

EXPLANATORY MEMORANDUM TO
THE EXCISE GOODS (DRAWBACK) (AMENDMENT) REGULATIONS 2009

2009 No. 1023

1. This explanatory memorandum has been prepared by H M Revenue and Customs and is laid before Parliament by command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations amend the Excise Goods (Drawback) Regulations 1995 (SI 1995/1046). There are two distinct changes:

(i) they withdraw entitlement to drawback for alcoholic liquors under the warehousing for export arrangements. "Alcoholic liquors" means the alcoholic liquors that are chargeable with duty under the Alcoholic Liquor Duties Act 1979;

(ii) they also introduce a technical amendment, bringing them into line with other areas of excise law allowing the Commissioners of HM Revenue & Customs to recover, by power of assessment, payments of drawback made by them in circumstances where it is subsequently found that a condition of the claim was contravened. The use of this power will be an appealable matter.

2.2 The drawback system allows for the repayment of excise duty paid on goods that have not and will not be consumed in the UK. It is only UK duty paid excise goods which have been warehoused for export, exported or destroyed that are eligible for drawback. Claims can only be made by a revenue trader who exports or destroys goods in the course of his business and who is responsible for the conditions of the claim being met.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None

4. Legislative Context

4.1 Section 133 of the Customs and Excise Management Act 1979 and Section 2 of the Finance (No 2) Act 1992 (as amended) provide for drawback of excise duty.

4.2 Section 2(2)(c) of the Finance (No.2) Act 1992 (c.48) provides the Commissioners with the power to make different provisions for different duties and different goods.

4.3 Section 2(3A) of the Finance (No.2) Act 1992 (c.48) provides that if entitlement to drawback is cancelled under any provision contained in regulations made under section 2 the Commissioners may assess as being excise duty due from a prescribed person, an amount equal to sums paid or credited to any person in respect of the drawback.

4.4 Section 2(3B) of the Finance (No2) Act 1992 provides that a “prescribed person” is a person as may be prescribed by regulations made under section 2¹.

4.5 Regulation 5 of the Excise Goods (Drawback) Regulations 1995 provides that drawback may only be made in relation to eligible goods. It specifies that goods are eligible if the duty has been paid and has not been remitted, repaid or drawn back and the goods have been: exported, warehoused for export, or destroyed.

4.6 These regulations amend regulation 5 withdrawing entitlement to drawback for alcoholic liquors that become warehoused for export on or after 1st June 2009.

4.7 Regulation 13 of the Excise Goods (Drawback) Regulations 1995 provides for the cancellation of drawback, by the Commissioners, where they are satisfied that any condition, on which the entitlement of drawback is dependent, has been contravened.

4.8 These Regulations amend regulation 13 to prescribe the person who may be assessed under section 2(3A) where drawback is cancelled under the regulation.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- *What is being done and why*

- (i) Warehousing for export

- 7.1 This regulation forms part of the tackling alcohol fraud measures to be announced at Budget 2009. Previously the Commissioners have allowed businesses to claim drawback (repayment of duty) on duty paid alcoholic liquor that is warehoused for export (WFE). Repayments relating to beer WFE have more than doubled (from £21m to £53m) when compared with last year. The Commissioners

¹ Section 2(3A) and (3B) were inserted by paragraph 6 of Schedule 2 to the Finance Act 1998 from an appointed day. For the purposes of assessments in respect of drawback of excise duty to which entitlement is cancelled under provisions contained in the Cider and Perry Regulations 1989 (S.I. 1989/1355), the Wine and Made-wine Regulations 1989 (S.I. 1989/1356) and the Beer Regulations 1993 (S.I.1993/1228), the appointed day is 1st September 2008 (see S.I. 2008/2302 (C.102)). For the purposes of assessments in respect of drawback of excise duty to which entitlement is cancelled under any provision contained in any other regulations made under section 2 of the Finance (No.2) Act 1992, the appointed day is 1st June 2009 (see S.I. 2009/1022(C.59)).

believe these increases are connected to fraud. WFE is particularly susceptible to abuse. In 2007 the Commissioners tightened up the evidential requirements for claiming drawback. However, as that action has not been effective they have now decided to abolish WFE for alcoholic liquors and this instrument gives effect to that.

