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The Ineffectiveness of Tax Stamps in Combating Illicit Trade & Tax Evasion in Alcohol

Synopsis

- Tax stamps, whether physical or digital, are markers applied to excise products. While traditionally used as evidence of paid excise tax, they are now marketed as tools for controlling the supply chain and authenticating products.
- There is a global momentum, often driven by tax stamp suppliers, advocating the promise of tax stamps to control illicit trade and strengthen excise collection.
- Governments considering tax stamps in this context often fail to conduct a thorough analysis of the size, shape, and drivers of illicit trade in their countries. Consequently, most proposed solutions fail to mitigate illicit trade because they do not address the root causes of the problem of illicit trade in alcohol.
- The implementation of tax stamp systems can be excessively costly, especially compared to the lack of any substantial impact on smuggling, counterfeiting, and tax leakage. In practice, tax stamps have failed to effectively reduce illicit trade in alcohol where they have been introduced.
- Moreover, there is inconclusive evidence that tax stamp schemes increase revenue collection compared to the cost of implementing and enforcing them.
- In light of these considerations, governments should take the responsibility to meticulously scrutinize public policy proposals, regulations, and systems. They must assess whether similar systems have been successfully implemented in other countries, and they should engage in a benchmarking exercise to gather actionable insights on what works and what does not. This scrutiny is essential to maintain a proportional balance between the effectiveness of potential measures aimed at curbing illicit trade in alcohol, the associated costs (including system enforcement), consumer safety, and the potential disruption to legitimate businesses.

I. Introduction

Illicit trade in alcohol

Illicit trade in alcohol is widespread and now accounts for a significant percentage of total alcohol consumption worldwide. Roughly 1 in 4 alcohol bottles is illicit.[1]

Types of illicit alcohol - The composition of the illicit alcohol market varies by region, country, and community.

- Counterfeit Alcohol: Illicit alcohol sold as a legal brand (substitute), empty bottles of legitimate products refilled with cheaper alcohol (refill) or industrial production of illicit brands or unbranded alcohol.
- Contraband of finished products or raw material: Illicit imports of ethanol as raw material or illicit imports of alcoholic beverages as finished product.
- Illegal artisanal: Illicit artisanal alcoholic beverages produced for commercial purposes.
- Alcohol not fit for human consumption (surrogate): Alcohol not produced for human consumption (e.g. pharmaceutical alcohol) redirected to the alcoholic beverages market.
- Tax evasion: Legal alcoholic beverages, locally produced, which do not pay excise duty.

Size and shape of markets for illicit alcohol:

While the production and sale of alcohol are regulated in many countries to ensure quality control and tax collection, the illicit market of alcoholic beverages represents a persistent and increasingly pressing challenge for policy makers worldwide. While illicit alcoholic beverages share some commonalities, there are also important and notable differences in their size, value and the ways in which the beverage is compromised in illicit trade activities.

- WHO estimates that unrecorded alcohol accounts for about 25.8% of total worldwide adult alcohol consumption and expects this to continue to rise, reaching an estimated 27.7% of consumption in 2025.[2]
- Overall, illicit distilled spirits are more common in the marketplace than illicit fermented beverages such as beer or wine. Of the illicit alcohol market, 81% is distilled (spirits). This can vary in different markets, for example, distilled spirits account for 92% of illicit alcohol volume in Latin America, 84% in Eastern Europe, and 73% in Africa.
- Of the remaining illicit alcohol market, 10% is beer and 9% is fermented (predominantly wine).[3]

Socio-economic impacts of illicit alcohol

The consequences are alarming:

- **According to OECD, the public health costs and personal tragedies from illicit alcohol are staggering**.[4] A significant concern is consumer exposure to health risks associated with toxic illicit alternatives.[5] As noted by the WHO, the consumption of illicitly or informally produced alcohol can have negative health consequences due to toxic substances and higher ethanol content.[6] These products also often fail to comply with sanitation, quality, and safety regulations, with the most perilous ones contaminated by toxic substances such as methanol, posing severe health threats, including poisoning and fatalities.[7] Deaths caused by illicit alcohol poisoning are a shocking and regular occurrence around the world.
- **Untaxed illicit alcohol drains fiscal revenues from governments** that depend on excise and other taxes to pay for services and public investment – with more severe impacts on developing countries. The EU reports a loss of EUR 1.2 billion in government revenues due to tax evasion associated with illicit trade in alcohol. The fiscal loss to governments across 24 countries in Africa, Eastern Europe, and Latin America is as much as USD 3.6 billion every year. In India, the fiscal losses associated with illegal trafficking and counterfeiting of alcohol are estimated to be EUR 273 million.
- **The COVID-19 pandemic exacerbated illicit trade in alcohol**. According to the OECD, COVID-19 restrictions increased traffic in illicit alcohol, increased consumer exposure to health risks, decreased tax revenues from the sale of alcohol, and damaged the legitimate alcohol industry.[8]

II. Introduction of tax stamps

What are tax stamps?

