



Combating Fake, Counterfeit, and Contraband Alcohol Challenges in the United Kingdom through the Alcohol Wholesaler Registration Scheme (AWRS)

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September 2017

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This study was supported by a grant from the Center for Alcohol Policy, Alexandria, Virginia, a section 501(c)(3) organization, established by the National Beer Wholesalers Association for the purposes of exploring, researching and expanding education on alcohol regulation. However, the views expressed in this study are solely those of the author and are not intended to represent the views of the Center for Alcohol Policy or the National Beer Wholesalers Association.

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Observations in this paper are drawn from my research as well as my informal and general discussions with HM Revenue and Customs, British Beer and Pub Association, Wine and Spirits Trade Association, and the Portman Group in the United Kingdom in April 2017. These observations reflect the views of the author alone and should not be interpreted as reflecting the official views of any of the aforementioned organizations.

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Introduction:

“Fake alcohol” causes immeasurable public and personal health costs, results in huge revenue losses for countries, undermines consumer confidence and protection, and poses marketing challenges to the lawful alcohol beverage industry. Fake alcohol encompasses surrogate alcohol where industrial alcohol is illegally put to a commercial beverage use; counterfeit alcohol where bottled products bear false labels of well-known brand names or look-alike brand names; and contraband alcohol where product is smuggled or illegally distributed in a country. The United States Department of State issued a travel warning in July 2017 over Mexico’s counterfeit, adulterated or fake alcohol situation.¹ My 2014 study entitled, “*The ‘Fake Alcohol’ Situation in the United States: The Impact of Culture, Market Economics, and the Current Regulatory Systems*,”² funded by the Center for Alcohol Policy examined this problem in countries around the world having significant incidents of fake alcohol compared with the United States, where fewer incidents are reported. The study identified three fundamental factors for these fewer incidents in the United States: First, there is a strong cultural respect for the rule of law and lack of corruption in governance. Second, there exists a strong regulatory system that polices the production, importation, distribution and retail sales of alcohol beverages through independent parties. The regulatory system is a reasonable fit given the maturity and character of the alcohol industry in the United States. Checks and balances exist at both the government and multiple industry tier levels that would identify fake alcohol products. This controlled and closed distribution system mitigates and generally prevents the introduction of fake alcohol products. Finally, the United States has a competitive marketplace that provides alcohol beverages at all price points thereby negating the demand for fake alcohol.

The 2014 study summarized a large number of instances of fake alcohol in the United Kingdom of Great Britain and Northern Ireland. The comparison with the United States was noteworthy because the United Kingdom and the United States share many cultural values, such as respect for the rule of law and lack of corruption in governance, and have strong competitive free marketplaces. Both countries share diversity in population makeup. This leaves for examination the factor of strong regulatory systems in the distribution of alcohol. In particular, there was a trend for deregulation in the United Kingdom for the past several decades.³

At the time of the 2014 study, the United Kingdom was considering the adoption of a regulated alcohol wholesaler system to address the estimated £1.2 billion [\$1.5 billion] annually lost in duty and VAT by alcohol fraud. The development of public policy to combat alcohol fraud dates from a comprehensive report in 1997-98. In this present stage of that debate, the United

¹ <http://www.jsonline.com/story/news/investigations/2017/07/26/u-s-state-department-issues-travel-warning-tainted-alcohol-mexico-resorts-after-tourists-blackouts/513563001/>

² http://www.centerforalcoholpolicy.org/wp-content/uploads/2015/04/The_Fake_Alcohol_Situation_in_the_United-States_compressed.pdf

³ Pamela S. Erikson, *The Dangers of Alcohol Deregulation: The UK Experience 2016 Update* to a report issued originally in 2009. <http://healthyalcoholmarket.com/pdf/UKUpdate2016.pdf>

Kingdom has adopted the Alcohol Wholesaler Registration Scheme (AWRS), which is now completely implemented by Her Majesty's Revenue and Customs (HMRC). The adoption of the AWRS recognizes the significant role of wholesalers in the distribution of alcohol in the UK. AWRS requires UK businesses selling alcohol to other persons for resale to register with HMRC. These are "trade buyers." Businesses buying from an unregistered wholesaler and wholesaler businesses failing to register are subject to monetary penalties, imprisonment and forfeiture of the alcohol. Overall, prior to the point of excise duty payment, the UK had regulatory controls in place. Similarly, retailers held local licenses. Weaknesses in the distribution system arose when alcohol products were physically in commercial channels after the excise duty point where this duty may or may not have been actually paid. New regulatory controls over wholesale distribution channels after the duty point would result in a "closed distribution system" that facilitates tracking whether the alcohol products were, in fact, excise duty paid.⁴ AWRS importantly created an enforcement tool whereby trade buyers (which includes retailers) could be held accountable under due diligence for the legitimacy of the alcohol they purchased. It is a strong recognition of the importance that wholesale activity controls what products, legitimate or illegitimate, are in the flow of the domestic distribution system.

The AWRS only focuses on the regulating the activity of wholesaling. A wholesaler required to register may be part of a supplier, a stand-alone wholesale business, or be part of a retailer in the United Kingdom that sells alcohol products to restaurants, caterers, or other trade buyers who then sell it to customers. Unlike the three-tier system in the United States, little consideration was given to requiring independence between these tiers.⁵ One stakeholder told me that there the segment of stand-alone wholesalers is small and that competition and mergers by suppliers and retailers are moving more suppliers and large retailers into registered wholesalers. Unlike the US marketplace, which was shut down and essentially started from scratch in 1933, the UK industry and its regulation has been developed from the experience of hundreds of years—including many changes in the past decades. The public policy evolution and formal adoption of the AWRS shows the importance of regulatory controls over the wholesale activity in the effort to combat fake, counterfeit, contraband and illicit alcohol. AWRS is an important first step. Over time as HMRC assesses the effectiveness of the AWRS, it can determine whether other regulatory changes at the various tiers in the supply chain, such as the independence of the three-tiers, are needed to ensure that only lawful and authentic alcohol products are distributed in domestic commerce. Lessons from the United States' experience may be helpful here.⁶

⁴ In the context of combatting illicit tobacco trade, the importance of an effective licensing or control system at all levels from manufacture, distribution and retailing has been recognized by international bodies. See, Protocol to Eliminate Illicit Trade in Tobacco Products, Part III: Supply Chain Control, Article 6, Licence, equivalent approval or control system, under the Framework Convention on Tobacco Control (FCTC) of the World Health Organization, at http://www.who.int/fctc/protocol/illicit_trade/protocol-publication/en/

⁵ During the second public consultation, "Alcohol Fraud: Next steps," the Wine and Spirits Wholesalers of American (WSWA) submitted a comment letter, dated October 28, 2013, explaining the three-tier system in the United States and the role of independent wholesalers in that system. See, <https://wswa.org/media/pnc/3/media.623.psd>

⁶ The Dangers of Common Ownership in an Uncommon Industry, Center for Alcohol Policy, at <http://www.centerforalcoholpolicy.org/2017/03/01/the-dangers-of-common-ownership-in-an-uncommon-industry/>

Executive Summary

After the adoption of the European single market in 1993, the United Kingdom experienced an increase in incidents of fake, counterfeit, contraband and illicit alcohol in its domestic market.

Starting in the late 1990s and continuing through 2011, HM Revenue and Customs (HMRC), and other Government Offices conducted research and prepared multiple strategy reports on how to combat alcohol fraud. Many of these studies identified weaknesses in the supply chain among producers, wholesalers and distributors as the points of entry for these illicit products in the distribution system. The public policy goal was “to disrupt the supply chain for alcohol diverted illicitly on to the UK market.” Consideration was to be given to registering and authorizing wholesale/cash and carry outlets to deal in alcohol products. Wholesaling activity, as such, was the only unregulated area in the supply chain. In the UK, producers and retailers operate wholesale activities, as well as independent wholesalers exist. While producers are regulated by HMRC and retailer are regulated by local governments, the gap existed for regulation focusing on wholesaler activity. Yet that is the supply chain activity by which retailers acquire their alcohol, which included illegal alcohol.

By 2012, a principal theme and aim of the Renewed Strategy was to “work with honest businesses to secure legitimate supply chains and to make it harder for criminals to obtain access to illicit alcohol...” Accordingly, between 2012 and 2014, HMRC undertook two public consultations on alcohol fraud that led to the development of the features of the AWRS that were enacted by Parliament as The Wholesaling of Controlled Liquor Regulations 2015 (2015 No. 1516).

Excise Notice 2002, promulgated by HMRC, contains the full details of the scheme. Fundamentally, AWRS uses three obligations to ensure that the scheme prevents fake, counterfeit, and contraband alcohol from entering the distribution system. First, it requires that all wholesalers register and are approved through a detailed application process. Approval is based on the applicant demonstrating it fulfills certain “fit and proper” criteria. Once approved, the registrant must comply with certain recordkeeping obligations. Second, a purchaser of alcohol from a business that is required to register must initially verify (and continue to do so periodically) that the seller is registered. HMRC has an online system to access. Third, it imposes an obligation of “due diligence” (based on HMRC criteria) on the parties (other than consumers) making the purchases of the alcohol products after the excise duty point. This due diligence duty is aimed at preventing the supply chain from exposure to the illicit alcohol market. It functions to create a culture of compliance.

Now that AWRS is fully implemented, HMRC can conduct assessments as part of its alcohol fraud strategies on the effectiveness of the scheme in combatting fake and other illegal alcohol. For example, AWRS is the first-time large retailers with wholesale arms are regulated by HMRC and that experience can be evaluated. It can refine the AWRS, if necessary, and utilize the expertise of the Joint Alcohol Anti-Fraud Taskforce comprised of government officials and industry stakeholders.

One of the policy debates in the development of the AWRS was whether a business conducting wholesaler operations that already held another alcohol-related license should also be required to apply for and receive the wholesaler registration.⁷ The decision was yes. It reflects that the fact that an industry member may function well in one line of business (such as being a producer/supplier or a retailer) but still needs to be assessed independently about its wholesaling activity. Implicitly, it recognizes the underlying notion of the three-tier in the United States that producer/supplier, wholesaler and retailer are separate business functions that need separate regulation.

The benefits of independent distributors to preserve and promote competition in the U.S. beer industry, for example, is a central feature of the Department of Justice's review of the acquisition of SAB Miller by Anheuser-Busch InBev and the terms and conditions contained in the Proposed Final Judgment.⁸

The UK policy makers did not undertake this next question of whether these businesses should be separate and independent entities. Since the repeal of Prohibition in the United States, the separateness of these tiers has been the public policy under state-based regulations. The 2014 study entitled, "*The 'Fake Alcohol' Situation in the United States: The Impact of Culture, Market Economics, and the Current Regulatory Systems*" concluded that independent entities at the different tiers provide checks and balances against abuses by their competitors and the other tiers in the supply chain.⁹ In *Granholm v. Heald*, 544 U.S. 460 (2005), the Supreme Court affirmed its prior view that the three-tier system is "unquestionably legitimate" under the 21st Amendment power of the states. By comparison, AWRS was designed to address a very specific void in effective regulatory controls. In adopting AWRS, the policy decision was to strengthen the existing regulatory system by including wholesaler activity in the overall alcohol registration/licensing system and left to another day the policy decision on whether other structural changes to the distribution system would be appropriate for ensuring revenue collections and combatting fake, counterfeit and contraband alcohol.

Finally, AWRS enables the UK to have a stronger domestic distribution system that can mitigate any new challenges of fake or illicit products in the supply chain distribution system through new trade relations with the European Union as a result of Brexit.

⁷ See discussion on pages 17-8 of this paper.