(ii) Recovery of drawback 'overpaid'

7.2 Previously the Commissioners have used the provisions in the Excise Goods (Drawback) Regulations 1995 to recover payments, by demand, of drawback in cases where drawback is cancelled because of a contravention of a condition to which it is subject. The amendments made by this instrument enable the Commissioner to assess a prescribed person for the repayment. By replacing the power to demand payment with a power to assess the right to require a review of an assessment and the right to appeal to the First-tier Tax Tribunal will apply.

- ***Consolidation***

7.3 There are no current plans to consolidate the Excise Goods (Drawback) Regulations 1995.

8. Consultation

8.1 The industry was consulted in June 2006 on reforming drawback arrangements to counter the threat of fraud. Following this consultation the Commissioners tightened up the evidential requirements for claims but kept open the option of withdrawing entitlement to claim drawback where goods are WFE. Further consultation on this measure is therefore not necessary.

8.2 No consultation was considered necessary in relation to the provision replacing the power to make a demand with a power to assess for the recovery of excise duty where there has been a breach of a condition to which a claim for drawback was subject. This is a technical amendment and the new power to assess has the added attraction of being an appealable matter which is not the case with the power to demand.

9. Guidance

9.1 The Commissioners intend to publicise the changes by way of a Budget Notice.

9.2 The Regulation will not affect the procedures for making and notifying assessments.

10. Impact

10.1 An Impact Assessment has been completed for the withdrawal of the entitlement to claim drawback on alcoholic liquors WFE and is attached to this memorandum.

10.2 An Impact Assessment has not been produced for the replacement of the power to make a demand with a power to assess as that provision has no impact on business, charities or voluntary bodies.

10.3 The impact on the public sector is nil.

11. Regulating small business

The legislation applies to small business.

12. Monitoring and Review

We intend to review the effectiveness of the measure within two years of the changes taking effect.

13. Contact

Bob Wales at HM Revenue and Customs Tel: 0161 827 0356 or email:
bob.wales@hmrc.gsi.gov.uk can answer any queries regarding the instrument.

Summary: Intervention & Options

Department /Agency: HM Revenue and Customs	Title: Impact Assessment of withdrawing warehousing for export for claimants of Drawback	
Stage: Final Proposal	Version: 1.0	Date: 22 April 2009
Related Publications: Excise News 02/07 & customs.hmrc.gov.uk/channelsPortalW ,		

Available to view or download at:

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

Contact for enquiries: Bob Wales

Telephone: 0161 827 0356

What is the problem under consideration? Why is government intervention necessary?

Drawback allows businesses to claim repayment of excise duty on 'duty paid' alcohol that they destroy, export or warehouse for export (WFE). Repayments relating to beer WFE have more than doubled (from £21m to £53m) over the past year and there is no obvious commercial rationale to explain this. There is evidence that WFE is linked to alcohol fraud.

What are the policy objectives and the intended effects?

The objectives and intended effects of the measure are:

1. to have an immediate and substantial impact on fraud including the risk of claims being made on non-eligible goods and the onward diversion of WFE goods re-entered into the duty suspension system
2. to reduce unfair competition in the SME wholesale sector
3. to contribute to the reduction of losses from alcohol fraud.

What policy options have been considered? Please justify any preferred option.