A tax stamp is a label or stamp affixed to a bottle of alcohol to show that the relevant excise taxes and customs duties have been paid to the government.

A tax stamp is typically created using security papers and embedded data (i.e., codes or serial numbers). They are created to be difficult to counterfeit and often feature fine details and complex designs to deter forgers. Some tax stamps are applied over the closure and double as a tamper-proof seal.

Some stamps may feature holograms and security inks. These elements promise to ensure the stamp can safeguard the product and is trackable through serialization technology. They are usually applied by the producer or the importer of the goods.

Modern tax stamps also can have a digital aspect. Various digital platforms enable businesses to register the tax information of their products and consumers assess the validity of products before purchase, such as by scanning the code with their smartphones.

What is the purpose of a tax stamp?

The main purpose of excise tax stamps is to provide a means of collecting tax. The stamps denote that a payment has been made – or is due to be made – to a recognized governing authority over an excisable item, such as a bottle of alcohol.

III. Tax stamps are ineffective measures for tackling illicit trade in alcohol

Some governments have turned to various forms of fiscal markers, such as tax stamps, to mitigate counterfeiting, smuggling, tax leakage, and other forms of illicit trade in alcohol. However, there is little evidence that tax stamps are effective in deterring illicit trade for the following reasons:

Tax stamps are an inadequate deterrent to illicit trade

Tax stamps are frequently imposed indiscriminately in markets to all categories of illicit alcohol and/or to all types of alcohol, failing to address the underlying cause and drivers of illicit trade and inadvertently or unintentionally facilitating consumer demand for illicit alcoholic beverages.

Case study Mozambique

The implementation of tax stamps in Mozambique faced criticism for its failure to demonstrate a significant impact on reducing illicit trade. According to a report by the Public Integrity Centre (PIC) of Mozambique, the introduction of tax stamps did not effectively mitigate the smuggling of illicit, untaxed products into the country. Despite the initiation of fiscal stamps in 2017, substantial quantities of wines and spirits continued to enter Mozambique without paying any tax. In October 2021, the Mozambique Ministry of Finance presented the results of the tax stamp program, revealing that the goals for tax collection were far from being achieved, and the prevalence of illicit trade in alcohol did not diminish.[9]

In 2023, six years after the implementation of tax stamps, the Mozambican Association of Alcoholic Beverages Producers and Importers applied for European Union funding for a tax stamp impact assessment study. Despite their disappointment in the results of the tax stamp program, the Mozambique Revenue Authority refused to execute the study, citing that the tax stamp implementation was “not yet consolidated.”

These experiences underscore the challenges and shortcomings in the effectiveness of the tax stamp system in addressing the issues of tax evasion and illicit trade in Mozambique.

Case study Kenya

In early 2019, the Kenyan Revenue Authority (KRA) discovered USD 12 million of alcohol products bearing counterfeit tax stamps, and legitimately stamped bottles were refilled with cheaper or illicit alcohol.[10] In addition, 22,000 liters of ethanol and 312,000 liters of illicit alcohol were seized, underscoring the point that a tax stamp does not prevent trading in illicit

alcohol. In response, the government has publicly announced that it has lost significant amounts of tax revenues because fake stamps are used on illicit products, with the intended tax collections going to counterfeiters.[11]

Case study India

The introduction of 2D barcodes in India's Uttar Pradesh region did not prevent the death of more 59 people from illicit alcohol poisoning, and the sale of illicit alcohol continues to flourish in the state. Moreover, legitimately stamped bottles are often refilled with cheaper, illicit alcohol.[12]

Case study Ghana

Illicit trade in alcohol is widespread in Ghana,[13] and is mainly driven by illicit homebrew intended for commercial purposes. Illicit homebrew producers are unregistered and operate clandestinely without the necessary permits and licenses, making it challenging for authorities to track their activities and or enforce fiscal marking requirements. Consequently, tax stamps are not usually applied to these informal, unregulated products and have no effective role deterring the consumption of these illicit and potentially dangerous products. Tax stamps are applied to the compliant part of the market, failing to control the categories that are illicit.