⁸ Competitive Impact Statement, pages 2-4, at <https://www.justice.gov/atr/case/us-v-anheuser-busch-inbev-sanv-and-sabmiller-plc>

⁹ Executive Summary, Paragraphs 7 and 9, at <http://www.centerforalcoholpolicy.org/2014/09/22/former-ttb-chief-counsel-to-present-new-study-on-counterfeit-alcohol-at-seventh-annual-alcohol-law-and-policy-conference-2/>

Background:

Scope of Paper

The decision to adopt the AWRS was not reached lightly and not without deliberation and widespread internal consultation among interested parties. This paper reviews that insightful history. The multiple public consultation and informal stakeholder consultations were designed to develop the most effective scheme to combat fake, counterfeit, contraband and illicit or fraudulent alcohol while at the same time very carefully evaluating the cost and benefits of each facet of the scheme. The legitimate alcohol industry had a strong financial incentive to work with HMRC to develop an effective scheme because that industry was losing huge sales volumes to the illicit industry.¹⁰

More specifically against this background, the scope of this study is two-fold. First, the paper summarizes the adoption and implementation process of the AWRS in the United Kingdom and gauges the initial views on its effectiveness to combat fake alcohol incidents. Essentially, on or after January 1, 2016, AWRS requires entities that wholesale alcohol on which excise duty has been paid or is payable to register and pass a “fit and proper” background investigation. The wholesaler is issued a unique reference number (URN) that must appear on all invoices. HMRC maintains an online website database listing information about the registered entities and the URN that can be accessed by trade buyers. On and after April 1, 2017, all trade buyers of alcohol must check the website to confirm that they are purchasing from a registered source. For example, most states in the United States have various requirements to make sure the source of product is original.¹¹ Certain recordkeeping requirements apply. Due diligence obligations are imposed on those in the alcohol supply chain. This is a very general description and nuances of these requirements are discussed later in this paper. Additionally, at various places in this study, descriptive information about features of the regulatory system in the United States are noted for comparative purposes.

Second, the study utilizes the AWRS example to examine briefly the importance of domestic distribution systems in the current political climate of Brexit and the re-evaluation of global trade agreements. Where internal markets in countries become more insular from a multi-lateral or common market regulatory regimes, the importance of a sound and solid domestic distribution

¹⁰ The second consultation, Alcohol Fraud: Next steps, states in the summary of responses:

Q4 asked for any further data industry could provide to help assess the overall impact that alcohol fraud has on legitimate businesses.

2.9. Everyone who responded to this question agreed the impacts of alcohol fraud on legitimate businesses was significant and one retail business claimed it was so far reaching that there were certain areas of the UK where honest businesses could not compete at all. Those respondents who were able to quantify losses quoted impacts ranging from lost sales of approx 40 dozen wine sales per week to a wholesale business losing approx £180m per year. The wholesale trade report a continuing decline, mainly in beer and wine sales in recent years. A major off licence chain quoted a 10% reduction in store numbers over recent years as a result of lost business to alcohol fraud.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

¹¹ These are often called primary source laws. See for example, <http://www.lrc.ky.gov/statutes/statute.aspx?id=42521>

system for alcohol takes on greater importance for protecting consumer expectations for authentic products, their health and safety, and excise revenue streams for governments. The UK after Brexit will have sole responsibility for the policing of products entering its internal market and (depending on negotiations with Brussels) may not benefit from any regulatory controls arising from being part of the European Union in the larger common market, such as the Excise Movement and Control System (EMCS).

Preliminary Nomenclature Comments

Initially, a few comments on nomenclature are necessary. The UK system uses the terminology “excise duty” and “customs duty.” Under the Internal Revenue Code of 1986 (IRC), in the United States, we refer to “excise taxes” instead of “excise duty” for the similar revenue impositions. The UK refers to “excise duty suspension” and under the IRC this concept is covered by “in bond” status for storage and warehousing on bonded premises, or transfers between bonded premises. References to a “guarantee” in the UK are similar to the “surety bond” requirements under the IRC in the United States. The AWRS registers business entities involved in alcohol distribution “at or after the duty point.” Under the IRC, this concept is covered by “tax-paid or tax-determined” alcohol after its “removal” from the bonded premises. In the UK there are references to “cash and carry outlets” which, may refer to sales at the wholesale level or the retail level. Cash and carry wholesalers are operations where the institutional buyer, such as a retailer or caterer, goes to a wholesale warehouse to purchase and take immediate delivery of the product with him/her rather than having the wholesaler deliver the goods to the purchaser’s business premises. The measure enacted as the AWRS by Parliament is labeled a “Regulation” whereas a measure enacted by Congress is a “law” or “statute” as compared with implementing measure promulgated by U.S. government agencies that are labeled “regulations.”

Alcohol Fraud Policy Development - Overview:

In 1993, the Single European Market was created. Each member state of the European Union had to make decisions over the domestic controls on the simplified movement of excise goods in the single market. The United Kingdom adopted a risk-based approach, removing many of their physical checks of goods and largely passing operational control over the system to the traders themselves.¹² It was anticipated that the simplified movement system would increase the risk of fraud. In fact, frauds between 1993 and 2000 led to alcohol duty evasion of £668 million from diversion onto UK markets, according to the National Audit Office report.¹³ Early efforts by HMRC to tackle alcohol fraud focused on criminal enforcement efforts of identifying and prosecuting fraudsters. Later efforts started to focus on regulatory enforcement tools. That is, strengthening controls to tighten up weaknesses in the system. Significantly, there was recognition that some amount of revenue would be lost as a result of the looser regulatory controls in order to facilitate trade of excise goods.¹⁴ From a public policy perspective, it is fair to assess the burden imposed on the industry by a specific regulatory tool against the outcome of combatting the specific public injury being prevented. In the context of the AWRS, as discussed below, a like consideration is the extent of the burden of wholesaler registration, recordkeeping, due diligence, and the source of goods checks required by the institutional purchasers and retailers against preventing fake, counterfeit and contraband alcohol products in the marketplace. As previously noted, the two public consultations did employ a cost-benefit approach in adopting the specific requirements of the AWRS.

In the years following, HMRC, the National Audit Office, and the Office of the Paymaster General conducted several reviews on alcohol and tobacco frauds leading to various recommendations. A HMRC report on Alcohol and Tobacco Fraud Review prepared in 1997-98, made 90 recommendations, including a recommendation on the licensing of wholesalers. Recommendation 34 provided:

In consultation with the trade, further consideration be given to registering and authorising wholesale/cash and carry outlets to deal in alcohol and tobacco products.¹⁵

The National Audit Office released an extensive report in 2001 titled, *“Losses to the Revenue from Frauds on Alcohol Duty.”* It characterized this recommendation as “(i)mplemented by other means.” It states: “The Home Office White Paper on licensing outlines plans to licence traders for wholesaling alcohol, and that customs offences should be taken into account when granting

¹² See generally, the National Audit Office report titled “Losses to the Revenue from Frauds on Alcohol Duty” prepared for the House of Commons. <https://www.nao.org.uk/wp-content/uploads/2001/07/0102178.pdf>

¹³ To help put these numbers in context, the National Audit Office report from 2001, on page 3, explains in 2000-01 HM Customs and Excise collected £6.7 billion from duty on alcohol, 6.6 per cent of the total revenue collected by the Department. Alcohol diversion duty losses identified from investigations between 1993-94 and 1999-00 represent some 1.4 per cent of the total revenue from alcohol duty over that period.

¹⁴ “Losses to the Revenue from Frauds on Alcohol Duty,” page 12.

¹⁵ Appendix B, in “Losses to the Revenue from Frauds on Alcohol Duty” (2001) at page 38. <https://www.nao.org.uk/wp-content/uploads/2001/07/0102178.pdf>

or renewing licences.”¹⁶ The report does not otherwise discuss the wholesaler registration approach.¹⁷

In 2005, HMRC adopted its “Tackling Alcohol Fraud” strategy that focused on spirits fraud and was successful in halving the size of the illicit market in spirits during 2005-06.¹⁸ However, alcohol fraud remained a problem that the government was committed to considering all options to tackle. Excise duties on alcohol generated £9.5 billion of revenue in 2010-11, but HMRC estimate of the tax gap indicated that up to a further £1.2 billion is lost each year due to excise duty evasion, principally fraud.¹⁹

In 2012, the National Audit Office published a report titled, “*Renewed Alcohol Strategy: A Progress Report.*”²⁰ The 2005 alcohol strategy covered spirits duty only, whereas the Renewed Strategy is more comprehensive and covers the duty payable on wine and beer as well. The Overall Conclusion of the report was:

“The Department has not, however, achieved tangible success in working with industry stakeholders to disrupt the supply chain for alcohol diverted illicitly on to the UK market. There is insufficient quality, depth and analysis in the performance information used to inform delivery of the Strategy. Significant improvements are needed in these areas to ensure that the Renewed Alcohol Strategy reduces the increasing level of alcohol duties lost to fraud.”²¹

¹⁶ Appendix B, in “Losses to the Revenue from Frauds on Alcohol Duty” (2001) at page 38.

<https://www.nao.org.uk/wp-content/uploads/2001/07/0102178.pdf> See, *Time for Reform: Proposals for the Modernisation of Our Licensing Laws* (CM 4696) April 2000.

¹⁷ Two other reports on alcohol duty losses were prepared in 2000 but neither report discusses the wholesaler registration scheme approach. These two other reports are discussed on page 9, of the 2001 report titled “Losses to the Revenue from Frauds on Alcohol Duty.” The Customs' Chairman commissioned an internal review of the handling of the alcohol duty losses which reported in May 2000. The review highlighted the serious weaknesses in the Department's control of excise duty collection, in particular the mechanisms for releasing dutiable spirits and wine from excise warehouses. The review concluded that there had been significant revenue losses, principally in the three years after 1995. The Customs' Chairman reported the results of the review to the Paymaster General, Dawn Primarolo, in June 2000. Following this, the Paymaster General commissioned an independent investigation, headed by John Roques, an ex-senior partner of Deloitte and Touche, to look into the matter. Mr Roques presented his report to Ministers on 15 December 2000. It contained 65 recommendations to improve controls and the way that fraud is tackled in Customs. The recommendations of the Roques report and the Paymaster General's announcement are set out at Appendices C and D, respectively, of the 2001 report.

¹⁸ HMRC Alcohol Fraud, Consultation Document, dated 26 March 2012, page 5.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212738/Alcohol_Fraud_consultation.pdf

¹⁹ House of Commons, Committee of Public Accounts, HMRC Renewed Alcohol Strategy, Sixth Report of Session 2012-13, page 5. <http://www.ias.org.uk/uploads/pdf/News%20stories/hmrc-alcohol-strategy-report6.pdf>

²⁰ <http://www.ias.org.uk/uploads/pdf/Consumption%20docs/10121702.pdf>

²¹ “Renewed Alcohol Strategy: A Progress Report, at page 7.

<http://www.ias.org.uk/uploads/pdf/Consumption%20docs/10121702.pdf>

The report identified weaknesses in the supply chain with producers, wholesalers and distributors as a cause of the alcohol fraud.²² The importance of the role of these entities in the supply chain to the administration of tax collections and the prevention of tax fraud has been highlighted in the state control systems in the United States.²³

One of the three principal themes and aims of the Renewed Strategy was to “work with honest businesses to secure legitimate supply chains and so make it harder for criminals to obtain access to illicit alcohol...”²⁴ Against the backdrop of this Renewed Strategy, HMRC commenced its consultation process leading to the adoption of the AWRS.

UK Government Decision to Adopt AWRS:

In its Budget 2011, the UK government announced the intent to explore potential legislative proposals to address alcohol fraud and, in particular, revenue receipts. Two major public consultations were undertaken by HMRC, following informal consultations with stakeholders in June 2011. The steps of this public consultation process entailed publishing a document describing the public policy concern and posing questions that all interested parties may respond to in written comments. This is followed by a summary of the responses and the UK government’s responding comments. Ultimately (and after a second public consultation) a legislative proposal was prepared by HMRC and laid before the House of Commons that contained the proposed Regulation that was enacted into law.²⁵

²² “The fraud is carried out primarily by organised criminals who exploit weaknesses in the supply chains of alcohol producers, wholesalers and distributors to divert goods on to the UK market without paying the taxes that are due. The illicit importation of alcohol products into the UK without the payment of UK duty is the main element of the fraudulent activity.” Paragraph 1.2, page 9.

