

# KEY CONTROLS IN THE ADMINISTRATION OF EXCISE DUTIES

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## Abstract

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With a general reduction in import tariffs, governments are placing increasing importance on excise taxation as a means of generating a reliable stream of sustainable income. Further, excise is playing a greater role in broader government policies as a form of taxation which can be used to influence consumption of certain products, generally on health or environmental protection grounds. Thus, the effective collection of excise duties is becoming a high national priority in many countries.

This paper examines ‘key controls’ in ensuring that excise revenues are properly managed. These controls centre on the requirements to license all excisable dealings and for licensees to properly record and report against relevant activities relating to these dealings. The relationship between the excise system, the associated risks and these key controls in a successful excise administration is examined.

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## Defining an excise system

For the purposes of this paper, the term ‘excise’ relates to an indirect form of taxation which is applied to a narrow base of goods (and often services) which are primarily ‘luxury’ or ‘consumer based’ in nature. Excise taxation is common throughout most countries, being an important component of their overall tax systems.

Excise taxes are classified by the Organisation for Economic Co-operation and Development (OECD) as being those taxes which are:

levied on particular products, or on a limited range of products...imposed at any stage of production or distribution and are usually assessed by reference to the weight or strength or quantity of the product, but sometimes by reference to the value.<sup>1</sup>

Excise is not a value added tax (VAT) or sales tax, which the OECD differentiates by reference to the application of such taxes (and tax credits for business inputs) at each stage or tier within the supply chain, as well as a generally broader tax base.<sup>2</sup> Excise is not usually levied instead of such taxes but rather, levied in addition to such taxes.

This paper recognises that in many countries the term ‘excise’ is not used, rather we see similar commodity and service-based taxes which meet this OECD classification for excise being known by their local titles, for example, ‘Consumption Tax’<sup>3</sup> or ‘Special Consumption Tax’<sup>4</sup>. In some cases these taxes may have a very limited base or be specific to a single type of commodity such as a ‘Fuel Tax’<sup>5</sup> or a ‘Tobacco Tax’<sup>6</sup>. The term ‘excise’ as used in this paper should be considered as including each country’s taxes that are classified as an ‘excise’ by the OECD.

Excise can also be levied on imported goods, in which case they are often referred to as ‘like goods’, that is, ‘or goods’, that is, which are like those domestically manufactured goods subject to excise. Excise

duties in this context are generally collected by the local Customs agency at the time they are declared at importation, along with any customs duties and VAT. Under the OECD classification of taxes, where an excise duty is to be collected from imported goods, it is not considered to be a 'customs' duty, but is considered to be an excise tax.<sup>7</sup>

This does raise an interesting issue as the traditional 'Customs and Excise Department' is slowly being replaced by two separate entities: a customs agency with increasing border security focus, and an inland revenue agency with responsibility for revenue collections including excise taxes and VATs. Notwithstanding this, wherever excise duties are applied to 'like' goods, both the relevant legislation, and the administration of this excise by the appropriate agency, should mirror those which apply to the equivalent locally produced excisable good.

This requirement stems from Article III of the General Agreement on Tariffs and Trade (GATT), which provides for the same treatment to be afforded to domestically produced goods as that being applied to like imported goods, 'so as not to afford any protection to domestic production'<sup>8</sup>. Therefore, in this context and for the purposes of this paper, it is assumed that consistency is in place between domestically produced excisable goods and like imported goods in terms of:

- excise duty rates
- concessions to excise duty rates
- administrative and other compliance requirements, such as reporting, registration, licensing, duty payment arrangements, etc.
- expectations in terms of compliance standards.

### **What are the major components of an excise system?**

All excise systems across the world are slightly different in terms of commodities and services taxed, the manner of taxation, the rates of excise and the taxing point. However, the basic objectives of an excise system are universal in that all excise duties due and payable should be properly brought to account and paid by the due date.

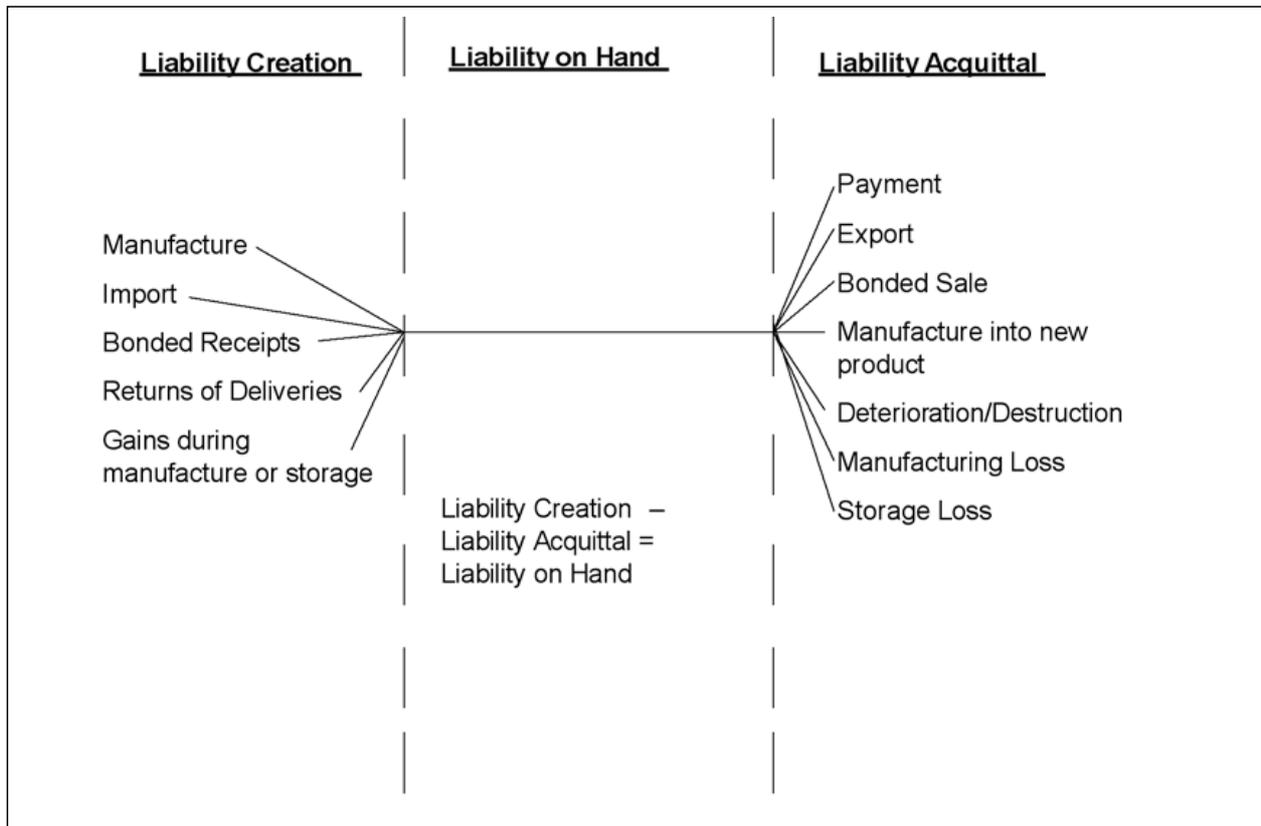
To begin examining the relationship between this objective and the key controls of an excise system which is the purpose of this paper, it is necessary to first break down a typical excise taxation system into three critical areas of operation: excise liability creation; excise liability on hand, and excise liability acquittal. Figure 1 'Tracking excise liabilities' is a diagrammatical representation of these three components and their relationship.

