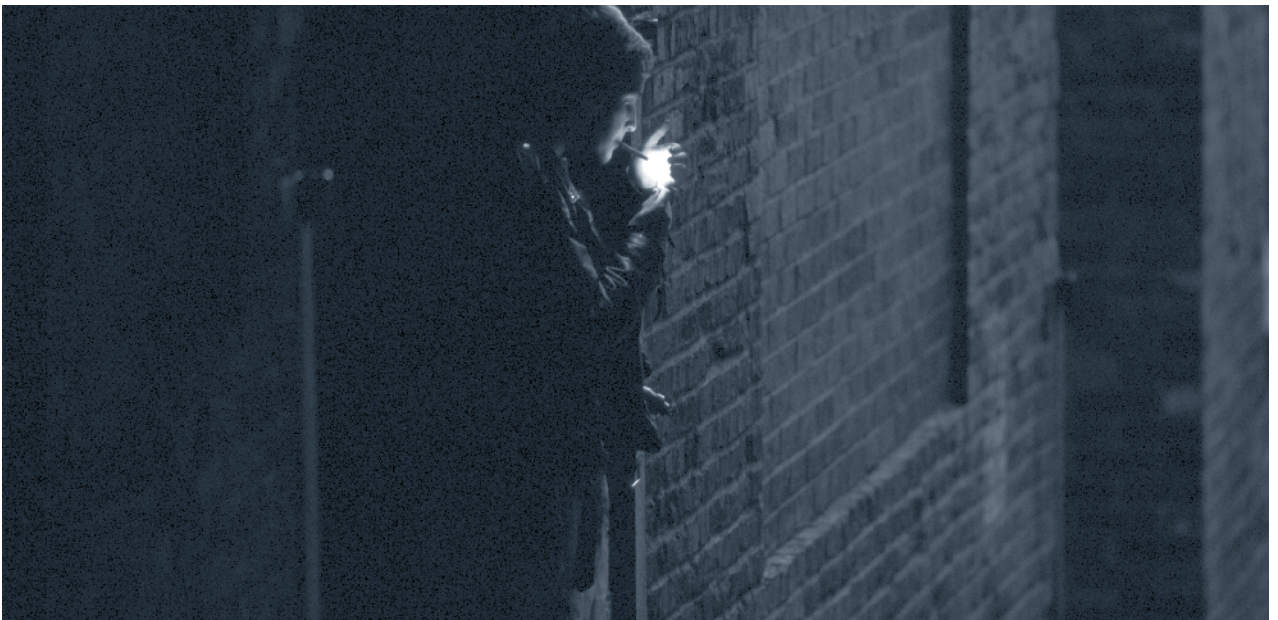


The Billion Pound Drop

*The impact of tobacco smuggling
and cross-border shopping in the UK*



Contents

<i>01</i>	Introduction	2
<i>02</i>	The UK tobacco market	4
<i>03</i>	Non-UK duty paid	6
<i>04</i>	The evolution of non-UK duty paid	9
<i>05</i>	Impact of non-UK duty paid	12
<i>06</i>	Measuring non-UK duty paid	14
<i>07</i>	Tackling the illegal trade	18
<i>08</i>	Future threats	20
<i>09</i>	Our recommendations	22
<i>10</i>	JTI's presence in the UK	24

01

Introduction

Taxing times ahead for the UK



When we published our last report on the UK's illegal tobacco market in 2010 we were greatly concerned about what might happen to levels of smuggling and cross-border shopping if the Government went ahead with a) plans to increase tobacco taxes and b) proposals to ban the display of tobacco products in retail outlets.

Since then the tax on a pack of Premium brand cigarettes, for example Benson & Hedges Gold, has risen by more than £1, an increase of 20%, and now sells at £7.72 RRP¹. As a result, we have seen levels of non-UK duty paid consumption increase by almost 20% so far this year. With the Government indicating that it intends to impose further above-inflation tax increases in the Budgets of 2013 and 2014, this trend will only continue.

The Government is well aware of the long-standing problems caused by the illegal tobacco market, the associated revenue loss (as much as £2.9 billion last year)², the involvement of organised crime and the wider impacts on society. A list of 20 of the UK's most wanted tax fugitives (released by HM Revenue & Customs in August 2012) revealed that eight of them were involved in the illegal tobacco trade³.

I find it perplexing that despite the Government's obvious concern, there were only 133 convictions⁴ for tobacco smuggling in 2010/11 at a time when it was losing up to £55 million per week in revenue. The level of fines and penalties must be sufficiently high and they must be better enforced (both in terms of penalties and prosecutions) in order for them to act as deterrents.

I do, however, welcome the renewed impetus and focus being given by the Government to tackle the illegal tobacco market. First, through the refreshed *Tackling Tobacco Smuggling* strategy, in which JTI is a partner, and second, by the additional resources being made available to HM Revenue & Customs and the UK Border Agency as part of the Government's £900 million funding to tackle fraud⁵.

Unfortunately, this enthusiasm and investment will be wasted if taxes continue to rise and other poorly thought through policy measures come to pass.

The impact of the display ban, only recently introduced in some parts of the UK, has not been assessed and already the Department of Health is

under pressure to introduce another drastic and unproven measure – plain packaging for tobacco products.

These measures will not help achieve a reduction in young people taking up smoking, this will only increase the illegal trade in tobacco.

It is hoped that the World Health Organisation's *Protocol on Illicit Trade in Tobacco Products* under the Framework Convention on Tobacco Control (FCTC) will tackle the illicit trade in tobacco products at a global level. This is an ambitious effort and encapsulates much of what JTI already does to ensure our products do not end up in illegal channels.