<http://www.ias.org.uk/uploads/pdf/Consumption%20docs/10121702.pdf>

²³ KPMG, “An Analysis of the Structure and Administration of State and Local Taxes Imposed on the Distribution of Beer at <https://www.nbwa.org/resources/kpmg-tax-study-state-and-local-taxes-distribution-and-sale-beer-0> A key conclusion of this report, pages 33-34 is:

“Other features of the regulatory system governing the sale of alcoholic beverages, including the [three-tier system of distribution](#), exclusive territories for beer wholesaling and various controls on the retailing of beer, significantly contribute to the administration of all types of taxes on beer. These regulations, taken together, create the opportunity to monitor the flow of alcoholic beverages in the state, provide state regulators and tax administrators with a limited number of points to tax and/or exercise control over the flow of alcoholic beverages, limit opportunities for contraband (i.e., untaxed) alcoholic beverages to enter the distribution chain and ensure compliance with the various tax systems. In particular, requirements that suppliers must sell only to licensed wholesalers and that retailers may purchase product only from certain licensed wholesalers is fundamental to ensuring compliance with beer taxes in an efficient manner. Without these controls, the level of resources necessary to achieve any given level of compliance would be substantially greater than at present.”

Eight important features impacting an effective tax system are cited in the report, at page 27. One of these features is the importance of addressing opportunities for evasion.

²⁴ Renewed Alcohol Strategy: A Progress Report, at page 10.

<http://www.ias.org.uk/uploads/pdf/Consumption%20docs/10121702.pdf>

²⁵ The Code of Practice on Consultation is in Annex A, at page 45, at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212738/Alcohol_Fraud_consultation.pdf

First Public Consultation: “Alcohol Fraud”

In March 2012, HMRC published a consultation document titled, “*Alcohol Fraud: Legislative measures to tackle existing and emerging threats to the UK alcohol duty regime.*”²⁶ The consultation specifically reached out to “Trade representatives, businesses and individuals trading in alcoholic drinks” as well as interested parties. The document did not expressly mention public advocacy groups or consumers, both of whom have interests in combatting fake, counterfeit and contraband alcohol due to the public health and safety harms caused by these illicit products—such as surrogate alcohol and refilling of containers with alcohol from unknown sources which are then interjected into commercial channels of distribution. For example, fake vodka containing 159 times the maximum permitted level of methanol has been found in a retail outlet in Wales where the proprietor bought it from a new wholesaler that he had never heard of before, which turned out to be a fictitious business.²⁷ Likewise, in Leeds, 600 bottles of fake vodka were seized from a club containing high levels of methanol and other contaminants that was produced illegally.²⁸ As these two examples show, illicit alcohol can appear in both on-trade and off-trade businesses.²⁹ Legal tools to prevent fake, counterfeit, and contraband alcohol in the marketplace not only protect the excise revenue stream for the government but protect the health and safety of consumers of alcohol as well.

The consultation focused on three measures:

- Fiscal marks on beer
- Supply chain legislation
- Registration³⁰ of alcohol wholesalers/brokers

²⁶ <https://www.gov.uk/government/consultations/alcohol-fraud> The consultation explains, at page 5, “Tackling alcohol fraud supports legitimate businesses and is part of the Government’s broader approach to alcohol in the UK. The Government will shortly publish a cross-departmental strategy that will set out a coordinated approach to tackling alcohol-related harm. It will address the full range of harm from alcohol (both health and social impacts). It will set out all Departments’ existing commitments and actions and will describe the respective future roles of central and local government, the third sector, other agencies and people. It will also set out how the new approach to public health will make a significant difference when local partners are empowered to take forward local solutions.”

²⁷ Fake Vodka on Sale in Shop, Wales Online March 5, 2009 at www.walesonline.co.uk/news/walers-news/fake-vodka-sale...

²⁸ Leeds: 600Bottles of Fake Vodka Seized from Nightclub, Yorkshire Evening Post, September 25, 2012, at www.yorkshireeveningpost.co.uk/news/latest-news/top

²⁹ Paragraphs 2.7 to 2.10, pages 9-10, at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212738/Alcohol_Fraud_consultation.pdf

³⁰ The AWRS is more than a mere registration system because the application process evaluates the fitness of the applicant. For example, in the United States alcohol dealers who are wholesalers and retailers are required to register at the Federal level (and maintain certain records). Internal Revenue Code of 1986, Section 5124. No background evaluation is undertaken as part of this registration. (Prior to 2005, this was a special (occupational) tax on such dealers.) This is a pure registration system. However, wholesalers are also subject to qualifying for basic permits under the Federal Alcohol Administration Act, where there is a significant background check. Similarly, retailers are subject to background checks under the State laws and local regimes that license that activity.

It also sought information and data on wine fraud and industry views on measures to address such fraud.

This paper looks at the registration of wholesalers/brokers measure. The consultation document explains:

The people behind this fraud in the UK are organised criminals, operating complex supply chains that involves sophisticated organisation in finance, procurement, logistics, supply chain control and marketing. *The criminal gangs have penetrated the legitimate market for wholesale and retail in the UK.* In doing so they undercut legitimate businesses trying to compete at all levels and undermine consumer confidence in the products they buy.³¹ (Emphasis added.)

The HMRC renewed strategy effort to tackle alcohol fraud had three themes,³² the second of which focused on the securing the legitimate supply chain. The consultation document explained in more detail this theme as:³³

2.13.2 Working with honest businesses

The majority of alcohol consumed in the UK is either produced or packaged in the UK. HMRC has worked with industry stakeholders to raise awareness of alcohol fraud within the industry at all levels. Sharing of information by UK brewers on supplies of potentially high risk goods has helped HMRC to disrupt large scale frauds. Work with the UK haulage sector has also discouraged legitimate operators from involvement in potentially high risk alcohol movements to the near continent. However, despite this positive collaboration with business, there has been no demonstrable reduction achieved in the level of supplies of popular UK brands of alcohol being sourced by fraudsters for their illicit supply chains.

Given the lack of demonstrable results from merely increasing awareness of the problem and sharing of information with the impacted businesses, additional tools and approaches were needed.

³¹ Paragraph 2.3, page 8, at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212738/Alcohol_Fraud_consultation.pdf

³² 2.13. The strategy has three principal themes:

- i. Changing the law: to make life tougher for criminals and easier for honest businesses to compete;
- ii. Working with honest businesses: to secure legitimate supply chains and so make it harder for criminals to source illicit alcohol; and
- iii. Strengthening our operational response to alcohol fraud: as part of a centrally coordinated effort to detect, disrupt and dismantle organised criminal networks and supply chains

See page 10, at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212738/Alcohol_Fraud_consultation.pdf

³³ Similarly, a major policy goal of policy makers in the United States around passage of the 21st Amendment was to drive out the criminal element. "At all costs ...bootlegging, racketeering, and the whole wretched nexus of crime that developed while the Eighteenth Amendment was in force must be wiped out." Fosdick and Scott, *Toward Liquor Control*, p.9. (1933, Republished by Center for Alcohol Policy)

The registration of wholesalers was proposed by the Federation of Wholesale Distributors (FWD).³⁴ HMRC aired the proposal for comment because the wholesalers were the only activity in the alcohol supply chain that was not licensed. Retailers are licensed under the Licensing Act 2003, and, as noted above, entities involved in the supply chain prior to the excise duty point were also regulated.

The consultation notice described many potential features of a wholesaler registration scheme under which wholesaler registrations could be refused, suspended or revoked; exemption for small volume or *de-minimis* sales by a wholesaler; where suppliers might be required to sell only to registered wholesalers; invoices would be annotated with the registration number of the registered wholesalers; stock records (that is, inventory) would be linked to sales; recordkeeping requirements; due diligence requirements by suppliers on their customers; and various penalties. Specific questions were posed to solicit information and data in each of these areas.³⁵ Other questions were posed relating to economic impact and small business impact.

³⁴ 4.3. The Federation of Wholesale Distributors (FWD) has proposed a registration system for wholesale dealers in alcohol as it believes this could significantly help in tackling alcohol fraud. This reflects their concern that legitimate wholesalers sourcing duty paid alcohol from brand owners are seeing their prices under-cut by competitors sourcing from the illicit market, resulting in lost trade damaging profits, and jeopardising jobs and business growth. Page 26, at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212738/Alcohol_Fraud_consultation.pdf

³⁵ REGISTRATION OF WHOLESALERS (See pages 40-41, at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212738/Alcohol_Fraud_consultation.pdf)

How might it work? – paras 4.8 – 4.10

Q55. Do you believe HMRC should have the authority to require wholesale alcohol dealers to register?

Q56. Do you believe HMRC should have the authority to refuse, revoke or suspend a person's ability to trade in alcohol?

Q57. What are the potential costs of complying with the requirement to register to deal in wholesale quantities of alcohol, or any of the other subsidiary requirements outlined? Please distinguish one off costs from ongoing costs.

Q58. What impact would a registration scheme have on alcohol fraud?

Exclusions from registration – para 4.11 40

Q59. Do you believe that de-minimis quantities should be introduced for the purposes of registration for any scheme? If so, please explain why.

Q60. At what level should a de-minimis limit be set?

Obligations of the customers of wholesale dealers – para 4.12

Q61. Do you believe that such an offence would be appropriate and necessary to deterring those currently sourcing goods from the illicit market?

Obligations of the suppliers of wholesale dealers – para 4.13 – 4.14

Q62. Do you believe that such conditions would be appropriate and necessary to deterring those currently supplying goods to the illicit market?

Q63. What potential implications and costs would there be for suppliers complying with these requirements?

Q64. What quantities could be considered as indicative of personal use?

Q65. What are the practical implications if retailers need to provide suppliers with copies of their licences when making purchases?

In July 2013, HMRC published a summary of the 55 responses received to the questions posed, the government's response, and the list of stakeholders who responded.³⁶ HMRC noted that the proposal to register wholesalers had the broadest support across the range of the respondents (29 of the 55 respondents addressed this proposal).³⁷

Both suppliers and retailer associations supported the wholesaler registration proposal because of the certainty it provided in knowing they are dealing with a legitimate company. It was felt that the recordkeeping costs relating to invoices would be modest but the stock (inventory) requirements would be difficult and expensive. More details on the actual registration system would be required in order for the wholesalers to consider all of its implications, including a determination of its one-off and on-going costs. In all cases, the registration scheme would only work if it were adequately policed and enforced rigorously which means that HMRC would have to be given the financial resources necessary. Several responses raised concerns about the *de-minimis* exemption as creating an enforcement loophole for fraudsters to structure their illicit transactions. Additionally, some large retailers questioned their inclusion in the registration system as a result of alcohol sales they make to other businesses. A group within the Parliament asked HMRC to consider whether this should be licensing at the local council level as is the situation for retail licenses.³⁸ In the Government Response, HMRC noted the positive responses

Record-keeping requirements – paras 4.15 – 4.16

Q66. Can you describe the current level of record keeping in place across the wholesale sector?

Q67. What practical difficulties and costs would you envisage in relation to the following:

(a) the inclusion of specific excise registration or wholesale registration numbers on sales invoices;

(b) specific alcohol stock records to enable HMRC officers to reconcile purchases against sales?

Q68. What solutions may be available within the industry to match goods in stock to specific purchase invoices?

Summary of Impacts – para 4.17

Q69. Do you agree with this impact assessment?

Q70. Are there any other impacts which should be taken into account?

Q71. If you are a small business (less than 20 employees) please provide details of the costs and impacts of this measure on your business.