Figure 1 below breaks down the excise taxation system into the three components identified. The first component comprises the creation of excise liabilities. An entity within the excise system can create an excise liability in one of several ways, including:

- domestic manufacture or production of goods which are subject to excise. The situation however, may be somewhat different for services, in which case the liability may not actually be created until the service is performed
- import of 'like' goods which are subject to excise
- receipt of excisable goods from other bonded entities in which the excise liability has been transferred from that other entity
- returns of goods from the market place for which the entity has paid excise or is liable to pay excise but for which that excise or excise liability can be credited or refunded and the goods placed back into a bonded status
- gains in product volumes during either the manufacturing or storage operation.

Once an excise liability has been created, the entity holding that liability needs to be able to either properly acquit the liability or be able to account for that liability in the form of stock on hand or expected losses. Acquittal of excise liability can occur in many different ways, but primarily it is the good or service passing through the ‘taxing point’ and appropriate excise duties being remitted by the licensee.

Figure 1. *Tracking excise liabilities. Source: Preece.*



The taxing point can be described as the ‘trigger’, or the point at which the legislation provides for the liability over the excisable goods or services to be recognised and brought to account for the purposes of payment of the appropriate duty. Whilst excise duty may not be reported and paid at the time the goods pass the taxing point, such as in systems that offer deferred or periodic settlement of duty, passing the taxing point will serve to confirm the following factors:

- the rate of excise in force for the calculation of the duty
- the accounting period for which the excise duty liability must be reported
- the due date for reporting the liability
- the due date for excise duty payment.

The taxing point will vary from excise system to excise system and will be aligned with how the government views the tax. If excise is viewed locally as a ‘production tax’ or ‘manufacturing tax’, then the taxing point will be closer to the place of manufacture, for example, delivery from the production area into storage, delivery from licensed excise manufacturer’s premises, or collected with any import duty at the time of importation. Alternatively, if excise is viewed more as ‘consumption tax’, then the taxing point is more likely to be at a point where the good or service enters the market for retail sale, perhaps at the end of a long supply chain.

Dependent upon local excise laws and administrative arrangements, excise liabilities may also be acquitted in several other ways. The nature of manufacture often gives rise to loss or waste of materials during production and it is common to find systems in which otherwise excisable goods can be ‘written off’ if they are lost, destroyed or laid to waste as part of the production process and will not be entering the domestic market for sale or consumption.

Similarly, the storage of excisable goods can also see damage, destruction and other forms of deterioration which result in those goods being sent on commercial grounds for some form of destruction or recycling processes, rather than being delivered into the market. In addition, the nature of some excisable goods will see other forms of production and storage losses such as evaporation, spillages, and pipe and tank dregs that are generally seen in volatile liquids like petroleum fuels and alcohol.

The notable aspect of such losses is that the excisable goods involved will not be delivered into the domestic market and as such may give rise to an acquittal of the excise liability which had attached to the goods upon their production or importation.

A final area of excise liability acquittal comes from other sales or transfers of excisable goods and services which acquit the liability by way of those goods meeting some prescribed conditions over their end-use or destination. In terms of end-use, certain prescribed end-uses may give rise to an acquittal of excise liability including use of a raw material input in the production of a non-excisable good, or the use of the product in a manner that the government does not intend to be excisable. Perhaps the best example of these circumstances arises for distilled spirits, in which consumption as a beverage is to be subject to excise, however, distilled spirits as a raw material input to the manufacture of paint, lacquers, dyes, aerosols, etc., should not be so taxed. Alternatively, there may be an excise on motor vehicles, however, certain vehicles such as ambulances, fire-fighting trucks, or vehicles used by say, the police force are exempt from excise, and upon fulfilling the specifications of such a delivery, the liability is acquitted.

Sales of excisable goods and services may also be exported to off-shore markets in which case, in the absence of any export duties, excise duties are not generally payable or are ‘zero rated’ or ‘exempted’. The basic principle which is followed in many excise systems is that if the good or service is not to be consumed in the domestic market, then there will be no excise payable. The confirmation of export status in such cases will acquit any liability. Sales of excisable goods may also be made to other entities that deal in excisable goods and have the necessary licensing and approvals to receive excisable products from manufacturers or importers. Such parties may be:

- regional wholesalers sitting down the supply chain supplying retailers, and who will pay the excise
- other manufacturers who will value add or undertake some further processing over the goods
- duty free shops for departing passengers or foreign tourists, or
- ship and aircraft catering service providers, supplying stores for ships and aircraft undertaking international voyages.

In these situations however, it should be noted that the excise liability is actually being transferred to another entity rather than being acquitted from the system altogether. Thus the excise liability in this situation is being transferred ‘off the books’ at one business and ‘on to the books’ at another business, thus simultaneously re-establishing in a new location the same liability as was acquitted. In some jurisdictions, this type of liability transfer is not ‘simultaneous’ rather the controls around the transfer will have one entity retaining the liability right up to the point where that liability is indeed accepted into the books at its destination.

### **Key controls operating in an excise system**

Having broken down the excise system into the three components: excise liability creation; excise liability on-hand; and excise liability acquittals; and then having further identified the objectives for an

excise system, we can begin to look at what are considered the key controls in use by administrations to meet their objectives. To facilitate this discussion, we will follow Figure 2 below, which attempts to illustrate the relationship between the components of the excise systems and relevant key controls. In this case, these key controls are considered to include the licensing or registration of all excisable activities, and then the preparation of records and accounts for reporting those excisable activities to the relevant agency.