However, there are some who say the tobacco companies should be excluded from the debate on curbing illegal trade, let alone working with others in solving the problem. JTI has much to contribute and we will continue to work with Governments and authorities in the UK, and around the world, to tackle the illegal trade in tobacco, in all its forms.

Martin Southgate
Managing Director UK

only 133
people were
sentenced for tobacco
fraud in 2010/11

£2.9bn
revenue lost
from illegal trade
in tobacco

8 out of the
top 20 tax
fugitives are
involved in
the illegal
tobacco trade

The UK tobacco market

An overview

One in five adults in the UK chooses to smoke – that's around 10 million people⁶

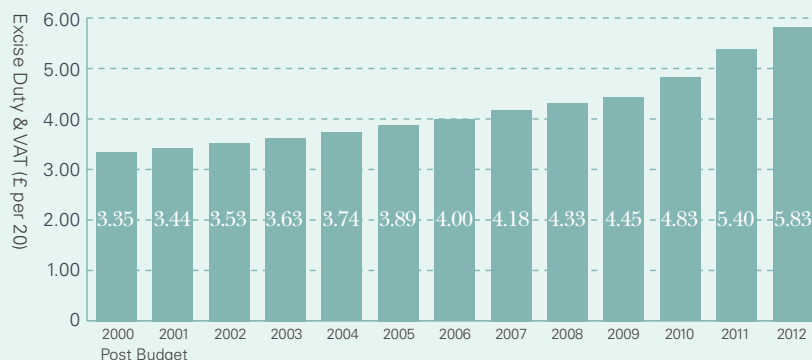
Last year the Government raised £12.1 billion in tax revenue from the sale of tobacco – £33 million a day. Over the last 10 years total revenues have exceeded £100 billion⁷.

High levels of tax are levied on tobacco products with the aim of raising revenue and influencing smokers' behaviour. Taxes (excise and VAT) currently account for close to 90% of the price of some cigarettes in the UK.

While high and increasing rates of tax might appear, to some, to be a logical way to reduce smoking, it is not effective and results in many smokers avoiding paying tax altogether. There are legal and illegal options; collectively this is referred to as non-UK duty paid consumption, or NUKDP.

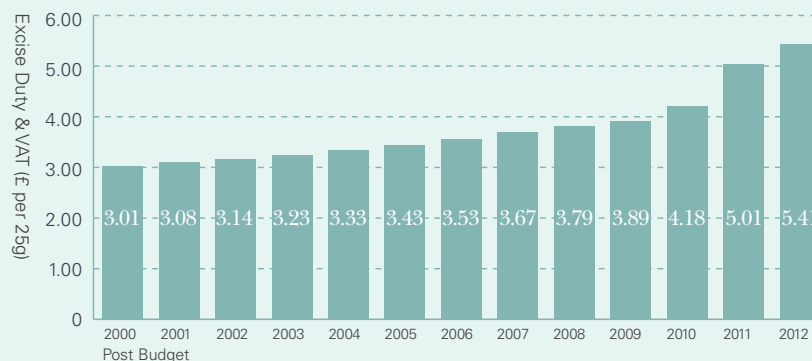
Total tax burden on Premium cigarettes

An increase of 74% since 2000



Total tax burden on Premium hand-rolling tobacco

An increase of 80% since 2000



UK duty paid tobacco consumption

Hand-rolling tobacco accounts for a growing share of the market

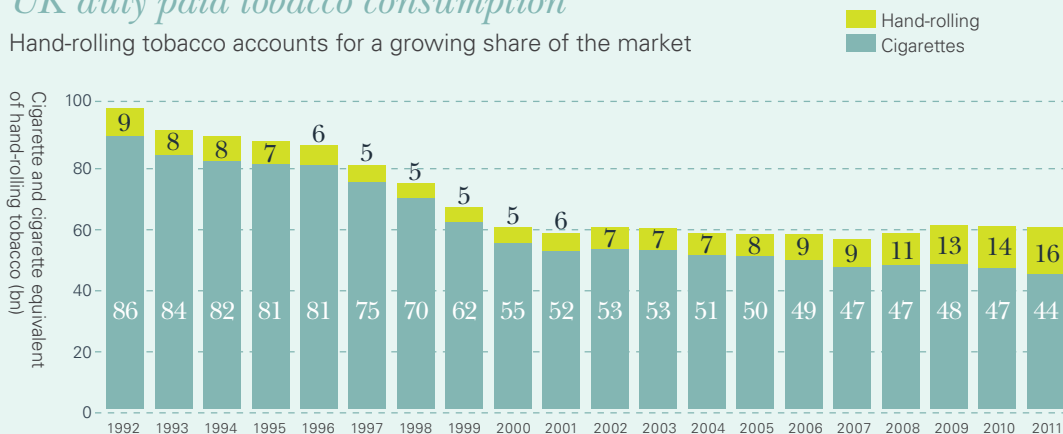


Chart shows JTI's estimates of UK duty paid market, measured by cigarettes and the cigarette equivalent of hand-rolling tobacco. Recent UK market growth is a result of reductions in NUKDP caused by falling rates of travel and the weakness of the pound.