³⁶ Summary of Responses, dated 17 July 2013, at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212739/FINAL_Summary_of_responses.pdf

³⁷ 1.14 Overall, the proposal to register alcohol wholesalers had the broadest of support across the range of respondents. Many respondents believed that the absence of any registration or licensing requirement in this part of the alcohol supply chain was a weakness and that introducing such requirements would allow HMRC to more effectively control the legitimacy of those carrying out wholesale trade. Page 4, at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212739/FINAL_Summary_of_responses.pdf

³⁸ 2.49 to 2.63, on pages 14 to 17, of the Summary of Responses at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212739/FINAL_Summary_of_responses.pdf

from stakeholders. It agreed on the need for robust enforcement. HMRC advised that it needs to develop more details and announced its intent to consult further with the relevant sectors.³⁹

Second Public Consultation: “Alcohol Fraud: Next Steps”

In 2013-14, HMRC held its second round of public consultation on “Alcohol Fraud: Next Steps” which resulted in the Regulation enacted by Parliament as the AWRS.⁴⁰ This consultation had three purposes of (1) strengthening HMRC’s existing alcohol anti-fraud strategy generally⁴¹ and more specifically, (2) developing the design of the scheme to register alcohol wholesalers and (3) consulting on strengthening due diligence obligations for all registered excise businesses including the registered alcohol wholesalers.⁴² In designing the AWRS, HMRC followed its policy strategy of Promote, Prevent, and Response.

The consultation on the wholesaler registration scheme solicited input on the determining the scope of who should be required to register as a wholesaler. Sales of excise duty paid alcohol are made for onward sale in many contexts in the UK. In addition to traditional wholesalers, suppliers, importers, brokers and some retailers make sales to customers who resell the alcohol. Some of these other entities already hold other registrations or licenses for their other business activities.

Essentially the wholesaler registration consultation sought input on four areas. First, it focused on who is required to register as a wholesaler. The consultation discussed both a legal definition of wholesaler and included example of the type of activities that would be considered “wholesale” conduct. Similarly, it examined whether any exemptions should be granted to certain categories of businesses but did note concerns that the exclusion of any such category could introduce an opportunity for a fraudster to circumvent the system. Rather, it identified retailers as the area of definitional concern because some retailers make “incidental sales” on a random basis to persons who purchase small quantities for resale, such as a small restaurant needing a few bottles of wine to restock or a retailer selling product for the annual “village fete.” It proposed that retailers who make routine sales for resale be required to register but allow a retailer to make “incidental sales” without triggering a registration requirement.⁴³

³⁹ 3.8 to 3.10, on page 21, of the Summary of Responses at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212739/FINAL_Summary_of_responses.pdf

⁴⁰ Informal consultation document and Summary of Responses, at <https://www.gov.uk/government/consultations/alcohol-fraud-next-steps>

⁴¹ Two examples were (1) the establishment of a joint alcohol anti-fraud task force (JAATF) comprised of representatives from HMRC, Border Force, Trading Standards, relevant trade associations, and senior figures from the alcohol industry and (2) increasing cooperation with other EU Member States such as through work with the Fiscal Crime Liaison network. See, 2, Strengthening HMRC’s existing alcohol anti-fraud strategy, on pages 7 to 10, at <https://www.gov.uk/government/consultations/alcohol-fraud-next-steps>

⁴² 1.5 of the informal consultation document confirmed that the Government would not proceed with the beer fiscal marks or supply-chain legislation that had been other subjects of the prior consultation. Page 5, at <https://www.gov.uk/government/consultations/alcohol-fraud-next-steps>

⁴³ By contrast, the Federal Alcohol Administration Act 27 USC 203(c) requires qualification as wholesaler on all sales to a retailer. “it shall be unlawful ...1) to engage in the business or purchasing for resale at wholesaler, distilled spirits, wine, or malt beverages. Or 2) for any person so engaged to receive or to sell, offer or deliver for

Second, the consultation solicited input on the detailed operations of the registration scheme by HMRC in reviewing and approving the wholesaler registration using a “fit and proper” standard of examining the business history of the applicant, including visits by HMRC to the applicant’s trading premises. The proposal envisioned online applications and one application would cover all of the business premises of the applicant. Once registered, the wholesaler would be given a unique reference number (URN) that would be required on invoices and would be the element of information accessed by others on the HMRC online database to confirm the legitimacy of the wholesaler with whom they are dealing. Additionally, minimum recordkeeping requirements were proposed.

Third, the consultation sought input on the obligations of all parties in the supply chain to comply with the requirements of the registration scheme. For a full discussion of the matter, the consultation sought input on the broader question of requiring all parties to confirm the status of their suppliers and customers in the supply chain and do so for a new supplier as well as do so monthly to confirm the current status of the registered wholesaler. Also, a record of this follow up work was required. During the consultation process, HMRC revised this proposal from a monthly refresh check to one based on “best judgement” in understanding the risk of their supply chain and the obligation to avoid sourcing illegally from an unregistered operator.⁴⁴

Fourth, the consultation discussed the range of penalties and sanctions that HMRC deemed necessary as part of an effective registration scheme. These were monetary penalties, revocation of registration, forfeiture of alcohol products by a person trading without registration and in the case of retailers, a referral to local authorities for action against the retail license. These sanctions and penalties were in addition to the existing criminal penalties applicable to excise tax fraud.

Finally, the consultation sought input on strengthening due diligence obligations for all registered excise businesses including the registered alcohol wholesalers. HMRC explained that some businesses openly enter into transactions that are often too good to be true and this due diligence requirement seeks to change the behavior of those businesses. HMRC would provide guidance on due diligence checks. As part of its checks on registered businesses, it would examine what actions or precautions the business took in response to any indicators of risk. HMRC sought comments on the types of sanctions it would apply, ranging from warning letters, to financial penalties, to revocation of the registration of the business for repeated failures or knowing participation in fraud.

In January, 2014, HMRC published a summary of the 63 responses received to the questions posed, the government’s response and the list of stakeholders who responded.⁴⁵ Overall, the

sale, contract to sell, or ship, in interstate or foreign commerce, directly or indirectly or through an affiliate, distilled spirits, wine, or malt beverages so purchased.

⁴⁴ Annex A: Alternative approach, page 27, of Alcohol Fraud: Next Steps, Summary of Responses, at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁴⁵

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

responses gave board support for the concept of wholesaler registration across the industry in order to prevent fraud. At this same time, the Joint Alcohol Anti-fraud Taskforce (JAAT) was launched and is comprised of government officials and industry stakeholders.⁴⁶ It was clear that the commenters felt the impact of alcohol fraud on legitimate businesses was significant and sales could be increased if the fraud was reduced.⁴⁷

The scope of exemptions from the registration scheme generated discussion with some believing that there should be no exemptions for incidental sales by retailers and the criteria for incidental sales was the subject of greater discussion.⁴⁸ Others discussed whether the definition of wholesaler encompassed auction houses, brokers, commission agents, and importers. These comments on inclusion or exclusion of businesses were important in determining the total number of business entries impacted. HMRC estimated approximately 20,000 registrations,⁴⁹ whereas in mid-April there were about 7,000 wholesalers registered, according to comments from an HMRC official. According to a press report, about 1,300 wholesaler applications were not approved⁵⁰; the author was told by HMRC that most were approved without problems.⁵¹

The question of whether business currently holding some sort of excise registration or license generated comments.⁵² Should existing businesses such as suppliers who are already in the regulated regime be required to register as a wholesaler for that activity? Many comments supported such AWRS registration because it would “improve traceability through the supply chain and would avoid fraudsters exploiting loopholes.” HMRC concluded that “it is essential to the success of the new scheme that registration is required for all businesses who routinely conduct wholesale activity” and would not introduce an “exemption for businesses that wholesale but hold other excise approvals.”⁵³ This conclusion reflects the importance of wholesaling activity in ensuring that only lawful alcohol products are in the distribution supply chain. In this regard, it reflects that an industry member may function well in one line of business (such as being a producer/supplier or a retailer) but still needs to be assessed independently about its wholesaling activity. Implicitly, it recognizes the underlying notion of the three-tier in the

⁴⁶ Foreword at pages 3-4, and 2.3.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁴⁷ 2.9 and 2.45 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁴⁸ 2.34 to 2.47 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁴⁹ Question 14, on page 12. This original figure was derived from a review of general business classification data so there was a degree of uncertainty in it.

⁵⁰ “Difficult conversations ahead on 1300 ‘dodgy distributors’ put out of business by AWRS,” *Harpers*, by Jo Gilbert, 20 April 2017, quoting an official from the Federation of Wholesale Distributors (FWD).

⁵¹ Per a conversation with a HMRC representative on April 12, 2017.

⁵² 2.12. to 2.13 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁵³ 3.10 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

United States that producer/supplier, wholesaler and retailer are separate business functions that need separate regulation.

Respondents favored the online registration system and the requirement for some sort of approval by HMRC in order to “root out criminals.” However, there were mixed comments about various qualifying criteria of “fit and proper” that had to be met, including the need for a “credible business plan,” scope of “any revenue non-compliance,” “debts of a serious nature” and “satisfactory due diligence.”⁵⁴ Parenthetically, many of these facts are similar to the determination made by the Alcohol and Tobacco Tax and Trade Bureau (TTB) in evaluating a wholesaler basic permit application under the Federal Alcohol Administration Act, 27 USC 204(a)(2)(A) through (C).⁵⁵

The frequency of verifying the wholesaler’s registration and accompanying record keeping generated many comments. Originally, HMRC proposed ongoing monthly checks by purchases but an alternative idea was proposed--during the consultation period--to use a standard of due diligence and that the obligation be placed on the purchaser, based on its experience with the wholesalers in its supply chain.⁵⁶ Sellers, however, were not required to check the registrations of their customers who were also wholesalers. One key feature proposed was the placing of the URN of the wholesaler on invoices (and possibly as case markings) and the associated costs. The methods of applying penalties and offences raised few comments but respondents were generally content with the proposal.⁵⁷

Finally, the overall obligation of the need to exercise due diligence by all parties in the alcohol supply chain including suppliers, wholesalers and some retailers received generally positive comments as a positive enforcement tool that would force purchasers not to turn a blind eye to

⁵⁴ 2.8 to 2.22 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁵⁵ §204. Permits (a) Who entitled thereto

The following persons shall, on application therefor, be entitled to a basic permit:

* * * * *

(2) Any other person unless the Secretary of the Treasury finds (A) that such person (or in case of a corporation, any of its officers, directors, or principal stockholders) has, within five years prior to the date of application, been convicted of a felony under Federal or State law or has, within three years prior to date of application, been convicted of a misdemeanor under any Federal law relating to liquor, including the taxation thereof; or (B) that such person is, by reason of his business experience, financial standing, or trade connections, not likely to commence operations within a reasonable period or to maintain such operations in conformity with Federal law; or (C) that the operations proposed to be conducted by such person are in violation of the law of the State in which they are to be conducted.

⁵⁶ 2.23 to 2.33 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁵⁷ 2.38 to 2.40 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

illicit activity but several questioned about how HMRC would conduct these checks.⁵⁸ There was no consensus on the cost of compliance with the due diligence condition, but no respondent suggested an unreasonable cost, and there was a view that increased profits by the legitimate businesses would offset these costs.

Based on the respondents' comments, HMRC adopted its next steps of preparing legislation to establish the AWRS and include the key proposed features: registration, requiring purchasers to verify in the HMRC online computer system the registration of the wholesaler from whom it purchases, invoices with URN and the overriding responsibility for the due diligence condition within all levels of the supply chain. The question of whether purchasers had to keep records of the registrations of delivery vehicles was deferred and to be revisited. Finally, the work of the JAAT would continue with an effort to strengthen HMRC's existing anti-fraud strategy.⁵⁹

Accordingly, "*The Wholesaling of Controlled Liquor Regulations 2015*" (2015 No 1516) was prepared by HMRC and laid before the House of Commons on 16 July 2015, and originally designated to come into force on 1 October 2015.⁶⁰ The regulation was subsequently amended regarding penalties and forfeiture in November 2015 to come into force on 1 January 2016.