Figure 2. *Key controls in excise administration. Source: Preece.*

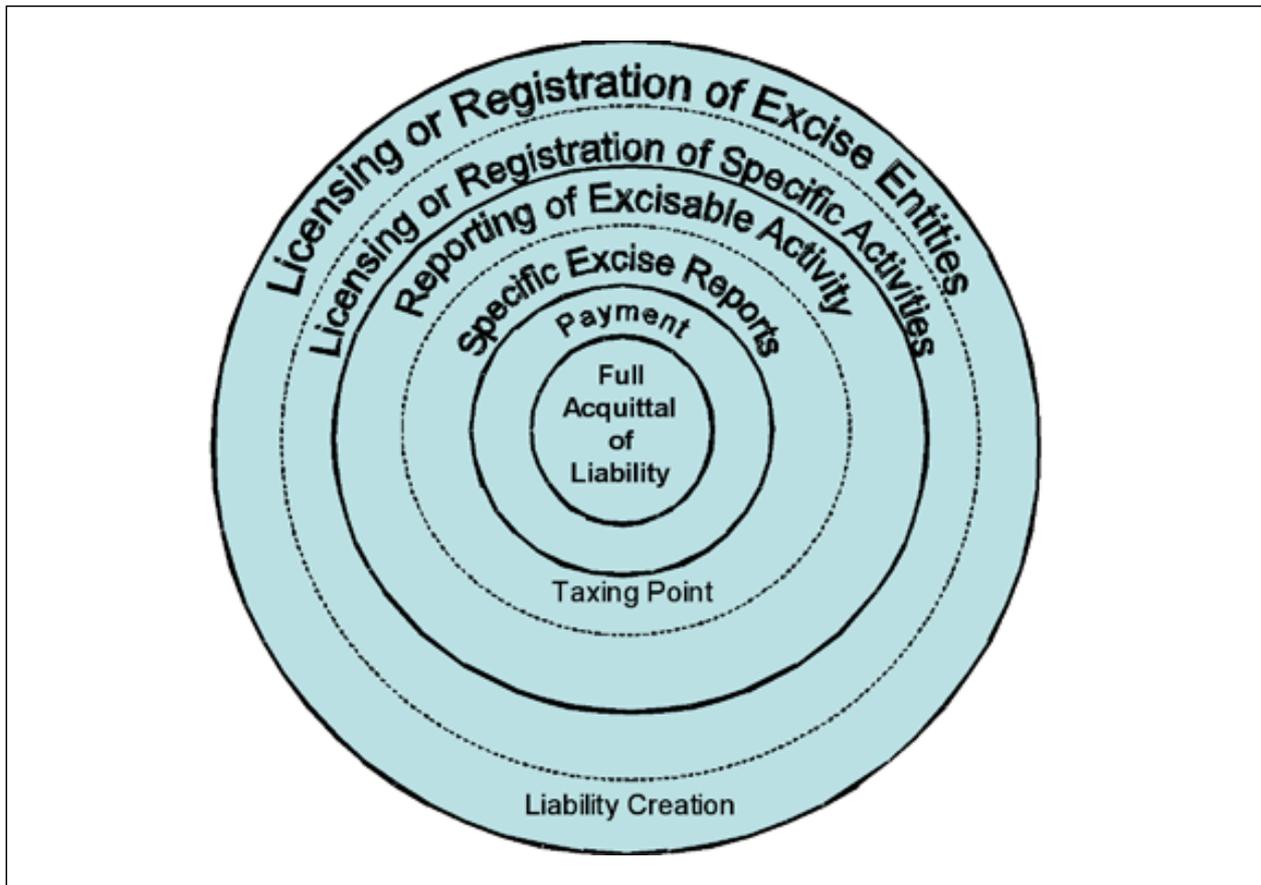


Figure 2 comprises a circle with several layers, with the outermost representing all excise liabilities created in the tax system. The layers move inwards to the point where we have full acquittal of all of the excise liability which has been created.

The layers in between represent the different layers of control which then apply as activities such as manufacture, storage, sales and deliveries occur, as well as identifying the points where excise duties become payable and are paid.