UK tobacco consumption

Non-UK duty paid products account for close to 30% of total consumption

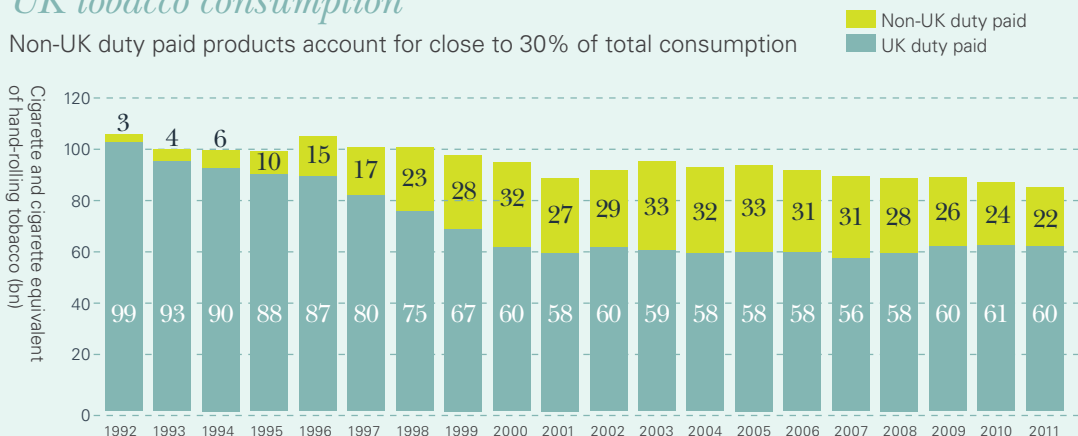


Chart shows JTI's estimates of tobacco consumption measured by cigarettes and the cigarette equivalent of hand-rolling tobacco, from both UK duty paid and non-UK duty paid sources.

03

Non-UK duty paid

What is it and where does it come from?

£10+

*the price difference
between a 50g pouch
of hand-rolling
tobacco in the UK
and Belgium*

76%

*of seizures of counterfeit
cigarettes entering the EU
reported by the Member
States originate in China*

Legal

Under the rules of the European Union (EU), smokers from the UK are entitled to buy and bring back cigarettes and hand-rolling tobacco from another Member State into the UK, as long as it is for their own use. This is generally referred to as cross-border shopping.

In every other EU country, the taxes levied on tobacco products are lower than in the UK, some dramatically so. This is reflected in the price differentials – most notably in the case of hand-rolling tobacco. At the beginning of July, a 50g pouch of a leading brand selling for around £14.50 RRP in the UK was £5.07 in Spain and only £3.94 in Belgium.

The risk of having different tax levels across the EU is clearly stated within the Directive⁸ that sets out the framework for tobacco taxation in the EU. It notes that “convergence between the tax levels applied in Member States would help to reduce fraud and smuggling within the Union”.

Even cheaper tobacco products may be available to those travelling outside the EU, either through a duty-free outlet or the country of destination. However, there is a limit of 200 cigarettes or 250g of hand-rolling tobacco on the amount that can be brought back into the UK.

The UK Border Agency’s guidance⁹ makes it clear that any tobacco products brought back into the UK by a traveller must only be for personal use or used as a gift, they must not be re-sold, even on a not-for-profit basis. They must not be used as a ‘payment’ for a favour, e.g. to thank someone for looking after a pet while the owner is on holiday.



Examples of illicit white cigarette packs

“Organised crime groups based in the EU are increasingly active in cigarette smuggling, seen as an attractive alternative to drug trafficking because of its lower penalties and large profits”. – Europol

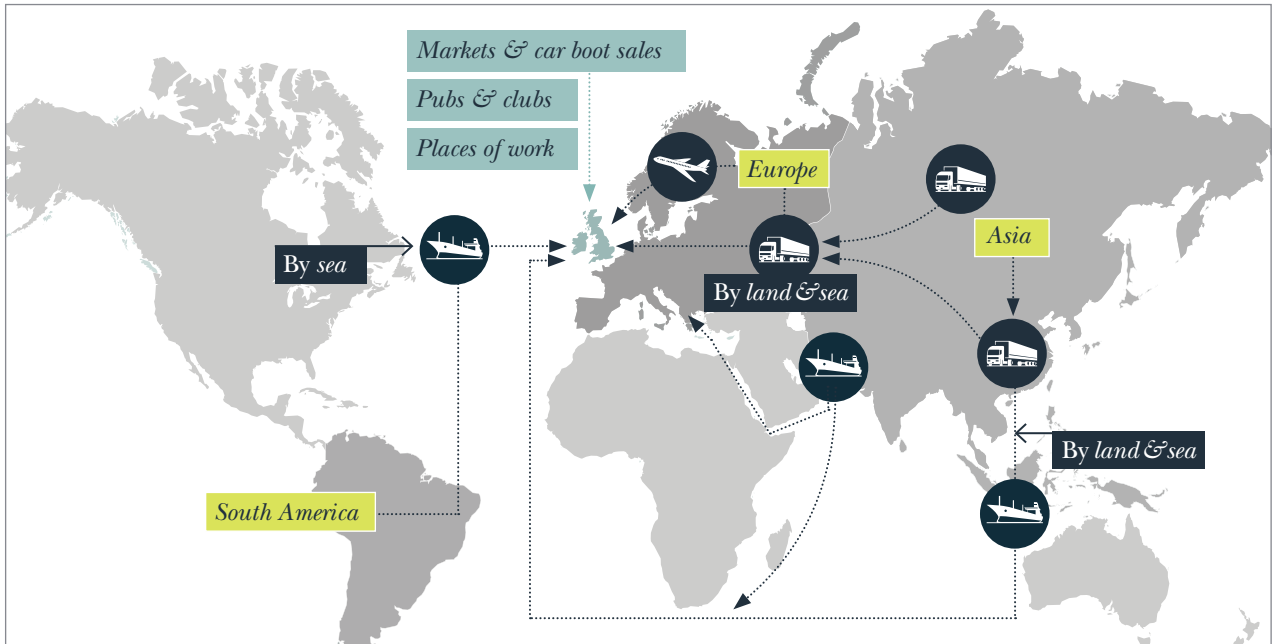
Illegal

For smokers who don't travel abroad, there is a 'black market' in tobacco products across the UK, with prices around half that of genuine products sold in legitimate retail outlets. In this 'black market', smuggled and counterfeit versions of well-known brands are supplemented with 'illicit whites' – products described by the Organised Crime Task Force as being “manufactured for the purpose of smuggling”¹⁰.