AWRS as Implemented by HMRC:

Excise Notice 2002: Alcohol Wholesaler Registration Scheme was promulgated by HMRC with the full details of the scheme.⁶¹ Fundamentally, the AWRS uses three obligations to ensure that the system prevents fake, counterfeit and fraudulent and illicit alcohol from entering the distribution system. First, it requires that all wholesalers⁶² register and are approved through a detailed application scheme. Approval is based on the applicant demonstrating that it fulfills certain "fit and proper" criteria. Once approved, the registrant must comply with certain recordkeeping obligations. Second, a purchaser of alcohol from a business that is required to register must initially verify (and continue to do so periodically) that the seller is registered. This is accomplished online in a HMRC system. Third, it imposes an obligation of "due diligence" (based on HMRC criteria) on the parties (other than consumers) making the purchases of the

⁵⁸ 2.48 to 2.56 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁵⁹ Pages 22 to 26 of

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

See also, HMRC Joint Alcohol Anti-Fraud Task Force, Annual Report for 2015

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/448659/04818_JAAT_Annual_report_2015.pdf

⁶⁰ <http://images.policy.mofcom.gov.cn/article/201509/1443161190390.pdf>

⁶¹ Several versions of this Notice were published and the current updated version was issued on 2 June 2017. All material from Excise Notice 2002 that is reproduced in this paper is taken from this version of the Notice.

<https://www.gov.uk/government/publications/excise-notice-2002-alcohol-wholesaler-registration-scheme/excise-notice-2002-alcohol-wholesaler-registration-scheme#trade-buyers-obligations>

⁶² A wholesaler is defined as: "For the purposes of this notice, a trader who sells, arranges to sell, or offers or exposes for sale duty paid alcohol to another trader." Glossary in Excise Notice 2002.

alcohol beverages after the excise duty payment point.⁶³ This due diligence duty is aimed at preventing the supply chain from exposure to the illicit alcohol market, and creates a culture of compliance.

The remainder of this section highlights the key features of the AWRS registration process, trade buyer compliance obligations and due diligence obligations in the context of combatting fake, counterfeit, fraudulent and illicit alcohol. Excise Notice 2002 is very extensive and anyone seeking fuller information on all of the precise details of this scheme should read the full notice. Appendix I of this paper contains the recordkeeping requirements and Appendix II contains the due diligence obligations.

Registration Obligation – Scope of Businesses Covered

The wholesalers required to register are persons who have an establishment in the United Kingdom⁶⁴ and carry on a “controlled activity” of:

- Selling “controlled liquor” wholesale⁶⁵
- Offering or exposing controlled liquor for wholesale sale⁶⁶
- Arranging in the course of a trade or business for controlled liquor to be sold wholesale.

⁶³ At some point in the supply chain, the excise duty must be paid to HMRC, unless there is a special exemption or relief granted. The duty point is the time at which the any duty chargeable takes effect whether or not actual payment is deferred. This is frequently referred to as the time the goods are “released for consumption.” See, 3.6 of Excise Notice 2002. In the United States, the Federal excise tax is similarly payable when the distilled spirits, wine or beer is removed or withdrawn from the bonded premises for domestic consumption, sale or use.

⁶⁴ 3.2 to 3.5 of Excise Notice 2002 lists the criteria for an establishment in the UK.

⁶⁵ 3.8, states: What is meant by the selling of controlled liquor ‘wholesale’

Controlled liquor is sold wholesale if:

- (a) The seller is carrying on a trade or business and the sale is made in the course of that business.
- (b) The sale is to a buyer carrying on a trade or business, for sale or supply in the course of that business.
- (c) The sale is not an incidental sale, a group sale or an excluded sale. See [section 4](#) for more information on exclusions.

⁶⁶ 3.5 of Excise Notice 2002, states, in part:

What is meant by ‘offering or exposing for sale’ For the purposes of AWRS, the words ‘offering or exposing for sale’ have the following meaning:

- offering - where a wholesaler makes a specific proposal to enter into an agreement to sell controlled liquor to another trader, for example, the wholesaler approaches a potential buyer and makes an offer to supply controlled liquor under specific terms
- exposing - where alcohol is displayed for the purpose of inducing people to enter into a contract to purchase it in circumstances in which the sale, if made, would be a wholesale sale, it covers ‘invitations to treat’, for example, displaying controlled liquor on premises for the purpose of inviting offers to purchase it

“Controlled liquor” is alcohol (that is, distilled spirits, wine, or beer) on which excise duty has been charged (at a rate greater than nil) and the excise duty point is at or before the time of sale at wholesale. AWRS covers anyone who is trading from the time excise duty becomes payable with the aim that all wholesalers who are trading in duty-paid or duty-owning alcohol are included in the scheme (though some types of sales are excepted). Thus, it does not include alcohol that is in duty suspension, duty free or denatured alcohol.⁶⁷

Certain activities were excluded from triggering a AWRS registration, such as incidental sales by retailers to a customer who will resell the alcohol at a “village fete” or a local restaurant needing an extra bottle.⁶⁸ Sales between members of the same corporate group are also excluded.⁶⁹ Finally, HMRC recognizes that situations arise where a retailer unknowing or unintentionally makes an occasional wholesale sale.⁷⁰ Presumably these are situations where HMRC determined as a matter of policy that there is little likelihood for illicit alcohol to be distributed; it reflects the costs and benefits framework used in the consultation process to devise an effective scheme with the least burden on the industry.

The AWRS recognizes that in the United Kingdom, wholesale sales take place by suppliers, importers, stand-alone wholesalers and retailers. Some retailers have a large wholesale arm to their businesses.⁷¹ The AWRS registration applies to a business even if it holds a license in another tier or level of the supply chain.⁷² This represents an important recognition of the significant role wholesaling activity plays in controlling the specific products that enter the domestic commercial distribution channels. This is where illicit product can penetrate the legitimate channels of commerce.⁷³ Accordingly, even if licensed by another regime, that business still had to register under the AWRS and comply with the due diligence obligations.

In order to show the breadth of coverage, Excise Notice 2002 contains a non-exhaustive list of some of the types of businesses required to register.⁷⁴

- a cash and carry selling UK duty paid alcoholic drinks to, for example, off-licences, supermarkets, restaurants, hotels, public houses, etc., or to another wholesaler for resale
- a merchant who buys alcoholic drinks direct from a producer or supplier and then supplies them UK duty paid to retailers for resale to the public

⁶⁷ 3.6, of Excise Notice 2002. HMRC Large Business Section, Customer Relations Managers monitor the denatured alcohol activity in order to avoid diversion of this alcohol to a beverage use.

⁶⁸ 4.3, of Excise Notice 2002.

⁶⁹ 4.1, of Excise Notice 2002.

⁷⁰ 4.2, of Excise Notice 2002.

⁷¹ 4.4, of Excise Notice 2002.

⁷² 3.10 to 3.11, of Notice 2002.

⁷³ “The consultation confirmed that illicit products typically penetrate supply chains at the wholesale level and concluded that registration of wholesalers was the most feasible and cost-effective means of achieving a sustained reduction in the level of illicit trade in alcohol products in the UK.” Alcohol Fraud: Next Steps, Summary of Responses, Forward, page 3.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273880/Alcohol_Fraud_Next_Steps_Summary_of_responses_FINAL.pdf

⁷⁴ 3.8 of Excise Notice 2002.

- a merchant or broker who specialises in supplying UK duty paid alcoholic drinks to the on or off-trade
- a drinks merchant, such as a specialist wine merchant, supplying UK duty paid alcohol to a business enterprise for resale
- a drinks producer such as brewers, wine producers and cider-makers supplying their own products duty paid to trade buyers
- a retailer with a wholesale arm to their business
- owners of goods in warehouse or warehouse keepers who are trading their own goods at or past a duty point
- auctioneers who are arranging a wholesale sale
- businesses that act as an agent between a supplier and another business to arrange, or offer for sale alcohol to other businesses - these agents often don't take physical possession of the goods and are known in the industry as 'dry brokers'

Internet sales are also within the AWRS coverage.⁷⁵ Internet sales from a UK established internet wholesaler to a UK trade buyer fall within the scheme in the same way as any other wholesale business. Internet sales to private individuals are not wholesale supplies and don't fall within the scope of the scheme. Overseas internet vendors, with no UK establishment, are not within the scope of the scheme, but they use one of the appropriate methods for importing alcohol into the UK.

Importers of alcohol only need to be approved under the scheme if they carrying on, or intend to carry on, a controlled activity. Import agents accounting for duty only do not need to be approved under the scheme.⁷⁶

Registration Obligation – Applying for Approval⁷⁷

New wholesalers must apply online at least 45 days in advance of the date they plan to commence business⁷⁸ and HMRC anticipates approving registrations within that timeframe.⁷⁹ All business locations where controlled activities take place are covered by the single application so applicants need to submit details of all of these business premises. Separate AWRS registrations must be submitted for distilled spirits, wine and beer.⁸⁰ The approval HMRC subsequently gives would normally be for all of these premises. In some cases, HMRC may decide that it is⁸¹ necessary to place conditions or restrictions on your approval regarding the premises from which you can carry on a controlled activity. If HMRC does, it will explain the reasons to you.

⁷⁵ 5.3, of Excise Notice 2002.

⁷⁶ 5.3 and 5.5, of Excise Notice 2002.

⁷⁷ There were transition rules for wholesaler businesses to apply for AWRS registration before the requirements for purchasers verifying the registration status of the wholesaler became effective on April 1, 2017. All businesses trading on or before March 31, 2016, had a three-month window between January 1 and March 31, to apply in order to keep trading. New businesses wanting to commence after March 31, 2016, had to apply at least 45 calendar days before they wished to commence trading.

⁷⁸ 6.2 of Excise Notice 2002.

⁷⁹ 6.4, of Excise Notice 2002.

⁸⁰ Per conversation with HMRC representative on April 12, 2017.

⁸¹ 6.3, of Excise Notice 2002.

Additionally, a single approval for a corporate group is possible under the AWRS.⁸² A number of procedures apply to the addition or departure of members of the group.

While the online application requires basic information about the company,⁸³ the key to approval is a determination based on the “fit and proper” criteria. HMRC will evaluate information about the applicant from government records sources and may conduct a visit of the applicant’s premises (generally via an appointment) to inquire about suppliers, customers, business plans, accounting and stock control systems, and premises and financial viability.⁸⁴

The “fit and proper” evaluation means that “means HMRC must be satisfied the business is genuine and that all persons with an important role or interest in it are law abiding, responsible and don’t pose any significant threat in terms of potential revenue non-compliance or fraud.” The guidance contains the following non-exhaustive list of criterion:⁸⁵

- there’s no evidence of illicit trading indicating the business is a serious threat to the revenue, or that key persons involved in the business have been previously involved in significant revenue non-compliance, or fraud, either within excise or other regimes. Some examples of evidence HMRC would consider are:
 - assessments for duty unpaid stock or for other under-declarations of tax that suggest there’s a significant risk that the business would be prepared to trade in duty unpaid alcohol
 - seizures of duty unpaid products
 - penalties for wrongdoing or other civil penalties, which suggest a business doesn’t have a responsible outlook on its tax obligations
 - trading with unapproved persons
 - previous occasions where approvals have been revoked or refused for this or other regimes (including liquor licensing, etc.)
 - previous confiscation orders and recovery proceedings under the Proceeds of Crime Act
 - key persons have been disqualified as a director under company law
- there are no connections between the businesses, or key persons involved in the business, with other known non-compliant or fraudulent businesses
- key persons involved in the business have no criminal convictions, which may include offences involving any dishonesty or links to organised criminal activity. HMRC will normally disregard convictions that are spent provided there are no wider indications that the person in question continues to pose a serious threat to the revenue (an ‘unspent’ conviction is one that has not expired under the terms of the Rehabilitation of Offenders Act 1974)
- the application is accurate and complete and there has been no attempt to deceive

⁸² 14.1 to 14.17, Excise Notice 2002. By comparison, in the United States, each location conducting businesses requiring a basic permit under the Federal Alcohol Administration Act, 27 USC 203, is required to be covered by its own basic permit. 27 CFR 1.29. This means that administrative action to suspend or revoke a basic permit only applies to the business premises covered by that basic permit in a multi-location industry member.