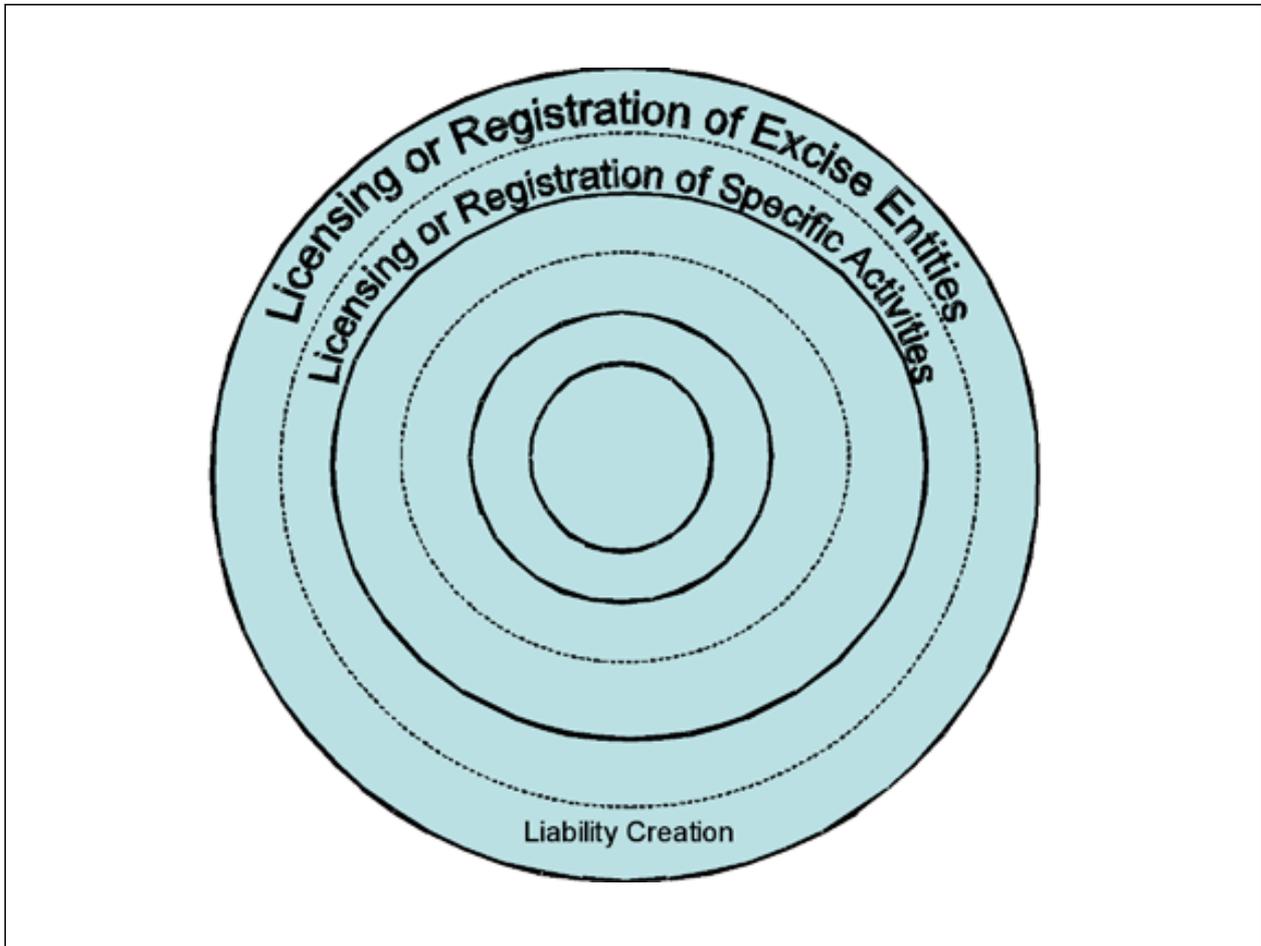
As mentioned above, the outermost layer represents all excise liabilities created within the system, be that by manufacture, importation, service delivery, bonded receipts or gains in product. In response to the need to identify all excise liability creation, the primary control in an effective excise administration is to apply a licensing or registration regime in which all those dealing with excisable goods first require such licensing or registration to do so.

In terms of use of the description ‘dealing in excisable goods’, it is contemplated that this applies to all activities including manufacture, import, storage, performance, and delivery, being brought into a registration system. Dealing in such excisable goods without the necessary registration or licensing then generally becomes a criminal offence against the relevant legislation.<sup>9</sup>

## Licensing as a control

In having a legal requirement for all entities dealing in excisable goods to be registered, licensed or in some way identified, the administering agency has full knowledge as to who is operating within the excise system and therefore will be creating excise liabilities.

Figure 3. *Primary control of excise activity. Source: Preece.*



The outer circle itself is then divided in two, the outermost ring capturing the primary control of requiring all excise activity to be licensed or registered, and the innermost ring providing for a range of ‘subsidiary’ controls relating to the licensing regime. These subsidiary controls assist in the operation of the primary licensing control by restricting licenses or registrations to specified goods or specified activities.

The concept of this primary control of licensing is to ensure that all excise liabilities which are created can be identified, be that through manufacture of excisable goods, delivery of excisable services, import of excisable goods, or other acquisitions. The control operates primarily from the administering agency having full knowledge as to where excisable operations are taking place for the purposes of monitoring and tracking any liabilities which are created.

The actual ‘granting’ of such registration or licensing contributes to the effectiveness of the control by way of a ‘review process’ in which the adequacy of the applicant as a licensed entity within the excise system is assessed. The review process over the application enables the administering agency to reject an applicant who may pose an unacceptable risk of non-compliance and loss of revenue. Alternatively, the agency can ensure modifications are undertaken to any part of the applicant’s operations it considers to be an unacceptable risk of non-compliance and loss of revenue.

Figure 4 below is an extract from the Australian excise system, in which the criteria for seeking an excise license are prescribed within the *Excise Act 1901*. The Australian Taxation Office, as administering agency, will grant or refuse an excise license based upon prescribed criteria.

The Australian excise licensing system would be considered quite rigid in the context of many other excise-type licensing or registration systems, and places considerable onus on the applicant to demonstrate that they are a bona-fide business with the full set of resources and skills for dealing in excisable goods. Further, that both the business and key personnel have sound compliance records in all taxation matters, and that there are no other aspects that put the excise revenue being generated by the business at risk of not being paid or being paid late.

Working with this over-arching control of licensing are any number of subsidiary controls such as the ability to then restrict or condition in some way, the operation of that license with a view to protecting the excise revenue.<sup>10</sup> At the first level, a license or registration can be issued against a tight scope, or in practical terms, issued for a specific activity, a certain location, a sole commodity, or a sole service delivery, any of which serve to further reduce risks to the revenue. For example, licences can be issued on the following basis:

- a single excise activity such as distillation of spirits, refining of crude oil, supply of lottery tickets, recycling of motor vehicle tyres, etc., and
- to be conducted at a single business address or location, such as a street address.

Alternatively, a single business with operations across the whole supply chain may have a licence issued for that purpose. For example, take a motor vehicle company involved in all aspects of the supply chain, a licence could be issued in the following manner:

- to a single business entity, and
- for the manufacture, movement, storage and sale of excisable cars, and
- for the manufacturing plant, the storage depots, the regional distribution depots, and perhaps the car dealerships where orders for sales are taken from customers and new vehicles delivered for delivery to those customers.

The result of scoping licences in this manner is to restrict the applicant to a single activity, or single range of related activities, at known and identifiable locations. The objectives of such restrictions are to allow administering agencies to control the nature of operations that will be conducted and to be able to reconcile such risk factors as the nature of the business applying for a licence against the type of operation for which the licence is sought.

Apart from setting the scope of a licence or registration, the licence or registration itself can then be further conditioned. These conditions will also form part of the outer ring (or primary licensing control) as shown in Figure 2, providing further subsidiary controls to the licensing or registration process designed to mitigate risks of revenue loss. Again, these conditions can be made specific dependent upon the applicant or the nature of the applicant's business.

Common forms of licence or registration conditions could include:

- the creation and maintenance of business records to a standard set by the administering agency, and which are capable of demonstrating compliance, and/or
- full and free access being available to those records, to the premises licensed, to the production machinery, to relevant apparatus such as flow meters, gauges and scales, and to any raw materials, partly manufactured goods and finished goods on the premises, and/or
- notification of changes to relevant operational matters such as replacement of key personnel, financial systems, measuring equipment or any other material change, and/or
- the lodgement of some form of documentary (or cash) security relating to the size of potential excise liabilities, to be held in the event of revenue loss from the licensed entity.