Law enforcement agencies in the UK, and around the world, have identified organised criminals as being key players in the tobacco 'black market'. Europol notes that these groups have become “increasingly active in cigarette smuggling, seen as an attractive alternative to drug trafficking because of its lower penalties and large profits”¹¹.

The European Commission has identified China as being a major source of counterfeit cigarettes entering the EU, with 76% of seizures reported by the Member States originating in China¹². Over 90% of cigarette seizures made in 2009/10 by UK authorities were counterfeit or illicit whites. Counterfeit manufacturing has been uncovered across Europe and even in the UK.

Routes to the UK illegal market



1

Source

Illegal tobacco products are sourced from different countries in Asia, South America or cheaper markets in Europe. From here, ready-made cigarettes or loose tobacco and materials are shipped to the UK, and sold on the black market.

2

Transit

Once the cigarettes are available to criminals, they choose different routes to smuggle them into the UK.

Most of the smuggled cigarettes shipped around the world are moved in containers, and when you consider that UK ports alone handle more than 15 million freight movements a year, it can be like looking for a needle in a haystack.

The movement of a consignment of illegal cigarettes can take months to reach its destination and is likely to take a convoluted passage to avoid detection by the authorities.

3

Destination

Most of the illegal cigarettes will evade detection and end up in the target market, through a variety of informal channels: car-boot sales, markets, pubs, clubs, 'tab houses' and people's workplaces.

The evolution of non-UK duty paid

How did it become such a problem?

“The principal cause of the smuggling, of course, is the high level of duty in the UK”. – Taylor Report

HMRC estimates that in 2011/12, up to 19% of cigarette and 50% of hand-rolling tobacco consumption in the UK was NUKDP¹³, with a substantial proportion of this thought to be illegal.

High levels of NUKDP are not a new phenomenon. In the early 1990s it increased from negligible levels, reaching a peak in the early 2000s when close to one-third of cigarettes and three-quarters of hand-rolling tobacco were NUKDP. While it has fallen since then, it remains at a high level.

This rise and fall in NUKDP is closely linked, in the main, to the tax policies employed by successive UK governments towards tobacco products.

The tobacco duty escalator

In 1993, a tobacco duty escalator was introduced with the aim of accelerating the underlying decline in consumption. Under the escalator, there was a commitment to increase tobacco taxes by at least 3% above the rate of inflation in each Budget. In 1997 the escalator was increased to 5% above the rate of inflation and ran until 2000 before being abandoned in 2001.

Over this period, the price of a typical pack of Premium cigarettes went up from £2.41 to £4.17, a real terms increase of 45%. It should have come as little surprise that NUKDP would reach such high levels.

It is also interesting to note that the underlying fall in smoking prevalence halted during the course of the escalator policy, completely the opposite to what was intended.

The Tackling Tobacco Smuggling strategy

To seek to address the problem of NUKDP, the £209 million *Tackling Tobacco Smuggling* strategy was unveiled by the Government in March 2000. This included additional resources for law enforcement (both manpower and equipment), new penalties and an extensive publicity campaign. Separately, but most crucially, the duty escalator was abandoned in favour of keeping future tobacco tax increases in line with inflation.

This strategy was largely based on advice given to the Government by an independent advisor, Martin Taylor, in 1999. Mr Taylor’s advice has only recently been made public¹⁴ and shows that the strategy ‘glossed over’ his key recommendations on taxation levels. His observation that the “principal cause of the smuggling, of course, is the high level of duty in the UK”, is as relevant today as it was then.

Consumers' incentives for NUKDP:

A smoker can save up to 15% of their income by buying NUKDP products

Criminals' incentives for NUKDP:

A single lorry crammed with illegal cigarettes represents a £1.5 million profit to the criminal



The economic crisis and the return of the escalator

The economic crisis that began in 2008 had a major impact on the level of NUKDP. Visits abroad by UK residents fell dramatically from 69.4 million in 2007 to 55.5 million in 2010¹⁵, while the pound lost more than 25% of its value against the euro¹⁶, limiting consumers' purchasing power if they did travel. NUKDP fell over this period.

The benefit of the decline in NUKDP was a growth in the legal UK market for tobacco products, bringing in additional revenues to government and business. It must be stressed that there was no change in the underlying trends in smoking levels, only a change in the source of the products. The Government saw this growth as an opportunity to reintroduce the tobacco duty escalator in 2010.

Since the end of 2009, the price of a typical pack of Premium cigarettes has risen by more than £1.70, almost 30%.

Recently there have been indications that NUKDP has started to rise again. Over the last year, data from the Empty Pack Survey (EPS) has shown cigarette NUKDP rising from 13.8% to 16.4%. This coincides with the tax increases outlined above, an upturn in travel and the renewed strength of the pound, all of which has made NUKDP channels attractive again.

In addition, pressures on household incomes may also make the purchase of illegal NUKDP more likely. An estimate of discretionary income, the amount of money available to spend after accounting for essential items like a mortgage or rent, utility bills, insurance and food, shows a fall of 18% in real terms between the start of 2009 and the end of 2011¹⁷.