⁸³ 6.6, of Excise Notice 2002.

⁸⁴ 6.8, of Excise Notice 2002.

⁸⁵ 6.9, of Excise Notice 2002.

- there haven't been persistent or negligent failures to comply with any HMRC record-keeping requirements. For example: poor record keeping in spite of warnings or absence of key business records
- the applicant, or key persons in the business, have not previously attempted to avoid being approved and traded unapproved
- the business has provided sufficient evidence of its commercial viability and/or credibility - HMRC won't approve applicants where they find that they cannot substantiate that there's a genuine plan to legitimately trade from the proposed date of approval
- there are no outstanding, unmanaged HMRC debts or a history of poor payment
- the business has in place satisfactory due diligence procedures covering its dealings with customers and suppliers to protect it from trading in illicit supply-chains, see [section 12](#) for more information about due diligence.

If an application is “refused” (that is, denied), HMRC will provide its reasons and there is an appeal process.⁸⁶ Interesting, HMRC also advised that, “Refusal of an AWRS approval may also lead HMRC to review whether you're fit and proper in relation to any other approvals you hold.”⁸⁷ Thus, wholesalers who are also producers or retailers may have their other approvals impacted here.

There are procedures for cancelling approvals where a wholesaler ceases to trade in alcohol.⁸⁸ The register is updated to show the cessation so trade buyers can determine that the wholesaler is no longer approved.

Wholesaler Obligations After Approval

HMRC will notify the wholesaler of its approval (along with any conditions or restrictions), issue the unique reference number (URN) and enter the wholesaler on the register of approved wholesalers that is accessible online to trade buyers. The URN must appear on all of the sales invoices of the wholesaler of controlled liquor (and may appear on other commercial records) and must be given to a trade buyer upon request.⁸⁹

The approval is conditioned on maintaining the business in accordance with the “fit and proper” standards along with “be vigilant and help to reduce the number of opportunities for fraudsters to infiltrate the sector.”⁹⁰ Again, along with the due diligence approach under the AWRS, this places a responsibility on the industry member to ensure that only legitimate products enter the distribution channels.

Detailed recordkeeping requirements apply to wholesalers covering their receipt and disposition of controlled liquors (and in some cases, other products), sales transactions information and other

⁸⁶ 9.1 to 9.2 and 19, of Excise Notice 2002.

⁸⁷ 9.1, of Excise Notice 2002.

⁸⁸ 15.1 to 15.3, of Excise Notice 2002.

⁸⁹ 7.1 to 7.2, 8.1 to 8.2, 10.1 to 10.4, of Excise Notice 2002.

⁹⁰ 10.2, of Excise Notice 2002.

commercial documents.⁹¹ Appendix I of this paper reproduces the list of required records. These documents must be preserved for six years and may be inspected by HMRC.⁹²

Due diligence obligations represent the core function of the AWRS to create a business culture of anti-fraudulent alcohol compliance. HMRC explains in Excise Notice 2002, in the following terms, what conduct is sought by this obligation:⁹³

Due diligence is the appropriate reasonable care a company exercises when entering into business relations or contracts with other companies, and how it responds to specific trading risks it identifies.

Without effective safeguards in place, all businesses are exposed to considerable risks along alcohol supply chains and may become implicated in illicit trading.

This condition requires all excise registered businesses operating in the alcohol sector to consider the risk of excise duty evasion, as well as any commercial or other risks when they are trading.

Doing so will help to drive illicit trading out of alcohol supply chains, and reduce the risk to businesses of financial liabilities associated with goods on which duty has been evaded.

To effectuate compliance with this obligation, HMRC has very detailed lists of “risk indicators”⁹⁴ of the type of business conduct that the approved wholesaler must take into consideration in evaluating both its suppliers and customers, as well as detailed examples of due diligence checks. Appendix II of this paper reproduces the guidance from Excise Notice 2002 on these indicators and examples of due diligence checks. During both the approval process and general audits later, HMRC assesses how well the wholesaler’s due diligence program complies with these standards.⁹⁵

Recalling that wholesaler conduct is undertaken by suppliers/producers, stand-alone wholesalers and retailers, the impact of this due diligence is felt throughout the supply chain in the UK. After examining the breadth of indicators that must be taken into account, one would reasonably conclude that it should effectively combat illegal products from being sold by trade buyers. It may be that many wholesalers have established supply arrangements so these risk indicators may not require constant checking of those suppliers. By way of comparison, in the United States, some wholesalers have long term “franchise agreements” with certain suppliers. In this

⁹¹ 11.1 and Annex A of Excise Notice 2002. The records in Annex A have the force of law under The Wholesaling of Controlled Liquor Regulation 2015.

⁹² 11.1 and 11.3, of Excise Notice 2002. The preservation and inspection provision has the force of law under the Regulation enacted in 2015.

⁹³ 12.1, of Excise Notice 2002.

⁹⁴ 12.3, of Excise Notice 2002.

⁹⁵ 12.5, of Excise Notice 2002. Per conversations with several industry stakeholders on April 12-13, 2017, some noted concerns about consistency between companies when HMRC officials applied these standards. Some in industry would like more updates from HMRC.

continuing relationship, the wholesalers know enough about their suppliers to make these types of product integrity decisions as part of the normal business relationship. Moreover, primary source, retail to retail sales bans and exclusive territory laws ensure a closed distribution system. If a product is on a retailer shelf, the wholesaler acts as a quasi-policeman to know it comes through its operation and not from an unauthorized channel. Retailers under the AWRS, however, may use many different wholesale sources and it may be that this burden is greater on them. As inspections take place in the future, it will be interesting to see if HMRC is able to access the burden time by wholesalers in undertaking their due diligence checks. It would be valuable if HMRC could determine whether certain of the risk indicators are better than others at preventing illegal alcohol products from entering the distribution system, and refine the list. These could be used as best practices by other regulators who seek to combat fake, counterfeit, fraudulent and illicit alcohol in their markets.

Trade Buyer Obligations

It is an offence to buy alcohol for re-sale from unapproved UK wholesalers. With the exception of purchases direct from overseas suppliers and purchases from licensed retailers who are making only incidental sales, trade buyers will need to ensure that the wholesalers they purchase from have been approved by HMRC. A trade buyer is “someone who purchases alcohol from a wholesaler to either sell to trade or private individuals, for example a retailer.”⁹⁶ Trade buyers have a due diligence obligation. First, they must confirm that the wholesaler from whom they are purchasing is approved on the online register or that the particular transaction is excluded from the AWRS. The online service shows the wholesaler’s approval URN, their date of registration, the business name and trading name and their principle place of business. For groups, it will also show details of the representative member and other members of the group and their trading names and addresses. If a wholesaler has been approved, but has since ceased trading, the look-up will return the dates that the wholesaler was removed from the register.⁹⁷ If they believe the person is not an approved wholesaler, the trade buyer must cease the transaction and is required to report this to HMRC.⁹⁸

Where the trade buyer has a continuing relationship with a wholesaler, the Excise Notice places the burden on the trade buyer to “refresh” its check of the register on a due diligence basis.⁹⁹ The Excise Notice does not prescribe a record format that the trade buyer must keep, but points out that the trade buyer must be able to provide commercial records upon request by HMRC to show that it met its obligation to not commit the offense of purchasing from an unapproved wholesaler. It encourages trade buyers to keep a record of the online checks.¹⁰⁰

Sanctions, Penalties, and Forfeitures

⁹⁶ Glossary in Excise Notice 2002.

⁹⁷ 13.1, 13.4, and 13.5, of Excise Notice 2002.

⁹⁸ 13.3, of Excise Notice 2002.

⁹⁹ 13, Opening Paragraph, of Excise Notice 2002.

¹⁰⁰ 13.6, of Excise Notice 2002.

In addition to the revocation of the approved registration,¹⁰¹ there are criminal and civil penalties and forfeiture potential. It is a criminal offense for a person to knowingly sell, arrange, offer or expose for sale alcohol wholesale without approval. From 1 April 2017, it is also an offense to knowingly buy alcohol wholesale from a person who should be approved. Penalties can include a fine, imprisonment of up to 7 years, or both.¹⁰²

Civil penalties are divided into two categories: Behavioural Penalties and Regulatory Penalties. Various tax regimes in the UK have behavioural penalties where HMRC works with the person to determine why the misconduct or contravention occurred and the type of behavior causing it will determine the amount of the actual penalty. In the AWRS, the behavioural penalty applies to (1) carrying on a controlled activity without approval or (2) buying from an unapproved wholesaler (applicable to all trade buyers, including wholesalers buying from other wholesalers who are not approved). The maximum AWRS behavioural penalty is £10,000. The actual penalty to be applied will be calculated based on the behaviour and quality of disclosure by the industry member using stated factors with numerical values to reduce the penalty amount.¹⁰³ Also, the penalty can be waived where the person has reasonable cause and the failure was not deliberate and the person has notified HMRC without unreasonable delay.¹⁰⁴

Regulatory penalties may be charged for contraventions of The Wholesaling of Controlled Liquor Regulations 2015 or of the conditions of the HMRC approval. Regulatory penalties are

¹⁰¹ 15.4, of Excise Notice 2002.

¹⁰² 16.1, of Excise Notice 2002.

¹⁰³ 16.5 Reducing the amount of the penalty you may be charged

HMRC can reduce the amount of any penalty they charge you depending on their view of how much assistance you gave them. HMRC refer to this assistance as the 'quality of disclosure' or as 'telling, helping and giving'.

Examples of telling, helping and giving include:

- telling HMRC about, or agreeing that there's a failure and how and why it happened
- telling HMRC everything you can about the extent of the failure as soon as you know about it
- telling and helping HMRC by answering their questions in full
- helping HMRC to understand your accounts or records
- helping HMRC by replying to their letters quickly
- helping HMRC by agreeing to attend any meetings, or visits, at a mutually convenient time
- helping HMRC by checking your own records to identify the extent of the failure
- giving HMRC access to documents they have asked for without unnecessary delay
- giving HMRC access to documents they may not know about, as well as those that they ask to see

HMRC will reduce the penalty by the maximum amount possible if you:

- tell them everything you can about any wrongdoing as soon as you know about it or you believe they are about to find it
- do everything you can to help them correct it

If you delay telling HMRC, you may still be entitled to a reduction but it will be smaller. If HMRC don't need any extra assistance from you, they will give you the full reduction that the law allows for 'telling, helping and giving'.

¹⁰⁴ 16.3 to 16.8, of Excise Notice 2002.

restriction of your approval, revocation of your approval, or the imposition of a financial penalty of £500 for each breach. This penalty may also be waived for a reasonable excuse.¹⁰⁵

Forfeiture of controlled liquor (whether or not the duty has been paid) is possible if a person carries on a controlled activity without approval, breaches any conditions or restrictions of an AWRS approval, continues to trade after cancellation or revocation of an approval, or buys controlled liquor from an unapproved wholesaler.¹⁰⁶

Conclusions about the AWRS

Solid public policy studies by the government identified a supply chain weakness in the wholesaler activity that was then addressed through detailed and lengthy public consultations with the various stakeholders. This more-than-a-decade-long process resulted in the AWRS. It recognizes the importance of the wholesaling function in controlling the alcohol products that enter the supply chain. The adoption of this scheme shows the importance of a “closed distribution system,” that is, one that is regulated at all levels of the supply chain. One trade article reported early successes in noting that some registered wholesalers had seen increase sales, which they believe were from ousting rogue traders from the market.¹⁰⁷ After all of the implementation steps were in place, industry stakeholders continue to support the scheme.¹⁰⁸ Between April 1 and April 12, 2017, there were 22 hits on the online registry URN check.¹⁰⁹

HMRC will likely conduct assessments as part of its alcohol fraud strategies on the effectiveness of the scheme in combatting fake and other illegal alcohol. For example, AWRS allows large retailers with wholesale arms to be regulated by HMRC for the first time, and for their experience to be evaluated. Also, some pubs are now wholesalers covered by the scheme. HMRC can refine the AWRS, if necessary, and utilize the expertise of the Joint Alcohol Anti-Fraud Taskforce comprised of government officials and industry stakeholders.