Figure 4. Section 39A, Excise Act 1901, Commonwealth of Australia, pp. 24-25.

Who can be granted an excise license in Australia?

**39A It is in the Collector's discretion whether to grant licence**

- (1) The Collector may grant, or refuse to grant, a licence.
- (2) Without limiting subsection (1) but subject to subsection (3), the Collector may refuse to grant a licence if, in the Collector's opinion:
  - (a) where the applicant is a natural person—the applicant is not a fit and proper person; or
  - (b) where the applicant is a partnership—any of the partners is not a fit and proper person; or
  - (c) where the applicant is a company—any director, officer or shareholder of the company who would participate in the management or control of the company is not a fit and proper person; or
  - (d) a natural person who would participate in the management or control of the premises in relation to which the licence is sought is not a fit and proper person; or
  - (e) where the applicant is a company—the company is not a fit and proper company; or
  - (f) the applicant is an associate (within the meaning of the *Income Tax Assessment Act 1997*) of a person who is not:
    - (i) a fit and proper person; or
    - (ii) a fit and proper company; or
  - (fa) if the applicant is a natural person—he or she does not have, and he or she does not have available to him or her, the skills and experience to carry out the activity that would be authorised by the licence; or
  - (fb) if the applicant is a company—the company does not have available to it the skills and experience to carry out the activity that would be authorised by the licence; or
  - (g) in relation to an application for a manufacturer licence or storage licence—the physical security of the premises in relation to which the licence is sought is not adequate having regard to:
    - (i) the nature of the premises; or
    - (ii) the kinds and quantity of goods that would be kept at the premises; or
    - (iii) the procedures and methods that would be adopted by the applicant to ensure the security of goods at the premises; or
  - (h) in relation to an application for a producer licence or dealer licence—the physical security of the storage place on the premises in relation to which the licence is sought is not adequate having regard to:
    - (i) the nature of the storage place; or
    - (ii) the quantity of tobacco leaf that would be kept at the storage place; or
    - (iii) the procedures and methods that would be adopted by the applicant to ensure the security of tobacco leaf at the storage place; or
  - (i) in relation to an application for a manufacturer licence or storage licence—the plant and equipment that would be used in relation to goods at the premises in relation to which the licence is sought are not suitable having regard to the nature of those goods and the premises; or
  - (ia) the applicant would not have a market for goods of a kind the licence would relate to; or
  - (j) the applicant would not be able to keep proper books of account or records to enable the CEO adequately to audit those books or records; or
  - (k) in relation to an application for a storage licence—the grant of the licence would delay liability for duty; or
  - (l) refusal to grant the licence is necessary to protect the revenue.

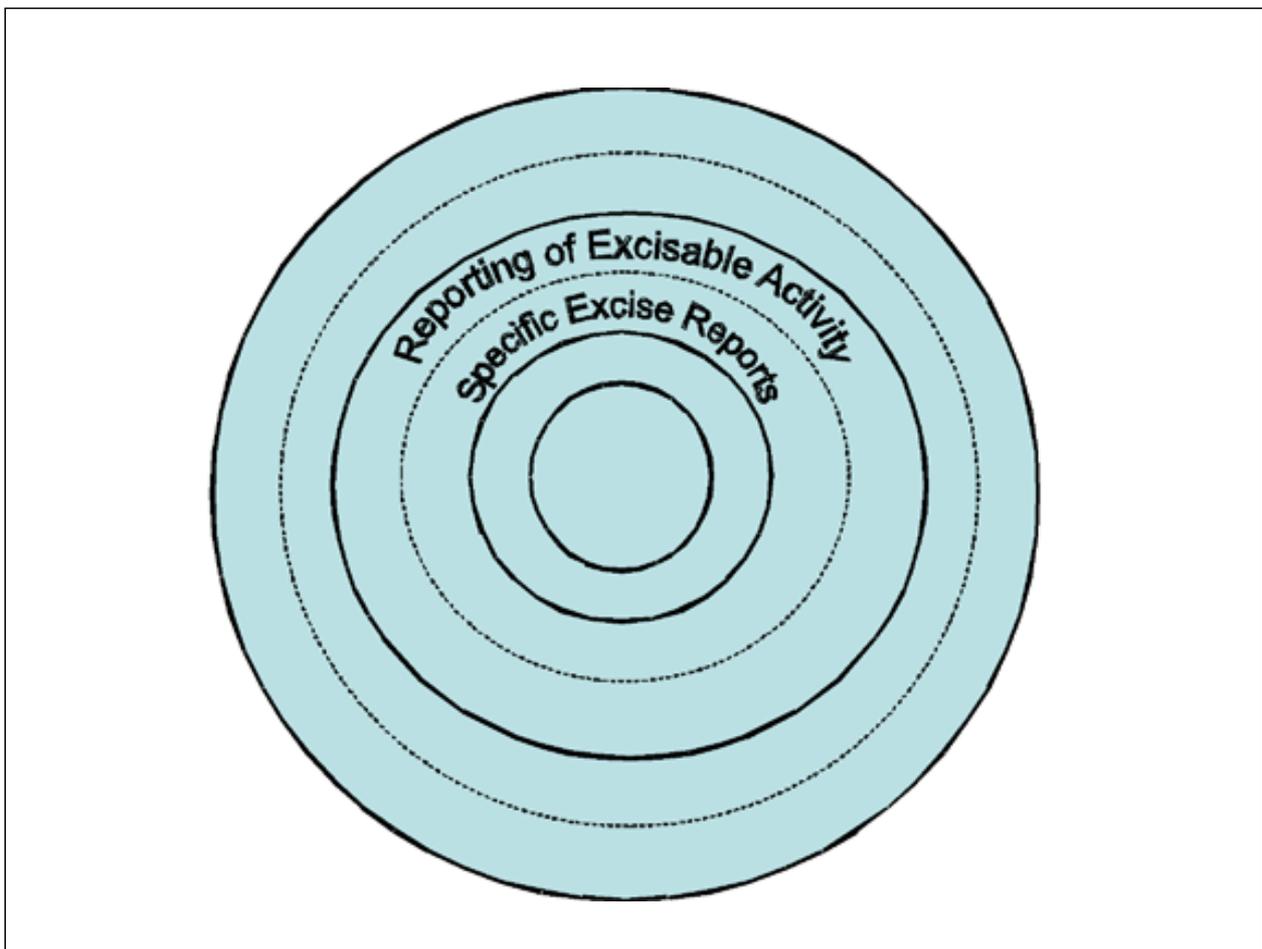
## Recording and reporting

Returning to Figure 2, we then move inwards towards the centre of the circle into the second ring and examine the key control of licensees reporting on their excise operations. This form of control relates to what information the licensee will capture and record for the purposes of reporting to the administering agency.