Consumers' incentives for NUKDP

While the Government may hope that a fall in income, together with increases in tobacco tax, will encourage smokers to give up, experience from around the world shows they look for cheaper alternatives.

A household containing a typical smoker who chooses a Premium brand bought in a legitimate retail outlet will see 25% of its discretionary income spent on cigarettes. By switching to a lower-priced brand, this would be reduced to 20%.

However, by moving to NUKDP the savings are far more dramatic, with expenditure reduced to around 10% of discretionary income.

Criminals' incentives for NUKDP

With many smokers willing to purchase cheap cigarettes and hand-rolling tobacco, criminals have increasingly become involved in the manufacture, distribution and sale of illegal tobacco products. The reason is simple; a single lorry crammed with illicit cigarettes represents a £1.5 million profit to the criminal, a 'saving' of £2.2 million to smokers and revenue loss to the Government of £2.9 million.

Although severe penalties are provided in the legislation (e.g. up to seven years in prison and unlimited fines), JTI does not believe these are sufficiently applied. Set against the low number of convictions for tobacco fraud (133 in 2010/11) it is little surprise that tobacco is seen by criminals as being "high gain and low risk"¹⁸.

Impact of non-UK duty paid

Government, business and society undermined

Government revenue

HMRC regularly publishes estimates of the scale of excise duty-related fraud in the UK. An analysis of these reports, conducted by the TaxPayers' Alliance (TPA), identified a total revenue loss from fraud related to tobacco, alcohol and oils of up to £28.5 billion since 2007, with tobacco accounting for almost 60% of the total – £16.7 billion¹⁹.

To illustrate that this fraud is not a 'victimless crime' and has an impact on every taxpayer, the TPA estimated that if this revenue had been collected, the basic rate of income tax could have been reduced by 1p.

Business

While 5,700 people are directly employed in the UK by the major tobacco companies – 1,850 of these by JTI – many more jobs in the economy rely on the manufacture, distribution and sale of tobacco products. It is estimated that a further 66,000 jobs in the UK economy are supported by the industry²⁰.

Many of these jobs are in the retail sector, where the sale of tobacco products through 80,000 outlets is a major revenue stream, an important driver of 'footfall' and profit.

NUKDP consumption affects retailers who not only lose out on the profits from the sale of cigarettes and hand-rolling tobacco but, as smokers don't visit their shop, also lose out on profits from the sale of other items.

The Tobacco Retailers Alliance, which represents more than 25,000 independent retailers, conducts an annual survey of its membership to gauge awareness of tobacco smuggling and the impact it has on their business. Results from the 2012 survey show that 47% of respondents were aware of smuggled tobacco being sold in their local area. Smuggling and cross-border shopping were identified as the main reasons for a decline in tobacco sales (63%) and, as a result, 31% of respondents said they had considered reducing the number of staff they employ.

Society

Illegal tobacco provides an opportunity for criminals to sell to children. Legitimate shops have a commitment to a culture of No ID No Sale, supported by UK tobacco companies.

The North of England Tackling Illegal Tobacco for Better Health programme shares our concerns about illegal tobacco being a source for young people, as well as welcoming the diligence of the legitimate retail trade. In its recent guide to tackling illegal trade in the community, it states that illegal sellers of tobacco "often target children and young people who are finding it increasingly difficult to buy under the age of 18 from responsible retailers"²¹.

Research conducted for Trading Standards North West into alcohol and tobacco use among 14 to 17-year-olds found that 50% of respondents had bought cigarettes with foreign health warnings while 28% claimed to have bought fake cigarettes²².

Concerns have been expressed by both Trading Standards and HMRC about the quality of counterfeit tobacco products. One Trading Standards officer has described them as being a product over which there is "no control of what goes into them"²³.

Illegal sellers often target children and young people under the age of 18 who find it increasingly difficult to buy from responsible shops



No ID No Sale
initiatives have helped to reduce the numbers of children being sold tobacco through retail outlets.

£16bn+
revenue lost by tobacco fraud since 2007

50%
of 14 to 17-year-olds illegally bought cigarettes with foreign health warnings

Measuring non-UK duty paid

16.4%

is the level of
NUKDP in
2012



Efforts are made by both the Government and industry to better estimate the level of NUKDP.

While these vary in the absolute level, they all show that NUKDP remains at a very high level.

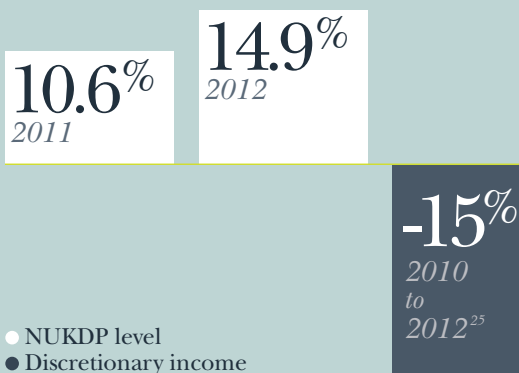
Cigarettes

JTI, together with the other major tobacco companies, commissions extensive research across the EU into levels of non-domestic cigarette consumption through the Empty Pack Survey (EPS).

The UK results for 2012 show a level of NUKDP of 16.4%, up from 13.8% a year earlier. We believe this is a direct result of the massive duty increases in the 2011 and 2012 Budgets and changing economic conditions. The latest research also continues to reveal differences in the level of NUKDP across the country. An analysis of just two of these regions – Northern Ireland and North East England – suggests a link between rising levels of NUKDP and the ongoing economic problems faced by consumers.