Future refinements may want to consider lessons from the United States’ experience in the distribution of alcohol. The three-tier system in the United States of supplier/producers, wholesaler/distributors and retailers has traditionally established these entities as separate and independent tiers under state-based regulation. The legitimacy of this system has been recognized by the United States Supreme Court in *Granholm v. Heald*.¹¹⁰

In designing AWRS, HMRC generally required all entities conducting wholesaling activity to register even if that company already held an alcohol related registration/license. This conclusion reflects the fact that an industry member may function well in one line of business (such as being

¹⁰⁵ 17.1 to 17.3, of Excise Notice 2002.

¹⁰⁶ 18.1, of Excise Notice 2002.

¹⁰⁷ 5 things you need to know about the Alcohol Wholesale Registration Scheme, **Retail Trade**, march 25, 2017 at <https://www.betterretailing.com/alcohol-whole-registration-scheme>

¹⁰⁸ AWRS comes into force for retailers, 3 April 2017, by Arabella Mileham at <https://www.thedrinksbusiness.com/2017/04/awrs-comes-into-force-for-retailers> and Make fools of alcohol fraudsters, by James Bielby, Chief Executive Director of the UK Federation of Wholesaler Distributors, **The Grocer**, 1 April 2017 at www.the-grocer.co.uk

¹⁰⁹ Per a conversation with an HRMC representative on April 12, 2017.

¹¹⁰ 544 U.S. 460 (2005)

a producer/supplier or a retailer) but still needs to be assessed independently about its wholesaling activity. Implicitly, it recognizes the underlying notion of the three-tier system in the United States where producer/supplier, wholesaler and retailer are separate business functions that need separate regulation. The 2014 study entitled, “The ‘Fake Alcohol’ Situation in the United States: The Impact of Culture, Market Economics, and the Current Regulatory Systems” concluded that independent entities at the different tiers provide checks and balances against abuses by their competitors and the other tiers in the supply chain.¹¹¹ Essentially, AWRS was adopted to address a specific void in the existing overall regulatory controls in the UK over the supply chain and left to another day public policy decisions on whether additional terms or conditions should be considered in the regulation businesses in this supply chain.

Finally, as discussed below, AWRS enables the UK to have a stronger domestic distribution system that can mitigate any new challenges of fake or illegal products in the supply chain distribution system through new trade relations with the European Union as a result of Brexit.

Domestic/Internal Regulatory Controls and Brexit:

Pending the outcome of the Brexit negotiations, a few observations may be offered about the importance of the AWRS in ensuring that only authentic alcohol products are in the domestic supply chain in the UK.

Multilateral-agreements like the World Trade Organization’s (WTO) Agreement on Trade-related Aspects of Intellectual Property (TRIPS) help to ensure the authenticity of products bearing certain marks and indications. The TRIPS Agreement requires that WTO members have domestic regimes that are in compliance with the TRIPS requirements. But actual distribution systems are the life-blood of those authentic products in reaching consumers. The Agreement on Technical Barriers to Trade (TBT) contains obligations that may impact distribution systems. However, many WTO Members do recognize the distribution of alcohol may require exceptions to some of these obligations. The General Counsel of the United States Trade Representative (USTR) explained in great detail the rationale for these exceptions in a letter, dated December 21, 2007, to the National Beer Wholesalers Association. The letter states:

As you are aware, the schedule of service commitments of the United States includes an exception for alcoholic beverages and certain other products from our otherwise broad commitments to allow market access for wholesale and retail distribution. This exception was created during the Uruguay round to reflect the variety of distribution regulations among the states relating to alcoholic beverages.

USTR has made our policy on alcohol distribution completely clear to our trading partners. The administration supports an ambitious outcome for services,... However, the proponents of liberalization in the distribution sector, including in the United States, have agreed that WTO Members should be permitted to take exceptions to distribution

¹¹¹ Executive Summary, Paragraphs 7 and 9, at <http://www.centerforalcoholpolicy.org/2014/09/22/former-ttb-chief-counsel-to-present-new-study-on-counterfeit-alcohol-at-seventh-annual-alcohol-law-and-policy-conference-2/>

commitments for a limited number of clearly specified sensitive products. I note that many other WTO Members agree with us that the distribution of alcoholic beverages warrants special treatment.¹¹²

This commitment clearly recognizes the importance of the domestic distribution systems for alcohol that meet the needs of the particular country.

The UK is a huge importer of alcohol products.¹¹³ For example, the UK imports 1.8 billion bottles of wine and approximately 55 percent of that comes from the European continent. The transit of these products is covered by the Excise Movement and Control System (EMCS) that facilitates the movement of these goods around the European Union. Beer is also a concern as this product has been smuggled into the UK.¹¹⁴ Currently, wine entering the UK is subject to safeguards and the terms of the European single market, such as the EMCS. There are some concerns about whether the UK will be able to continue its participation in EMCS. Dover handles about 290 lorries per hour carrying a range of goods, which works out to one lorry every 12.4 seconds. There is a concern that if ports of entry become “lorry parks” that the authentic goods will not get to market and this will encourage criminals to find other ways of getting alcohol into the UK.¹¹⁵

Assuming that smuggled alcohol crosses the border into the UK, domestic regulatory schemes like AWRS should mitigate the entry of the smuggled goods into supply chain.¹¹⁶ This will require aggressive compliance by all trade buyers in the scheme with the obligation to verify the approval status of the source they are buying from. It also shows the importance of the “fit and proper” standard and the inclusion of trade buyers on the register to ensure that criminal organizations are not able to obtain an imprimatur of legitimacy through a URN.

Conclusion

HMRC has a strategy encompassing three aims in its efforts:¹¹⁷

¹¹² Letter to Craig A. Purser, President, NBWA, dated December 21, 2007, from Warren H. Maruyama, General Counsel, USTR.

¹¹³ For a discussion of the scope of the wine and spirits trade, see “Brexit: The road ahead for the wine and spirits industry” at <http://www.wsta.co.uk/press/809-let-industry-lead> For statistics on beer in the UK, see the British Beer and Pub Association at <http://www.beerandpub.com/statistics>

¹¹⁴ Three jailed over € 23 million beer smuggling operations, 16 December 2016, by Lauren Eads at <https://thedrinksbusiness.com/2016/12/three-jailed-over-e23m-beer-smuggling-operation/>

¹¹⁵ WSTA: Brexit could see ‘resurgence of alcohol smugglers,’ 27 March 2017, by Lauren Eads at <https://www.thedrinksbusiness.com/2017/03/wsta-brexit-could-see-resurgence-of-alcohol-smugglers/>

¹¹⁶ One British “think tank” has observed that the UK may have to adopt more domestic regulatory controls once outside of the EU. OMFIF in a June 26, 2017, article titled “UK risks falling behind Europe” https://www.omfif.org/analysis/commentary/2017/june/uk-risks-falling-behind-europe/?utm_source=OMFIFupdate

¹¹⁷ HMRC The Alcohol Strategy, Modernising alcohol taxes to tackle fraud and reduce burdens on alcohol businesses (March 2016) https://www.newcastle.gov.uk/sites/default/files/wwwfileroot/business/trading-standards/age-restricted-products/alcohol-links-crime-and-health/governments-alcohol-strategy/hmrc_alcohol_strategy.pdf

- Promote good compliance
- Prevent tax loss
- Respond to those who cheat

AWRS advances all of these aims. Through the registration of wholesalers based on the fit and proper standard for approval, the required URN checks on the online database by purchasers from trade buyer and the due diligence obligations, HMRC promotes compliance. Some early anecdotal comments in the trade press suggest that it is preventing excise duty loss and HMRC will undoubtedly do research on this question. The wide range of sanctions, including forfeiture, available for contraventions of AWRS both promote compliance through the behavioural penalties framework and respond more strongly to those who cheat.

While the time from inception of the idea of a wholesaler registration scheme to its final implementation was lengthy, a review of that administrative history reveals a thoughtful and detailed process. From early government agency research and reports to comprehensive public consultations designed to identify the necessary features of AWRS, the review also reflects a cost-benefit approach was used to identify regulatory burdens.

Finally, AWRS recognizes the significant role played by wholesaler activity in the supply chain. It is key in preventing fake, counterfeit, contraband and illicit alcohol products from entering the distribution channels of commerce and ultimately making its way to consumers. *AWRS was adopted to address a specific void in the overall regulatory system.*

Ensuring the integrity, operation and functionality of that activity, level, or tier of the distribution system is vital for combatting fake alcohol in the UK or anywhere and, as the public policy continues to develop, it can consider whether additional conditions are appropriate to ensure the effective operations of each tier of the supply chain.

Appendix I – Record-keeping Requirements for Wholesalers
Annex A

(referred to in [paragraph 11.1](#))

This annex has force of law under Regulation 8(1) of the Wholesaling of Controlled Liquor Regulations 2015

Items and records to be kept and preserved:

(1) An approved wholesaler who receives, prepares, maintains or issues an item described in the list of required records below must:

- (a) In the case of a received item, keep and preserve the item.
- (b) In the case of an issued item, keep and preserve a copy of the item and
- (c) In the case of an item that is prepared or maintained and which hasn't been received or which isn't issued, preserve the item.

(2) An approved wholesaler must keep and preserve a record of -

- (a) The production, buying, selling, importation, exportation, dealing in or handling of controlled liquor carried on by him.
- (b) The goods (whether or not they are controlled liquor) or services received by him in connection with or to enable him to undertake a transaction or activity described in sub-paragraph (a) of this paragraph and
- (c) The financing or the facilitation, made or effected by him, of a transaction or activity described in sub-paragraph (a) of this paragraph (whether or not that transaction or activity was carried on by him).

(3) The record, required of an approved wholesaler by paragraph (2), must include:

- (a) In the case of a receipt by him of controlled liquor, the date of receipt, and the name and address of the supplier of those goods to him.
- (b) In the case of the disposal by him of controlled liquor, the name and address, except where disposed of by a retail sale, of the person who acquires them, and the date of that disposal and
- (c) In the case of a transaction described in sub-paragraph (c) of paragraph (2) (financing or facilitation):

(i) the date of receipt and the name and address of the person making or effecting that transaction, where the approved wholesaler (keeping and preserving a record as required by paragraph (2) is the recipient of that transaction

(ii) the date of making or effecting that transaction and the name and address of the recipient of it, where the approved wholesaler (keeping and preserving a record as required by paragraph (2) is making or effecting that transaction

(4) The record, required of an approved wholesaler by paragraph (2) of this annex must contain sufficient information, by way of cross referencing or otherwise, to enable an officer to trace readily any payments, made or received by that trader in respect of any controlled liquor or of any financing or facilitation described in sub-paragraph (c) of paragraph (2).

Records which must be maintained Received, Prepared, Maintained or Issued Items

- an invoice
- a credit note
- a debit note
- a statement of account
- a record relating to an importation or to an exportation
- daily record of payments to suppliers and of receipts from customers
- a journal or ledger
- a profit and loss account, trading account, management account, management report or balance sheet
- an internal or external auditor's report
- any other record maintained for a trading or business purpose

Additionally, as an approved wholesaler, you're required to keep:

- copies of delivery documents, accessible to HMRC on-site
- name and URN of suppliers
- a stock control system
- details of any premises used for storage

Appendix II – Due Diligence Obligations of Wholesalers (Chapter 12 of Excise Notice 2002)

12. Excise due diligence

One of the conditions of approval requires wholesalers to carry out reasonable due diligence checks on their supply chains. Full details of the due diligence condition is set out below.