Additionally, the effectiveness of the tax stamp program is not publicly known, as the government pays the stamps directly to the service provider. Information regarding the system's effectiveness, cost, performance and the number of stamps invoiced by the service provider and paid by the government is not disclosed to the public.

Case Study Tanzania

Tax Stamps were introduced in Tanzania in 2019, as part of the government's efforts to mitigate tax evasion, increase excise tax collections and fight illicit trade. Nonetheless, illicit alcohol remains prevalent in Tanzania.

Local spirits producers continue to face the unfair competition from criminal groups who counterfeit their brands and "authenticate" them with counterfeited tax stamps.[14] Distributors of international brands face a similar problem when their products are smuggled into the country by unregistered operators and traded in the market using fake or otherwise improper tax stamps to "authenticate" their legitimacy.

Case study Dominican Republic

In some countries, artisanal and homebrew products are the primary form of illicit alcohol. Tax stamps are not applied to these informal, unregulated products and consequently have no role effectiveness in deterring the consumption of these illicit and potentially dangerous products. The introduction of tax stamps in the Dominican Republic has not curbed the consumption of locally produced "cleren," which has caused hundreds of deaths in the past years.[15]

On September 29, 2021, the Dominican Republic tax authority created the Fiscal Control and Traceability System for Alcoholic Beverages and Cigars (TRAFICO) to tackle illicit trade and tax evasion in the alcoholic beverage and cigarette sectors. However, the norm did not consider the shape of the illicit market, failing to apply the new system to the categories of alcohol causing the problem.

In the case of imported alcoholic beverages, importers, foreign governments and local associations have expressed concerns over the additional costs and logistical challenges associated with complying with the new regulation and have proposed alternative ways to enhance protection against illicit trade. In response, the Dominican authorities excluded imported beer from the regulation. The application of TRAFICO is currently postponed.

Increased costs to legitimate business incentivize illicit consumption

Among the most important considerations policymakers should give to requiring tax stamps on alcoholic beverages is the unanticipated potential to incentivize the consumption of illicit alcoholic beverages. This is because the high cost of implementing a tax stamp program makes legal products more expensive – expanding the price gap between legal and illegal and incentivizing consumers to pursue cheaper, unregulated illicit products.

Higher cost burdens on legitimate businesses include (i) costs of new equipment, (ii) administrative burdens, (iii) loss of efficiency and disruptions, (iv) slower bottling lines. These additional operation costs can increase the costs of bottling by 7-10 percent on automated lines and as much as 50 percent when the stamps are applied manually. These increased costs are relatively more burdensome for small producers when tax stamps are required to be paid for in advance, presenting a cash flow impediment to small- or medium-sized firms trying to compete in the markets. For some global brands, the loss of efficiency and disruptions associated with affixing stamps may present a compelling reason to opt out of serving a particular market altogether. This decision could result in consumers in that market being deprived of access to globally recognized brands that are readily available elsewhere.

Case study Ghana

The use of paper stamps in Ghana hampers the efficiency of large-scale producers by slowing down packaging lines. This deceleration is a result of an additional mechanical process required to affix the paper stamps. Consequently, this situation prompts companies to relocate to neighboring countries like Burkina Faso, Ivory Coast, and Togo. The elevated overhead costs, associated with the additional burden of tax stamps, has resulted in a loss of foreign direct investment and capital for the Ghanaian government.

Case study Tanzania

In 2019, the Tanzanian government introduced a tax stamp regime for beer, placing the burden of equipment and installation costs on the industry, in addition to direct payments to the printing firm for each stamp. During the same year, a major beer producer in Tanzania incurred expenses exceeding USD 7.5 million on tax stamps. Moreover, the company had to absorb costs related to line downtime, electricity, and special equipment. Consequently, the

company's revenue declined, resulting in a reduction in corporate tax payments. Ultimately, the government's tax income from beer suffered due to the implementation of the tax regime.