Northern Ireland

In its latest annual report²⁴ and threat assessment, the Organised Crime Task Force has identified tobacco fraud as a priority for HM Revenue & Customs in Northern Ireland.



North East England

The North East has long been identified as a region with high levels of NUKDP. The North of England Tackling Illicit Tobacco for Better Health programme stating that it is a "hotspot for illicit tobacco".



Reductions in consumers' spending power may influence behaviour towards NUKDP. It will therefore come as little surprise that those areas where there have been the biggest increases in levels of NUKDP are also those where consumers' discretionary income have fallen the most.

50%

*of hand-rolling
tobacco was
NUKDP in 2011*

Hand-rolling tobacco

In addition to our work with the other major tobacco companies through EPS, JTI conducts its own research into levels of NUKDP hand-rolling tobacco consumption.

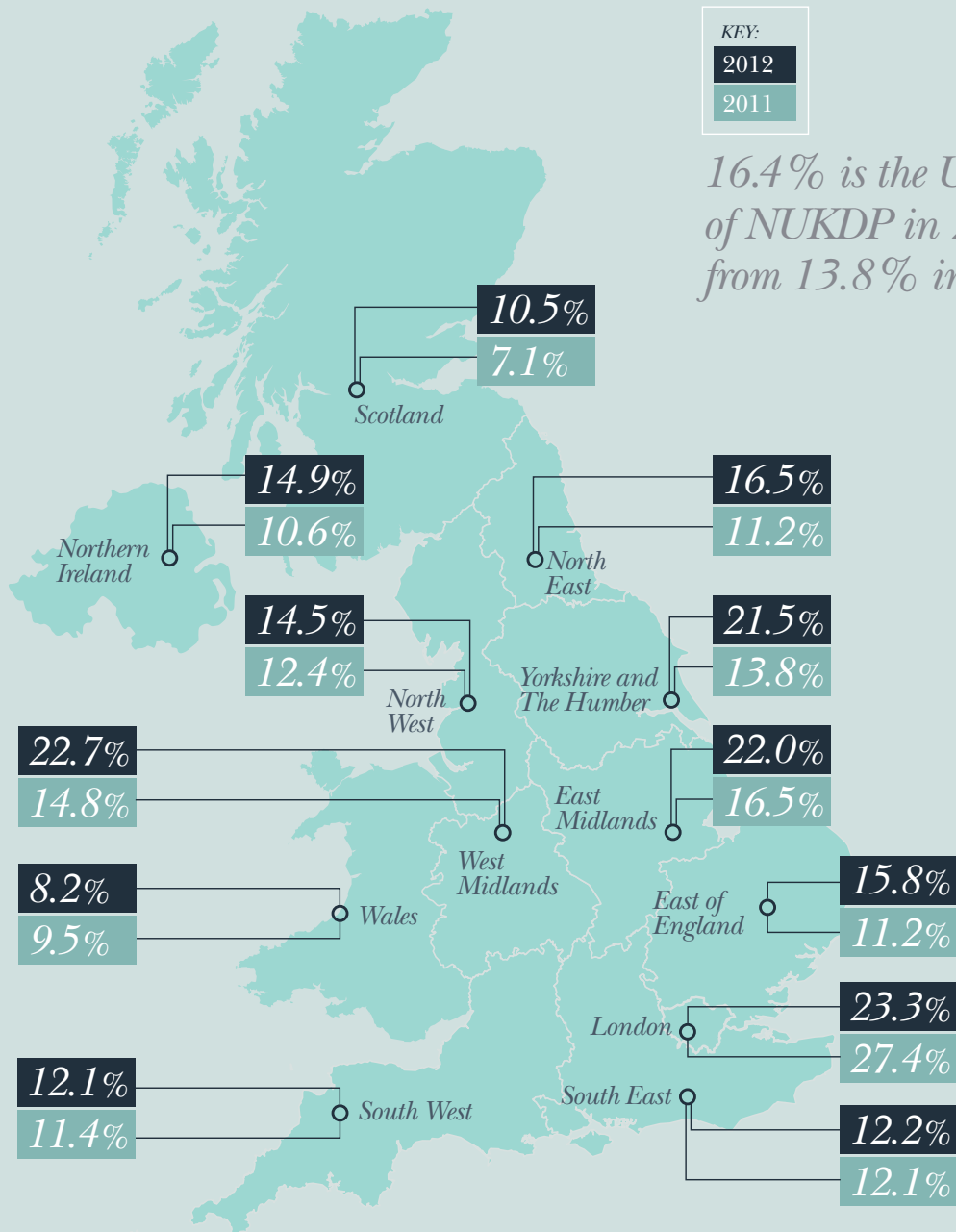
For 2011, we estimate that 50% of hand-rolling tobacco was NUKDP, broadly in line with HMRC's estimate of 50% for 2010/11. It is interesting to note that the regions with the highest rates of growth in cigarette NUKDP observed in the EPS also have a very high level of hand-rolling tobacco NUKDP, 69% in the case of the North East.

NUKDP's effect on overall consumption

To see the full impact of NUKDP hand-rolling tobacco on overall consumption, it needs to be converted into a cigarette equivalent. This is consistent with the Government's view that a cigarette smoker is someone who smokes ready-made or hand-rolled cigarettes. The typical UK hand-rolling tobacco smoker uses 0.4g of tobacco in each cigarette.

