whether the products are genuine or counterfeit. In addition, Revenue meets regularly with the trade association representing the leading tobacco companies as well as the four major global manufacturers to discuss global and national trends, including cigarette consumption figures and penetration of market by illicit product.

15.40 The Accounting Officer informed me that an internal group was established in January 2010 to examine the risks related to tobacco excise. A number of initiatives have already been taken arising from the work of this group. These include

- convening a national profiling conference
- the establishment of a tobacco hotline
- co-ordinating periodical national ‘blitz’ type operations on distribution outlets and at ports and airports to supplement normal activities
- the acquisition of additional hand held scanners and the evaluation of tobacco X-ray and other detection technology
- looking at best practice in other relevant jurisdictions
- the planned research into the market for tobacco in Ireland.

15.41 In addition, the group has initiated a number of projects including

- evaluation of a tobacco dog unit including a cost-benefit analysis
- establishment of a National Profiling Network and reviewing profiling effectiveness
- sourcing further guidance and training internationally
- a report to be prepared on alternative mobile scanning devices.

15.42 The group has also re-emphasised the benefits of enhanced co-operation with the Gardaí, the road haulage industry and the cigarette machine vending industry. It has also requested a review of seizure policies with a view to increasing the impact of Revenue activity against the smuggling of tobacco products.

Conclusion

Revenue needs to measure whether or not its activities are succeeding in reducing the problem of evasion of tobacco duty. The market research carried out gives an indication of the level of the problem and Revenue should use those results to set specific objectives in terms of reducing the illicit market share. To have value, this estimate needs to be updated regularly. Revenue should continue to explore other methodologies for estimating evasion.

Output targets for all key activities should be set and published to enable an assessment to be made of whether the activities are on course to deliver the required outcomes.