These types of reports are used for tracking excise liabilities as we saw in Figure 1, and monitoring the risks to that excise liability as it moves from creation to acquittal. The process of reporting licensee operational details is being made simpler for both industry and revenue agencies with the increasing use of electronic returns based upon, or created directly from, the licensee's usual commercial records.

In Figure 2, this key control of licensee reporting is again separated into an outer ring which sets the objective, the control being in this case the legal or administrative requirement to make reports to the relevant agency, and an inner ring which then requires those reports to relate directly to the nature of the excise dealings.

Figure 5. *Reporting of excise operations. Source: Preece.*



In looking at the sorts of activities to be monitored in this way, the main areas of activity which we expect to have some form of monitoring will relate to the three key components of an excise system as we examined in Figure 1, that is, excise liability creation, excise liability, excise liabilities on hand, and the acquittal of excise liabilities.

In terms of reporting against excise liability creation, we need to consider the means by which that liability is created. Looking at the detail of Figure 1, we established that such liabilities are created

through: the manufacture or production of excisable goods and services, import of excisable goods, receipts on bonded stock, or through gains. In terms of reporting in this context, the issue becomes one of establishing the right liability that has been created and now sits accurately in the licensee's records.

For liability creation originating from imports of finished excisable goods or receipts of finished excisable goods from other licensees, that liability can be reconciled fairly comfortably through reference to the relevant transactions conducted with the local Customs agency (possibly the same agency administering excise), or reference to the records of the business that has despatched the finished goods.

The issue of liability creation from manufacture is somewhat different and more complex. The objective in such circumstances is to be able to reconcile raw material inputs to final production of excisable goods. Many factors make this a difficult process and these factors include:

- the nature of the raw material, for example, how much sugar is in the fruit being fermented to make liquor
- whether there is wastage of raw materials as part of the production process
- whether there are losses of raw materials, partly manufactured or manufactured products as part of the production process, such as liquids left in pipes or tanks
- the efficiency of the production process, that is, can all raw materials be recovered
- whether there are processes such as sampling for quality control, sampling for fill, sampling for strength, etc., which require finished goods to be consumed as part of the overall manufacturing process.

Figure 6 below represents an excise report which monitors production for the purposes of ensuring all liabilities from manufacture are captured. In this case, Figure 6 relates to the distillation of spirits in Belize.<sup>11</sup>

Using Figure 6, we can see that the records to be kept by distillers facilitate the reconciliation of raw material inputs, in this case a mash of material for fermentation, a 'wash' of fermented material for distillation, and the resultant spirit from distillation. The purpose of such records allows officials to find a ratio of fermentable materials to a fermented wash, or how much fermented ethyl alcohol is produced during the fermentation process. From this point, the alcohol present in the final distilled spirit product can be compared with the alcohol present in the fermented wash that went into the distillation.

Whilst we would expect variations in ethyl alcohol produced from batch to batch as raw materials are fermented, the ratio of fermented alcohol to raw material inputs should become clear over time. Indeed, we should see a range of expected production where a specified amount of raw materials is used. Deviations from that expected range would see the licensee called to account as it could mean the potential for undeclared production. Likewise, the expected efficiency of the distillation operation will become apparent over time as the amount of alcohol recovered in distillation is compared with the amount of alcohol in the fermented mash which was put into the distillation process. Again, deviations from the expected range of alcohol recovery in the still could mean undeclared production.

These same principles will apply to the manufacture of any excisable goods; in particular, where raw material and other inputs can be measured against final production figures and efficiencies in production established.

The types of records we see at Figure 6 deal exclusively with production, and as such are likely to be associated only with that component of the licensee's business. Once excisable goods are manufactured (or imported) as finished goods, a number of activities are likely to occur in which the liability created is subsequently acquitted, transferred or written-off in some way. For licensed manufactures this information would then be recorded separately. As a result, we generally see finished goods from production (from a Figure 6 type record) being translated into a Figure 7 type record which we will now discuss.

Figure 6. *Record Book, Schedule 2, Excise Regulations Act Revised 2000.*

<p><b>PERIOD FROM ... TO:</b></p> <p><b>WASH ACCOUNT:</b></p> <p><b>Wash set up:</b></p> <ul style="list-style-type: none"> <li>b. Date</li> <li>b. Number of vat</li> <li>b. Number of gallons</li> <li>b. Density before fermentation</li> <li>b. Temperature of wash</li> </ul> <p><b>Wash attenuated:</b></p> <ul style="list-style-type: none"> <li>b. Density after fermentation</li> <li>b. Temperature of wash</li> <li>b. Number of degrees attenuated</li> <li>b. Date</li> <li>b. Number of vats distilled</li> <li>b. Gallons of wash distilled</li> </ul> <p><b>SPIRIT ACCOUNT:</b></p> <p><b>Spirit Manufactured:</b></p> <ul style="list-style-type: none"> <li>a. Liquid gallons from still</li> <li>a. Strength</li> <li>a. Number of proof gallons</li> <li>a. Average attenuation of wash</li> <li>a. Return of proof spirits per cent of wash per 5 deg. of attenuation</li> </ul> <p>Signature of Distiller:</p> <p>Signature of Excise:</p> <ul style="list-style-type: none"> <li>a. To be filled in by the proper officer when delivering spirit from receiver to distiller.</li> <li>b. To be filled in by or on behalf of the distiller as the respective operations proceed.</li> </ul>
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Figure 7 below is a generic return dealing with the movements of excisable goods in and out of a licensed warehouse in the United Kingdom<sup>12</sup> – be that part of a manufacturing operation or a separate stock warehouse operation. The return itself tracks liability by starting with an opening balance for the accounting period, then adding to that liability from the different categories of receipt. For example, using the fields from Figure 7, we see excise liability being created from production (as per our discussion on Figure 6 above), imports, gains, transfers in from other bonded warehouses, or adjustments.