Case study Morocco

The tax stamp system introduced in Morocco increased the costs of production by 6 to 12 percent, resulting in a 12 to 25 percent increase in the price of legitimate beer. This, in turn, led to a fall in sales of about 9 percent, but there was no reduction in the smuggling of beer. "If the objective is to mitigate illicit trade in beer, careful consideration should be given to whether investments in tax stamp programs would not be better spent on monitoring, control, and enforcement programs."[16]

Case study Angola

In May 2023, Angola introduced a requirement on the use of high security tax stamps for wines and spirits. The effectiveness of tax stamps is yet to be tested, however the legitimate operators had to deal with significant and unnecessary trade disruptions associated with the implementation of the requirement, including the lack of flexibility in terms of location where tax stamps can be affixed, insufficient stock exhaustion clause, which is problematic given the long shelf life of these products and the period of validity of tax stamps. Furthermore, in accordance with international trade regulations, draft regulations pertaining to the implementation of tax stamps are expected to be notified to the World Trade Organization (WTO) Technical Barriers to Trade (TBT) committee. This notification process provides an opportunity for a country's international partners to raise potential questions and concerns at a stage where the draft regulation can still be amended. However, in the case of Angola, the regulation on stamps was notified to the WTO TBT after the requirement had already been enforced, thus depriving its trading partners of their right to comment.[17]

Tax stamps do not guarantee increased tax collections

In cases where the government implements a tax stamp program, there is little evidence that it will increase revenue collection, especially compared to the costs of implementation.

According to the OECD, when taxpayer money is used to finance a tax stamp program, it is critical that attention be given to the different types and methods in which illicit alcohol products (spirits, wine and beer) are traded and the proportionality between the effectiveness of potentially curbing illicit trade, the cost of the remedy and the potential disruption to legitimate business.[18]

Governments should undertake empirical assessments of how tax stamps will impact the collection of tax revenues and where they have failed to increase excise tax collections as intended.

Case study Ecuador

In 2017, Ecuador introduced a tax stamp program to combat tax evasion, counterfeiting and smuggling in spirits and beer (and also tobacco) called the *"Project for the measurement,*

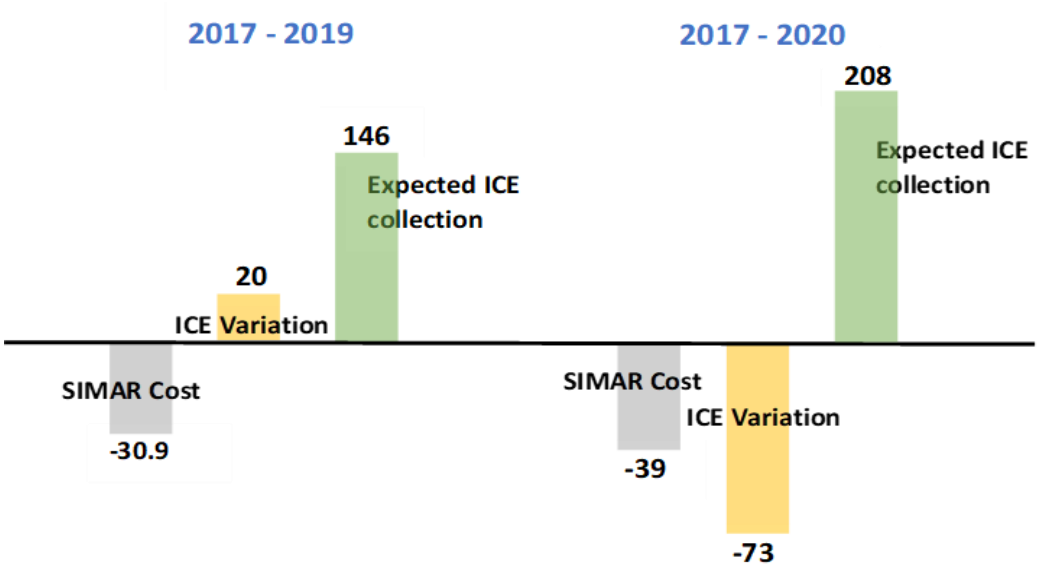
marking and tracking of cigarettes and alcoholic beverages," known as SIMAR.[19] The system was introduced at a cost to taxpayers of USD 72 million in the expectation that revenue receipts would increase significantly.[20]

Between the years 2017-2019, the government invested USD 30.9 million on the implementation of the SIMAR system. It was expected that the excise tax (ICE) collection would increase at least USD 146 million, but it only increased USD 20 million, resulting in a net negative balance for the government. When the first year of the pandemic lockdown is included in the analysis, namely the 2017-2020 period, the cost to implement the SIMAR system increased another USD 8.1 million to a total of USD 39m, with an expected increase of the ICE collections to USD 208.