12.1 What HMRC means by ‘due diligence’

Due diligence is the appropriate reasonable care a company exercises when entering into business relations or contracts with other companies, and how it responds to specific trading risks it identifies.

Without effective safeguards in place, all businesses are exposed to considerable risks along alcohol supply chains and may become implicated in illicit trading.

This condition requires all excise registered businesses operating in the alcohol sector consider the risk of excise duty evasion as well as any commercial or other risks when they are trading.

Doing so will help to drive illicit trading out of alcohol supply chains, and reduce the risk to businesses of financial liabilities associated with goods on which duty has been evaded.

12.2 What you need to do

It’s a condition of your approval as an alcohol wholesaler that you:

- objectively assess the risks of alcohol duty fraud within the supply chains in which you operate
- put in place reasonable and proportionate checks in your day to day trading to identify transactions that may lead to fraud or involve goods on which duty may have been evaded
- have procedures in place to take timely and effective mitigating action where a risk of fraud is identified
- document the checks you intend to carry out and have appropriate management governance in place to make sure that these are, and continue to be, carried out as intended

12.3 Assessing risks and carrying out checks

The fraud risks within a supply chain are unique to each business, and objective assessment of the likelihood of your trading activities contributing to fraud is an essential first step to developing effective due diligence procedures. You’ll need to consider the full range of trading relationships you have established and the potential for fraud in each one.

The main risks within the alcohol sector include:

- involvement in the supply of goods for fraud
- receiving goods that have been smuggled or diverted into the UK

Import and warehousing procedures are often exploited to provide cover for the illicit movement of goods. Fraudsters will seek to distribute duty evaded goods as well as counterfeit alcohol into legitimate retail supply chains. It's often the point of wholesale in the supply chain at which these goods are distributed.

To assess your exposure to this risk you will need to consider objectively whether the supply chain and trading activity is credible which includes knowing who you trade with.

Risk indicators

Possible indicators of risk include goods being received from unusually complex or apparently uneconomic supply routes. You'll also need to consider the credibility of suppliers and the level of evidence you can obtain to demonstrate the provenance and duty status of goods.

[Paragraph 12.6](#) of this notice provides further detail on risk indicators.

Once you've established the main risks of fraud you may be exposed to, your regular checks during trading should be of a type and level sufficient to establish the integrity of the excise transactions and supply chains you're trading in. The type and level need to be reasonable and proportionate to the risk.

Depending on the nature of your business and complexity of your transactions, checks will need to be individually tailored. In particular, they must be sufficiently sensitive, yet robust enough, to pick up potential fraud risks. These checks should provide protection from the threat of fraud or you becoming inadvertently involved in fraudulent activity.

As a general rule 'FITTED' checks should normally focus on:

- financial health of the company you intend trading with
- identity of the business you intend trading with
- terms of any contracts, payment and credit agreements
- transport details of the movement of the goods involved whether or not you're directly involved in this
- existence/provenance of goods - where goods are said to be duty paid you should normally seek sufficient detail to satisfy yourself of the status of the goods
- the deal, understanding the nature of the transaction itself, including:
 - how the cost of the goods is built up, for example, whether it includes appropriate taxes, transport etc
 - why is it being offered
 - whether it's too good to be true
 - how the deal compares to the market generally

[Paragraph 12.7](#) of this notice provides more examples.

12.4 Responses to identified risks

It is expected that your due diligence procedures will provide effective control over the risks of fraud within your supply chains. Where your checks indicate real concerns, HMRC would expect aspects of your supply chain to be changed to address this, e.g. the supplier or the destination of the goods.

However, a decision about whether or not to trade with another party remains a commercial decision for your business to take.

If your checks lead you to suspect duty fraud you should also contact the [Customs Hotline](#).

12.5 Review of due diligence procedures

As part of HMRC's approval process and general audit programmes, they will consider whether or not the steps you have taken to embed anti-fraud due diligence into your trading activity are sufficient and timely to address fraud risks in your supply chains. HMRC will aim to establish whether you have objectively assessed the risks in your supply chain, and you must be able to demonstrate that you have put in place reasonable and proportionate checks and effective procedures to respond to fraud risks when they arise.

If your due diligence procedures are considered insufficient to address fraud risks, HMRC will carefully consider the facts of the case before taking further action, but where appropriate they will seek to support you to strengthen your procedures.

In more serious cases such as a failure to consider the risks, undertake due diligence checks or respond to clear indications of fraud, HMRC will apply appropriate and proportionate sanctions. For serious non-compliance, such as ignoring warnings or knowingly entering into high risk transactions, they may refuse your application or revoke your AWRs approval.

You're also reminded that holding goods liable to Excise Duty outside a duty suspension arrangement on which UK excise duty hasn't been paid may cause you to become liable for any Excise Duty payable on those goods and an [excise wrongdoing penalty](#). Any of those goods you hold could also be liable to forfeiture.

[Paragraphs 12.6](#) and [12.7](#) of this notice provide further details on risk indicators and outline some of the checks that you may carry out to identify high risk transactions. Please note these are not intended to be prescriptive or exhaustive.

Once you've established the most appropriate due diligence tests for your business, these should be used to test both new and existing transactions and supply chains linked to your business. Some checks may be more appropriate to your business than others.

12.6 Examples of due diligence risk indicators

You should be concerned about a prospective transaction where you identify one or more of the following indicators in both suppliers and customers, the presence of which may lead you to make further inquiries.

Financial health of the company you intend trading with

- there's no, or poor credit ratings but it's still able to finance substantial deals
- there are high levels of debt
- they are buying high value goods on extended credit
- they are a new company with little or no trading history
- there are little or no fixed assets

Identity of the business

- you're unable to confirm the validity of their AWRS approval status, for example, they don't provide an AWRS URN, or it appears to be for a different wholesaler
- there's a lack of detail about the business's identity, e.g. no address details, or HMRC approval number
- they don't appear to be on Companies House records as originally described
- they are dealing in high value goods from short term lease accommodation and/or residential addresses
- there's no general visibility of the company you intend to trade with, for example, they don't appear to advertise or have a website
- they have returned only partly completed application or trading forms
- **Terms of contract, payment and credit agreements**
- an insistence on dealing in cash, especially where the transaction is a high value one
- cash payments made using money couriers
- offers of credit appear to be outside normal business practice - payment terms are normally 21, 31 or 45 days but high-risk transactions may have short payment terms, for example, 48 hours
- you're asked to make payment to an account or person that doesn't appear to be linked to the seller, or other unusual payment arrangements requested by the seller - the same applies to customers
- a valid pro-forma or purchase invoice is not/won't be provided
- the circumstances of the trading arrangement seem false or contrived - for example, a supplier provides you with the details of a customer for the goods he's selling to you, or offers you a contract with no financial loss to you

Transport

The goods are to be received from an unusual source or supply route, for example, UK produced goods are sourced from another country and directly compete with those from a more direct supply route.

Existence or provenance of goods

- the goods are claimed to be duty paid but your supplier (or person on whose behalf you are storing the goods) can't provide reasonable evidence of duty payment to support the status of the goods - (For further detail about what constitutes evidence of duty payment please refer to our [Excise Notice 207: Excise Duty drawback](#))
- individuals in the company have little knowledge of your trade sector
- the company has only been trading for a very short period of time but has still managed to achieve a large income
- where samples are provided or the goods have been received:
 - for spirits there's no duty stamp in circumstances where there should be one or the duty stamp does not fluoresce (read section 5.1 of [Excise Notice DS5: UK Duty Stamps Scheme](#))
 - the goods appear counterfeit, in that the quality of labels and or packaging is poor when compared to the genuine article
 - the supporting paperwork seems false
 - the goods are older than supporting evidence (such as documents demonstrating duty payment) suggest, for example, the best before dates indicate an earlier production date whereas documentation gives the impression you were buying newer stock

The deal

These indicators are not exhaustive:

- the goods are to be moved in an unusual supply route that would add significant logistic costs and bring into question the economics of that trade (unless duty was to be evaded)
- supplies are offered via unsolicited emails or flyers received
- goods are offered at very low prices that seem too good to be true
- free gifts of similar or other excise goods not fully documented and would call into question the deal as a whole
- there are other incentives such as contingency discounts which make the deal seem too good to be true

12.7 Examples of due diligence checks

Financial health

- you should undertake credit checks or other background checks on the business you intend to trade with
- where a poor credit rating is identified, establish how the transactions will be funded - what security can be offered that you will be paid
- where credit is offered by the business, confirm who's providing the credit facility
- check which payment terms are offered and if they're commercially viable

Identity

- check company details provided to you against other sources (for example websites, letterheads and telephone directories)
- ask whether your customer or supplier is a member of a relevant trade association
- obtain copies of certificates of incorporation, VAT registration certificates and excise registration certificates where appropriate and where a trade class is quoted on these check whether or not it relates to the type of trade you're engaging in
- verify VAT and excise registration details with HMRC, including checks of the online look-up system for AWRS-approved wholesalers (HMRC recommend that these checks are undertaken regularly for new trading arrangements and proportionately longer for trusted ones, unless you suspect a problem)
- obtain signed letters of introduction on headed letter paper and references from other customers or suppliers
- insist on personal contact with a senior official of the prospective supplier and where necessary, make an initial visit to their premises - you should use this opportunity to confirm the identity of the person you intend to do business with and keep a record of your meeting
- establish what your customers' or suppliers' history in the trade is - and if this can be evidenced
- obtain the prospective customers' or suppliers' bank details - in the case of an import or export, check if the supplier or recipient share the same country of residence as their bank
- establish who you'll be paying and if this is the same company as the one you're directly dealing with
- if you're providing a service check find out who will be paying for it

Terms of any contracts, payments and credit agreements

- carefully consider the terms of any contracts and credit agreements before entering into them, and challenge elements which appear unusual
- confirm what recourse there is if the goods are not as described
- if payment is to be made to or from a third party, check if there's a sound commercial reason for this
- if payment is to be made to or from a third party, confirm if it's to or from an offshore account
- check if there are there normal commercial arrangements in place for the financing of the goods
- when payment is made from an overseas business confirm how it's to be made
- check if your supplier has referred you to a customer who is willing to buy goods of the same quantity and brand as being offered by the supplier
- confirm if your supplier offers deals that carry no commercial risk for you, for example, no requirement to pay for goods until the payment is received
- consider if the goods are adequately insured
- check if high value deals offered with no formal contractual arrangements
- when you are buying from a broker, consider:
 - what overall value does this link in the supply chain add
 - is it possible to source more directly

- how competitive is the broker's pricing compared to those from a more direct route
 - are there savings opportunities in a longer supply chain to make it viable
- where transactions are being financed by a third party, check if this person is a regulated financial body, such as a bank

Transport

Check:

- who is responsible for the transport and if the cost of the goods is inclusive of transport - if so, does this mean that the potential logistical costs make the unit price unrealistic
- details of delivery vehicles are retained, and if necessary, any variations to expected transport arrangements recorded

Existence or provenance

Consider:

- how the trader contacted you
- if the goods exist
- if you can inspect the goods before purchasing them
- if they're in good condition and not damaged
- if the quantities offered seem credible for the type of business you intend to trade with
- getting sufficient detail to satisfy yourself that the goods are duty paid - this will be easier the closer you are in the supply chain to production

The deal

Review:

- the nature of the transaction, including:
 - does it just look too good to be true
 - if the alcohol has come from abroad but is of UK origin, how did this occur and why
 - if incentives are offered, does this make the overall deal seem too good to be true
 - why is it being offered
 - have normal commercial practices been adopted in negotiating prices
 - how does the price compete with that offered by competitors
 - what is the age of the goods - if the stock is old you should seek an explanation as to its provenance
 - does the price seem realistic - you should be aware of unit cost when duty and VAT values are removed
- if you're already established in a trading agreement HMRC would also recommend that you continue to monitor correspondence and business paperwork to identify changes in those arrangements and take any follow-up action as necessary.