1. Withdrawal of warehousing for export (the preferred option). We believe this will immediately and substantially reduce drawback-related fraud.
2. Requiring original duty payment document to be presented with claims to drawback as evidence that duty was paid on the goods in the first place.
3. Tightening up alternative (ie other than the original duty payment document) evidential requirements of duty payment.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

Within two years of the changes being introduced.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments::

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



Date: 06/04/2009

Summary: Analysis & Evidence

Policy Option: Policy Option 1	Description: Withdrawal of warehousing for export
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Delay in receipt of drawback due to need to wait for confirmation of export. Increased administrative burden of direct export process. One off costs of changing business model are likely to be low because 75% of business affected already use direct export for some claims and only around 50 businesses are affected.			
	One-off (Transition) Yrs				
	£ Low				
	Average Annual Cost (excluding one-off)			Total Cost (PV)	£ 0.19m
	£ 0.04m				
Other key non-monetised costs by 'main affected groups' HMRC does not expect any additional operational costs. The one off costs to change business operating systems are not quantifiable because no businesses provided estimates in response to the 2006 consultation exercise.					

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups'			
	One-off Yrs				
	£ Not quantifiable				
	Average Annual Benefit (excluding one-off)			Total Benefit (PV)	£ Not quantifiable
	£ Not quantifiable				
Other key non-monetised benefits by 'main affected groups' Protection of legitimate wholesale and retail sector from unfair competition as a result of undutied beer. The retail value of trade expected to transfer to legitimate traders is £60m in the first year, reducing to £30m a year thereafter.					

Key Assumptions/Sensitivities/Risks This measure is expected to increase the amount of duty collected by £20m in 09/10 and £10m pa thereafter. The PV is based on a 5 year period and discount rate of 3.5% and does not include one off costs. A 3.5% interest rate has been applied to estimate the cash flow cost.

Price Base Year 2009	Time Period Years 5	Net Benefit Range (NPV) £ Likely to exceed costs	NET BENEFIT (NPV Best estimate) £ Likely to exceed costs
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What is the geographic coverage of the policy/option?	United Kingdom			
On what date will the policy be implemented?	1 st June 2009			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ None			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ N/A			
What is the value of changes in greenhouse gas emissions?	£ None			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro 900	Small 900	Medium 900	Large 900
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ 8,000	Decrease of	£ 5,500
		Net Impact	£ 2,500

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

The issue

1. The drawback system allows businesses to claim repayment of excise duty on duty paid alcohol that they destroy, export or warehouse for export (WFE). The largest proportion of repayments relates to beer WFE and in the past year there has been a sharp increase, with claims more than doubling (from £21m to £53m) compared with the same period last year. We believe these increases are substantially linked to fraud, and that duty losses may well be as high as £25m in 08/09 – of a projected £70m duty we expect will be claimed on all alcohol intended for export. In the absence of a robust regulatory response to this threat, it is feared losses may rise as high as £40m in 2009/10. The fraud itself bears some of the hallmarks of VAT MTIC fraud, with claimants sourcing alcohol from lengthy complex supply chains containing occasional missing traders. This has hampered HMRC's ability to establish the eligibility of goods for drawback.
2. We consulted formally with businesses on reform of the drawback regime in 2006 and in particular on withdrawing WFE ([a summary of the responses to this consultation is available on the HMRC website](#)). We were eventually persuaded, at that time, by arguments that fraud-related problems could be contained by applying more rigorous evidence of UK duty payment. However, we undertook to continue to monitor the drawback system closely and stated, in supporting documents published at Budget 2007, that options for further reform would remain under review, including abolishing the WFE provisions.
3. After a measure of initial success, the changes we made proved to be ineffective as fraudsters found ways to circumvent the more rigorous evidence requirements. We have therefore concluded that, in its present form, the drawback system is inherently risky and the only way that we can make a real impact on drawback-related fraud is through regulatory change, the aim of which is to design out two risks that the WFE system presents:
 - (i) claims for drawback on goods that were never duty paid in the first place; and
 - (ii) the re-entry – via WFE – of goods into the duty suspension system that are later diverted onto the UK market without payment of duty.

4. In line with what we said in 2007, we believe it is now necessary to go ahead and remove the WFE provisions. As an alternative, businesses will be able to use the 'direct export' drawback scheme where UK duty is repaid only after evidence of duty payment in another EU Member State. We acknowledge that this will place certain additional requirements on businesses that were brought to our attention in the 2006 consultation exercise. In response to this, where possible, HMRC will work with legitimate businesses to make the operation of the direct export scheme as straightforward as possible.