However, the actual tax collection decreased USD 73m compared to 2016. While some of the decreases can be attributed to the effects of the pandemic, in 2020 the government still spent an extra USD 8.1 million of taxpayer money to implement a system that had not and did not generate net revenue.[21]

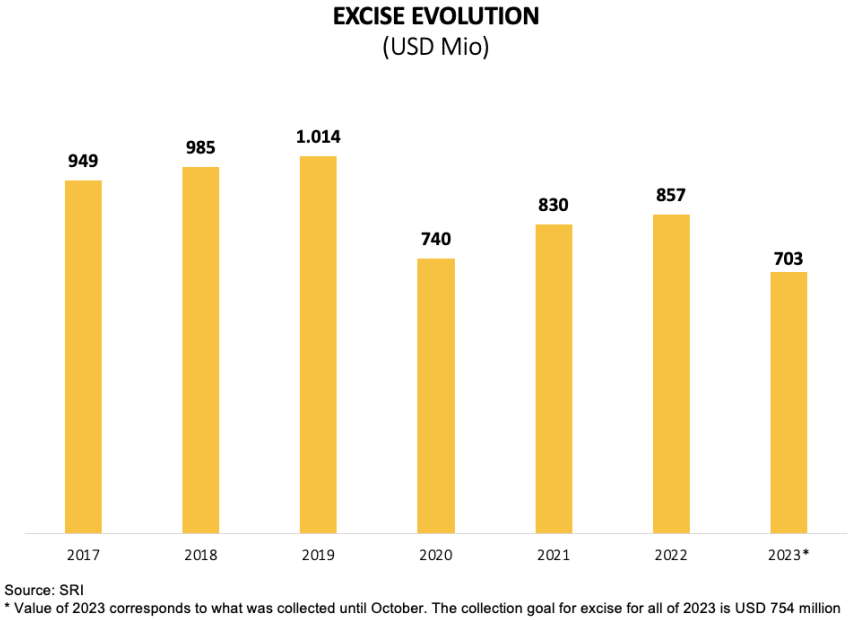
In addition to the decrease in excise tax collection concerning all three of the SIMAR targeted products,[22] implementation of the program was not balanced. For example, although illicit trade in beer represented less than 1 percent of the total market, 90 percent of SIMAR's resources were used to implement the system on the beer market, with the remaining 10 percent allocated to the other products, i.e., spirits and cigarettes.[23] Consequently, most of the program costs were allocated to a sector with the smallest incidence of illicit trade.

Given the failure of the program to increase additional excise tax receipts beyond the cost of the program, Ecuador Customs announced that it would not renew the service provider contract and will remove the requirement for fiscal marking on beer imports.



Due to the high cost of SIMAR and the lack of compliance with its objectives, in 2021 the national tax authority decided to allow producers and importers of products subject to

SIMAR to trace their products through a supplier selected by the companies. After this change was implemented, the tax collection remained stable.



Source: SRI
* Value of 2023 corresponds to what was collected until October. The collection goal for excise for all of 2023 is USD 754 million

In October 2023, the SRI decided to eliminate the requirement to mark imported beer. This decision followed the observation that applying SIMAR to imported beer proved inefficient due to the absence of beer smuggling, the high cost of the system, and the risks associated with product manipulation. Despite the fiscal traceability in place until that point, there has been consistent and effective excise payment on imported beer, facilitated by accurate entry declarations at Customs.

Case study Ghana

Ghana implemented the *Excise Tax Stamp Act 873* in 2014, requiring an excise tax stamp on tobacco products, alcoholic beverages, non-alcoholic carbonated beverages, and bottled water,[24] to serve as evidence of payments of required duties and taxes.[25] The program has failed to attain its goals and excise tax collections have fallen. According to the government's budget statements, the excise tax revenue was higher before the implementation of *Act 873*.

For example, in 2018, prior to the implementation of the tax stamp program, the Ghanian government collected USD 398 million in excise duty, which represented approximately a 14 percent increase over 2017 and a 34 percent increase over 2016. However, in 2019, during the first year of the tax stamp regime, the government excise tax collections fell by 7 percent. Moreover, the USD 5.5 million paid to the stamp vendor, increased costs to taxpayers while dramatically reducing the cost/revenue ratio for the programs.[26]

Case Study – UK

In 2006, the UK government mandated tax stamps for most spirits products on the basis of preventing perceived levels of fraud. Over several years, the industry had argued that levels of fraud were minimal; that the handling of and compliance costs for tax stamps were disproportionate and that no relevant offences had been prosecuted. The UK's existing due

diligence regime means that excise goods traders are already under a significant obligation to ensure that they are not contributing to a fraudulent supply chain. Tax stamps were only a minimal part of that due diligence requirement. In the Spring Budget 2024, it was announced its intention that these tax stamps would be abolished.