Liability is then deducted through various categories such as duty paid deliveries into the home market, exports, diplomatic sales, losses, and destructions of stock. This leaves a closing balance of liabilities for the accounting period, a balance that can, if desired, be verified through physical means such as a stock take.

### **Payment of excise and acquittal of liabilities**

The final component we need to look at in the tracking of excise liabilities is the area of liability acquittal. From Figure 1 we know that excise liabilities can be acquitted in several different ways, and we see how these can apply through the reporting requirements such as those outlined in Figure 7 below, as there will be an auditable relationship between say, item 10 'Home (duty paid)' and duty payment reports; item 11 'To export...& ship stores' and export declarations; and item 14 'To other duty free uses' and duty payment reports.

As such, we now move into the innermost rings of Figure 2 circle which relate to the controls over excise duty payments and final acquittal of excise liabilities. It is also important to note that certain deliveries past the taxing point may in fact not give rise to an excise payment, for example, goods or services classified as having a 'free' rate, or some other concession which effectively reduces the rate to zero. Such goods and services may include exports, ship's stores, diplomatic sales, or sales to government. In support of these types of excise free sales, reporting of such deliveries over the accounting period is still required and allows for monitoring by the local excise administering agency.

As a result of this, the ring in Figure 2 titled 'Payment' relates to all goods and services passing the taxing point with the actual 'taxing point' indicated as being located at the edge of these two inner rings. Once all the excise liabilities which have been created have been brought properly to account either through proper payment, export, destruction, etc., then we have moved into the centre of the circle and achieved our main excise tax system objective of full acquittal.

On a licensed premise by licensed premise basis, liability is acquitted by either the goods or services passing the 'taxing' point and being brought to account with appropriate payment of excise duties, or the liability being in some way 'written-off' through losses, destruction or deterioration of goods whilst they are still within the licensed premises. Alternatively, liability can be acquitted at the individual licensee operation by the effective transfer of that liability to another licensed party – although for the excise system as a whole, the liability remains and a new risk is created through these liability transfers and further discussion appears later.

The principal liability acquittal mechanism will be the goods or services passing the taxing point and triggering the requirement for the liability to be brought to account and remitted. Just exactly when this liability is brought to account and remitted will depend on local excise law, but increasingly this process is self-assessed and the reporting and payment of excise duties relating to deliveries of goods and services are performed periodically.<sup>13</sup> However, in many jurisdictions some excisable commodities, or some excise licensees, are required to 'pre-pay' excise prior to the taxing point. In fact, they cannot deliver such goods past the taxing point unless the excise duty has been paid.

This approach can be achieved through several means. Firstly, the licensee may need to make some form of declaration or return relating to excisable goods intended to be delivered, pay an amount of excise duty relating to those intended deliveries, and await some form of clearance or other authority that delivery can take place.<sup>14</sup> This could, for example, be upon assessment as to the accuracy of the return, or perhaps the clearance of funds when paid in the form of a cheque.

The alternative approach to 'pre-payment' is through a tax strip stamp system, such as that shown as an illustrative example in Figure 9 below,<sup>15</sup> in which licensees again estimate deliveries, calculate their excise liabilities, acquire tax strip stamps to that value and affix them to individual product packaging

Figure 7. HM Revenue &amp; Customs Stock Return.

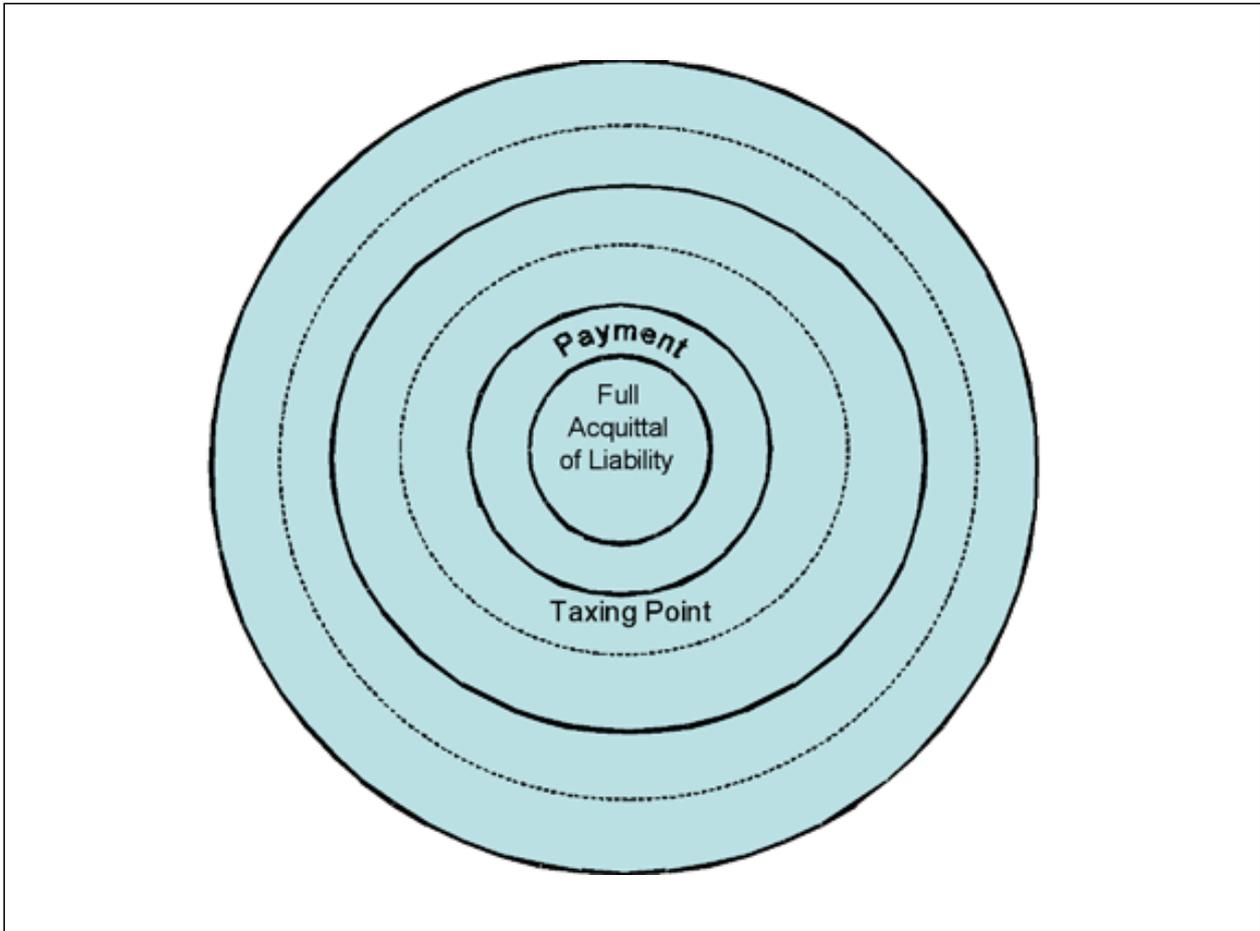
		<b>Section B Stock Return</b>		
Classification				
Unit of Measure				
		Number of cases	Number of units	Quantity
<b>Stock in w/h at start of period</b>				
Adjustment	1			
Reason for adjustment	2			
<b>Receipts for period</b>				
From importation (non EU)	3			
From EU	4			
From UK production sites and other w/h	5			
Other	6			
Gains storage	7			
Increases from operations	8			
<b>Removals during period</b>	9			
Home (duty paid)	10			
To export (outside EU) & ship stores	11			
To other UK w/h	12			
To EU	13			
To other d/f uses	14			
Losses allowed in storage	15			
Reductions/losses from ops	16			
Authorised destructions	17			
<b>Stock in w/h at end of period</b>	18			