Policy objectives and intended effects

5. The proposed measure will:

- ◆ have an immediate and substantial impact on the frauds described above
- ◆ contribute to the reduction of the tax gap
- ◆ reduce unfair competition for those businesses currently competing with the illicit market, thus creating a more level playing field
- ◆ streamline the processing of claims to the benefit of both legitimate claimants (who should receive a more prompt and tailored service) and HMRC (enabling processing, assurance and enforcement resources to be redeployed on higher impact activities).

Options

6. **Option 1 - Withdrawal of warehousing for export.** This is our preferred option which we believe will meet the objectives and have the intended effects set out above.
7. **Option 2 – Presentation of original duty payment document with claim.** This option could only seek to address the first risk identified in para 3 above: claims to drawback on goods that were never duty paid in the first place. It would not address the risk of goods re-entering the duty suspension system (via WFE) and later being diverted onto the UK market without payment of duty. Also, we considered that there would be a high risk of successful legal challenge to this course of action under EU law - Council Directive 92/12 (on the general arrangements for the holding, movement and monitoring of products subject to excise duty) – which states that Member States authorities cannot refuse repayment solely on the grounds of non-production of the document certifying

that the initial payment has been made. There would also be issues of commercial confidentiality in businesses providing original duty payment documents and a potentially high risk of fraud in organisations providing or producing forged or duplicate documents.

8. **Option 3 – Tightening evidential requirements.** We tried this approach following consultation in 2006. Although initially successful, this measure proved to be ineffective as, we believe, fraudsters quickly found a way of circumventing our controls by providing manufactured evidence in support of non-eligible claims. Also, discrediting suspect claims involves complex and intensive supply chain audits and with claim numbers and values increasing it is becoming increasingly difficult to justify the disproportionate level of resources required to undertake this work.

- Claim numbers have risen from 3874 in 2007/08 to over 5000 in 08/09.
- There are 565 WFE claims currently on hand pending litigation/investigation with a combined value of £8.3 million.
- At any given time, up to 20 staff can be tied up on this work (in policy, processing, assurance, enforcement and legal services).

Costs and Benefits and Impacts

9. Our analysis shows that the value of beer WFE claims from SMEs between May 2006 and October 2006 was £18m. After we introduced stricter controls, this figure, for the same period in 2007, declined to £8m. In 2008, claims for the same period rose to £21m. Other alcohol drawback claims remained steady over the period.

10. The above analysis, together with operational evidence, suggests that the higher levels of WFE beer drawback claims before May 2007 and after October 2007 are linked to fraud. There has been little of evidence of any upward trend or seasonal effects for other drawback claims. HMRC impact estimates are therefore based on the following assumptions.

- ◆ The average monthly level of beer WFE drawback claims by SMEs for the period May 2007 to October 2007 represents the legitimate business need for beer WFE drawback from SMEs.
- ◆ All drawback claims other than beer WFE claims by SMEs are legitimate.

- ◆ If the measure is introduced, all businesses making legitimate WFE claims will continue to make the same average monthly number and value of claims using the direct export drawback regime.
11. Under the above assumptions, around 2000 claims from 50 businesses would be affected with the total value of these claims being around £30m. HMRC considers the above assumptions are more likely to overestimate the level of legitimate WFE drawback claims than to underestimate it.
12. The value of claims for WFE drawback that are linked to fraud is estimated by subtracting total beer WFE drawback in 2008/9 from the estimated level of legitimate WFE drawback claims. This gives rise to an estimated loss of duty revenue in 2008/9 of £25m. Trends indicate that this would be likely to rise to £30m in 2009/10 if no action is taken. Not all of the £30m potential revenue loss would result in additional revenue collected by HMRC, because there would be a degree of displacement to other types of fraud and the higher price of duty paid alcohol would reduce consumption to an extent. After allowing for these factors, HMRC estimates that excise duty receipts will be £20m higher than forecast in 2009/10 if the measure is introduced with these savings forecast to fall to £10m thereafter. HMRC estimates that an additional £5m of revenue per annum would be at risk due to increases in WFE drawback fraud from 2009/10 onwards if no action is taken.