V. Recommendations

Implementation of any tax policy—including the introduction of tax stamp schemes—is complicated and will have far-reaching intended and unintended impacts on consumer choice, manufacturing, trade and the actual mix of legal and illegal products in the marketplace.

Tax stamps are used by governments to reduce fraud and the grey economy, but there is little conclusive evidence that tax stamps successfully stop illegal activity in the long term.

If a government nonetheless chooses to implement a tax stamp regime, it must examine the cost and benefits of the fiscal marking scheme before considering its introduction, including the development of an accompanying comprehensive policy to fight illicit products and avoid costs that would disrupt legitimate business. Moreover, such governments should notify the planned introduction of tax stamps to the WTO TBT committee, allowing its trading partners to comment and raise questions to minimize the implications on international trade.

1. Analyze the specific size and shape of the illicit alcohol market in the country (i.e., smuggling vs. domestic counterfeit vs. illicit artisan) to ensure that the solution matches the problem. For example, if the illicit market is wholly or largely comprised of informal production by unregistered producers, tax stamps will have little impact.
    a. Relevance to smuggling. Regulators must be aware that tax stamps will not prevent illicit smuggled alcohol from entering the market.
    b. Impact of tampering. Regulators must evaluate if the presence of forged stamps can create a false sense of authenticity and confidence among consumers, undermining the purpose of the stamps to deter the acquisition of illicit products.
    c. Impact on price and demand. Regulators must account for the upward pressures tax stamps will have on prices – making legal products more expensive to consumers and incentivizing their demand for unregulated products.
    d. Impact on reducing illicit trade. Regulators must evaluate whether tax stamps help to address the underlying drivers of illicit trade (e.g., the price gap between licit and illicit products, lack of enforcement of current regulations, excessive tax rates, large tax differentials between neighboring jurisdictions, poor border control and ineffective deterrent and enforcement programs).
    e. Costs to legitimate industry. Regulators must account for the economic burdens tax stamps can have on legitimate businesses, including increasing their costs of equipment, administrative burdens around ordering and storage of stamps, loss of efficiency, and disruptions, including slower bottling lines.

2. Investigate alternative approaches to enforcement as a priority: Consider whether investments in enforcement, improving capability and capacity to audit manufacturers, ethanol control, risk analysis and monitoring borders (in the case of smuggling), tighter controls on the duty suspension regime and bonded warehouses, better use and protection of existing traceability mechanisms, like "lot codes" may provide more effective and less costly approaches to mitigating illicit trade.
3. Empirical assessments and modeling for tax stamp systems: Undertake empirical assessments and modeling of proposed tax stamp systems to discover whether changes in tax policy and the introduction of tax stamps will impact the collection of tax revenues, as well as the effects on taxpayers and the economic burdens on industry, trade, and economic activity.
4. Strengthen revenue management institutions: Governments should consider fortifying the powers of revenue management institutions to determine the public costs or value of introducing tax stamp programs. Limited oversight may explain why several countries without tax stamps exhibit low levels of tax evasion and illicit alcohol. On the other hand, certain countries, despite having implemented a tax stamp system, still grapple with issues of illicit alcohol and tax evasion that the system was intended to address. A simple, non-discriminatory tax structure can foster compliance and transparency. If the level of taxation is too high, it will make tax evasion attractive to illegal traders.
5. Collaborate with industry players for insight: Collaborate with legitimate industry players who are most affected by the regulations to leverage their market knowledge, technical expertise, supply chain parameters, and insights into import/export challenges. Additionally, seek their input on the full costs associated with implementing a tax stamp scheme. Brand owners, in particular, possess valuable expertise and are often well-versed in determining best practices within the framework of standards defined by the government.
6. Ensure transparency in tax stamp processes: Ensure transparency in the tax stamp processes from the outset (award of tenders) to the conclusion (showing results, costs, and change in fiscal revenues). Identification of the "problem to be solved" and presentation of the solutions should be communicated transparently. Additionally, governments have an incumbent responsibility to scrutinize public policy proposals and regulations to ensure proportionality between the effectiveness of potentially curbing illicit trade in alcohol, the cost of the remedy, and the potential disruption to legitimate business.

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