*We estimate
that the NUKDP
hand-rolling tobacco
volume was the
equivalent of 16
billion cigarettes.
For 2011 we estimate
that 27% of total
tobacco consumption
was NUKDP.*

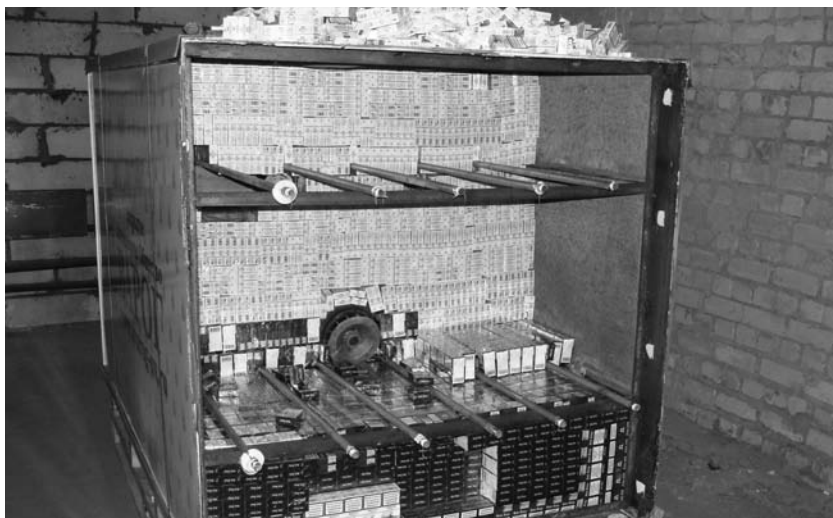
Regional levels of cigarette non-UK duty paid



Source: Empty Pack Survey

Tackling the illegal trade

Cooperation is essential



JTI is active in supporting law enforcement agencies across the UK in tackling the illegal sale of tobacco products.

Securing our products and our supply chain

We strive to ensure that our products are not illegally moved from one market to another. We have stringent 'Know Your Customer' programmes ensuring that products are sold in quantities consistent with legitimate demand. As part of JTI's 'track and trace' programme, our products bear identifying codes to assist us in determining where any seized products have been diverted from legal channels.

Developing global and local partnerships

The UK, alongside the other EU Member States, is a signatory to JTI's Agreement with the European Commission, which has established ongoing cooperation to combat the illegal sale and distribution of tobacco throughout Europe. At the time of signing the Agreement, the UK Government said it was "an important new element in the fight against tobacco smuggling", and that the Government was "determined to continue working with tobacco manufacturers to tackle smuggling"²⁶.

JTI is a partner in the UK Government's *Tackling Tobacco Smuggling* strategy, contributing to a joint working group that is developing a shared and improved understanding of the illegal tobacco market.

At a local level, we assist Trading Standards, who have a vital role in policing the retail environment, prosecuting those who are involved in the sale of illegal products. We educate our retail customers to provide law enforcement agencies with any information they may have about the illegal sale of tobacco, which, in turn, will protect their business.

JTI's Anti-Illicit Trade Operations team undertakes test purchasing and other investigations to provide law enforcement agencies with information to enable seizures and prosecutions.

Identifying changing trends

The World Customs Organization recognises that the criminals involved in the illegal tobacco trade "continuously develop more sophisticated smuggling techniques"²⁷.

Therefore, in JTI's view, it is vital that information is shared by industry and law enforcement agencies to ensure each side is fully aware of the changing trends. This is demonstrated by recent experiences in the UK.

Traditionally, finished cigarettes and hand-rolling tobacco have been favoured by criminals for smuggling into the UK. However, in attempting to reduce the risks of having valuable finished products seized, some are now smuggling the component parts in separate consignments for assembly within the UK.

Over the past year close to 1 million counterfeit hand-rolling tobacco pouches bearing JTI trademarks have been seized in the UK. Separately, large quantities of processed and semi-processed tobacco have also been seized. These were destined to be 'married up' with the counterfeit pouches for assembly before being sold on the 'black market'.

The viability of this 'business model' was clearly demonstrated following the arrest of nine people on suspicion of their involvement in a £6 million-a-year fraud involving the manufacture of counterfeit hand-rolling tobacco²⁸.

The manufacture of counterfeit hand-rolling tobacco is relatively simple. However, the more complex requirements of illegal cigarette production have not prevented criminals from attempting this in the UK.

In January of this year, a gang was successfully prosecuted following the discovery of a fully equipped cigarette factory in Chesterfield, capable of producing 625 million cigarettes a year²⁹ – that's more than 3 times the volume sold by all the supermarkets in the area in 2011.

This was not the first case of its type in the UK and it is unlikely to be the last. Earlier this year a consignment of counterfeit JTI cigarette packaging was seized from a lorry arriving at Dover, indicating that at least one illegal cigarette manufacturing factory may still be in operation somewhere in the UK.

Future threats

Government initiatives intended to reduce smoking will ultimately encourage more NUKDP

Leaving aside the Government's tobacco taxation policy, other initiatives intended to reduce smoking, particularly among young people, could unwittingly encourage NUKDP.

Display Ban

A ban on the display of tobacco products in the UK started to come into effect in April 2012, with a full ban anticipated by the end of 2015. Any impact of these display bans will not be known for many years, either in terms of reducing youth smoking or the potential increase in illegal NUKDP, yet the Government has recently undertaken a consultation on plain or standardised packaging.

Plain Packaging

JTI believes that plain packaging amounts to commercial vandalism and we have serious concerns around illegal trade and ultimately its impact on retailers.

Alongside our submission to the Government's consultation in July 2012, we included a report from Professor Chaudhry and Professor Zimmerman³⁰, who specifically analysed the potential impact of plain packaging on the illegal trade in tobacco products.