Costs

13. HMRC has identified the following costs to legitimate trade.
- ◆ Additional administrative burden of direct export drawback claims compared to WFE.
 - ◆ Delays in receipt of payment for the claim due to the requirement of proof of export and foreign duty payment.
 - ◆ One off costs of changing business operating systems.
14. The above costs were identified through the consultation exercise. No other significant costs were identified.
15. HMRC has estimated the additional administrative burden using its standard cost model which provides estimates of the costs to business associated with its administrative processes. The net additional annual administration cost associated

with the change to direct export drawback for legitimate claims is estimated to be around £3000 at current prices.

16. The estimated cash flow costs assume a delay of 14 days and annual interest rate of 3.5%. This gives rise to an estimated annual loss of interest of £43,000 on legitimate claims (£30m).
17. Together these give rise to an estimated total annual on-going cost of £0.04m.
18. HMRC has been unable to quantify one off costs of changing business operating systems because the consultation responses provided no quantitative information on which to base these estimates. However HMRC expects these to be low because 75% of those businesses who currently make use of WFE drawback already also use the direct drawback regime and the total number of businesses affected is small (around 50).

Benefits

19. HMRC expects there to be benefits to the legitimate retail and wholesale sector as a result of the reduction in unfair competition from those currently trading in non-UK duty paid beer. The estimated revenue savings would translate into an increase in legitimate trade to the retail value of around £60m. However the complex nature of the supply chain both for legitimate and fraudulent trade in alcohol means that it is not possible to quantify the net benefits to these sectors.

Geographic coverage

20. The measure will apply to all revenue traders eligible to claim drawback in the UK.

Caveats and Risks

21. There remains a risk (over time) that criminal gangs could adapt and establish new networks / warehouses in other Member States to legitimise movements through the alternative 'direct export' drawback scheme, where UK duty is repaid only after evidence of duty payment in another member state is provided, and that fraudulent repayment levels may rise. But the 'direct export' system is inherently more secure and it will be more difficult for the would-be fraudster to abuse that system. But we shall be monitoring the position very closely and keeping it under review.

Specific Impact tests:

Competition assessment/ Small firms Impact test

22. The main beneficiaries of these changes will be SME UK wholesalers and retailers trading legitimately in the UK market. It should reduce unfair competition for those businesses currently competing with black market traders thus creating a level playing field. We estimate that the retail value of trade expected to transfer to legitimate businesses will be £60 million in the first year.
23. For legitimate businesses currently operating WFE there will be an impact but we judge that this will be marginal for most businesses for which WFE is not a core business activity. As an alternative, businesses will be able to use the 'direct export' drawback scheme where UK duty is repaid only after evidence of duty payment in another member state. Although inherently more secure from a revenue point, this system does place certain additional requirements on businesses. HMRC will work with them, taking a pragmatic approach, to make it as simple to work as possible.

Legal Aid

24. This does not apply as the measure does not impose new criminal sanctions or civil penalties.

Sustainable Development

25. This is primarily an anti-fraud measure, it is intended to close the tax gap and reduce the number of illicit products on our streets as such it will support the legitimate alcohol wholesale sector who will be able to better compete in the market place.

Carbon Assessment/other environment

26. This measure will have a negligible impact on carbon/ environment or other green issues.

Health

27. This measure will have a negligible impact on health issues.

Race Equality/Gender Equality

28. This measure is race and gender neutral

Human Rights

29. We believe this does not directly impact on HRA.

Rural Proofing

30. This measure will have no impact on rural areas.

Monitoring and evaluation

31. We intend to monitor the effectiveness of the measure and the impact it has on the sector affected within two years of the changes taking effect.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No