The Professors found that "Plain packaging will allow the illicit traders to provide counterfeit cigarettes using the mandated plain packaging specified by national legislation" and it "may also encourage new entrants to the lucrative business of counterfeiting cigarette packs since the costs and barriers of getting into this business will be reduced".

They also noted that current packaging "acts as a deterrent to counterfeiters of tobacco products since keeping up with the evolving packaging of genuine product is an expensive and time-consuming process". Plain packaging significantly lowers the level of technical expertise and costs required to counterfeit tobacco products and their packaging.

In their expert opinion, the Professors state that "plain packaging is highly likely to aggravate the existing negative impacts of the already serious and socially damaging trade in illicit tobacco. Since illicit products are often more accessible to those underage and those from low-income groups, plain pack laws risk undermining a key objective of plain packaging: to reduce smoking by these groups".

A senior HMRC official has also expressed concerns about the threat of plain packaging, saying that "the obvious danger from our point of view is that the ability to detect counterfeit or illicit material would be made more difficult by a system where there was no difference between one packet and another"³¹.

Think about it:

If you were a criminal – a cigarette smuggler – what would be on your wish list?

You'd target a country with high taxes and prices; the higher, the better, as your illegal products will be cheaper, a lot cheaper. That is already the case in the UK.

1

With no taxes to pay to government, limited manufacturing costs or investments to make in your business, you'd welcome a display ban. The boot of your car or a stall at an open market becomes the new tobacco 'kiosk'.

2

The 'icing on the cake': plain packaging. Because copying and printing the pack is one of the most expensive parts of the counterfeiting operation, the less you have to invest, the more money you'll make.

3



An illustration of an Australian plain pack

Our recommendations

In our 2010 report, we put forward ideas based on our experiences from around the world and our analysis of the problems facing the UK, which would help to reduce NUKDP. We are pleased to see that some of these have been taken into consideration and acted upon.

JTI recommended that the indicative allowances for travellers returning from other EU Member States to the UK should be reduced to help law enforcement more easily distinguish between legal and illegal imports of NUKDP. This occurred in October 2011 with indicative allowances reduced from 3,200 to 800 cigarettes and 3kg to 1kg in the case of hand-rolling tobacco.

We called for additional funding of enforcement agencies to provide them with the tools needed to support the effort against NUKDP tobacco. Shortly after the publication of our report, a commitment was given by the Government to provide an additional £900 million to HM Revenue & Customs to tackle fraud in all its forms, including tobacco-related fraud.

We expressed concern that tobacco smuggling was seen as a 'soft touch'. We are therefore pleased that new civil penalties are coming into effect that will see criminals stripped of their products, forced to pay the evaded taxes and also be liable for a fine.

However, there is more that must be done.

Better regulation

The concept of standardised packaging must be dismissed. It will not have the intended effect of reducing youth smoking and will only increase NUKDP.

Sustainable taxation

The primary driver of NUKDP is the high level of tax on tobacco products in the UK. While this is seen by some as a tool to reduce consumption, experience shows that it is counterproductive.

Tobacco taxes should be set at a level that does not result in high levels of NUKDP. Cigarette taxes have already increased by more than £1 per pack since our last report and are set to rise further. Given we have already seen an increase in NUKDP consumption, we question the wisdom of this policy.

“People need to know that trading in or possession of contraband tobacco is an offence and they need to see that the authorities are treating it as such. Impunity breeds contempt for the law”. – Taylor Report

Effective enforcement

The latest *Tackling Tobacco Smuggling* strategy document sets out 11 'hard-hitting sanctions' available to penalise criminals. However, last year only 133 people were sentenced for tobacco-related fraud. In relation to the rewards available, it is unlikely this acts as a deterrent. While the use of new civil penalties is very welcome, steps should be taken to prosecute more of those involved and to ensure that the severity of sanctions reflect the crime.

More dialogue

The future *Protocol on Illicit Trade in Tobacco Products* recently agreed by the World Health Organization is seen by some as an ultimate solution in fighting tobacco smuggling.

While the intention is good, it is clear that some of its supporters do not believe the tobacco companies should share their knowledge and experience in tackling this problem. It will be a wasted opportunity if governments around the world do not learn from the successful partnerships we have enjoyed with national enforcement agencies.

Greater awareness

Explaining to smokers that cheap tobacco isn't a bargain is difficult, but highlighting the wider impact of NUKDP on under-age smoking is very important.

10

JTI's presence in the UK

Manchester

Business Service Centre (BSC)
around 200 employees

Lisnafillan

JTI Manufacturing Facilities
around 940 employees

Crewe

National Distribution Centre
120 employees

Weybridge

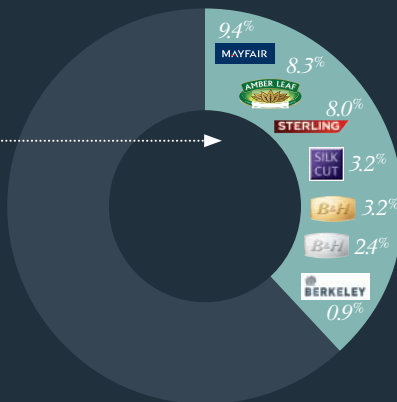
JTI UK Headquarters
around 350 employees

● Field Sales force

*Tobacco market share
in the UK:*

38.3%

*Is our share of the
market in the UK¹²*



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3. HMRC press release – ‘Top tax cheats put in the frame’, 16 August 2012
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All information contained in this report was correct at time of going to press.
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