prior to delivery. Tax strip stamps are most popular with tobacco and alcohol products which by nature are subject to high tax rates, and are vulnerable to high levels of tax evasion, but can be used for other commodities.

The main objective of the use of tax strip stamps is as a control over tax avoidance, although their use has been extended to controlling counterfeit products. The tax strip stamp is both a means of reconciling taxes paid against volumes of excisable product leaving a bonded warehouse and as a real time indication as to whether a product in the marketplace has had the appropriate tax paid.

At least 40 countries employ strip stamps on excisable products for anti-avoidance (and anti-counterfeiting) purposes. Their use is limited to a small range of excisable goods, and within this narrow range, there are often further limitations such as liquor of a certain strength.<sup>16</sup> The main exception is the United Kingdom which recently introduced tax strip stamps for all liquor exceeding 30% alcohol by volume,<sup>17</sup> on the basis of combating tax fraud. However, the use of such tax strip stamps is in decline with the advent of greater self assessment of tax liabilities supported by fully automated reporting and processing systems.<sup>18</sup>

Figure 8. *Payment and full acquittal of liability.* Source: Preece.



In such self assessment based excise systems, pre-payment is not the preferred form of excise reporting and payment, rather excise liabilities are reported and paid on a periodic basis. This means that licensees operate to an accounting period for which any deliveries past the taxing point are reported for that period, and this report and associated payment of excise are filed on a due date set for each accounting period.

To illustrate this point, Figure 10 below comprises the ‘schedule’ (or working sheet) which forms part of a periodic excise payment return. Figure 10 is an extract from the schedule to the ‘Automobiles and Non-essential Products’ return,<sup>19</sup> as required by the Philippines Bureau of Internal Revenue, relating only to the deliveries of excisable non-essential goods. Note that the licensee is reporting both taxable and non-taxable deliveries on a quantity and value basis, and the final ‘total excise tax due’ will become a single line liability reported on the actual excise return main page.

The extent to which reporting deliveries occurs depends on the local excise administration. However, there are several common key objectives in any such excise payment return. Firstly, the total excise duty due and payable needs to reconcile with the physical payment made by the licensee, whether that be by an electronic transfer, cash or cheque. Secondly, the administering agency can use the detail relating to volume or values of the differing types of deliveries to remotely monitor the nature and extent of both excisable and concessional sales with a view to establishing norms in such sales. Finally, there are statistical objectives, allowing agencies to monitor revenue receipts and sales across industry sectors, like operations, or across the entire excise system.

With the nature of excise duties, particularly as they relate to manufacturing and distributing goods, there will be a need for adjustments to these periodic return amounts. Whilst it is common in the compilation

Figure 9. Tax strip stamp example.



of any type of tax return to find errors and omissions for adjusting, excise manufacturers in particular are also dealing with issues such as:

- incorrect deliveries such as incorrect stock, or incorrect volumes or quantities selected to fill orders
- returns of stock due to those reasons above, or due perhaps to a fault or deficiency in the product, or customer simply seeking a return and refund
- incorrect classification of deliveries such as domestic sale being classified as an export, an end use requirement not being fulfilled, or a required end user not taking delivery
- failures in recording and measuring systems detected such as pipes, flow-meters, gauges or scales
- incorrect delivery date reported causing payment to occur in wrong accounting period
- the goods deteriorate, perish, break or otherwise become unsaleable.

These adjustment issues are generally addressed in two ways. Firstly, allowing for the adjustment to apply to the excise return for the current (or to a future) accounting period being reported. If we return to Figure 10 below, we can note the provision in the excise return document which permits the making of adjustments which will impact on the excise payable on the current return. Notwithstanding, as with any details provided on an excise return, the statements need to be supported by appropriate records to substantiate the adjustments being sought.

Alternatively, a document separate to a return could be required in which the licensee seeks application for the administering agency to grant a refund of excise payable. This refund could be payable to a nominated bank account, by cheque, or by a credit of excise tax which can be applied against a future excise payment. This process is also used in those situations in which excisable goods have not been delivered and the licensee wishes only that the relevant liability be ‘written-off’ their books.

In those jurisdictions in which a separate application process is in place, they will also require a similar process for licensees to make any increasing adjustments or provide for those situations where additional excise duties need to be reported and paid. Here, similar errors and circumstances to those listed above have actually caused under-payments of excise which need to be declared and remitted.

In terms of refunds, credits, or write-off of excise duties, it is generally a requirement that the licensee has to meet various criteria or be subject to certain conditions in order to be granted an excise refund or credit.<sup>20</sup> Often these criteria are prescribed in law, and are designed to ensure that excise refund policy is not ‘under-writing’ poor business or commercial decisions. As excise can often be a major cost component of the price of such goods, easy access to full refunds does remove certain risks from a business.

Figure 11 below is an extract from the Canadian application for an excise refund,<sup>21</sup> a process which requires the applicant to provide the nature of the circumstance or situation which gives rise to the entitlement. The extract provides for our information, the list of ‘eligible reasons’ for which a refund can be sought.

Returning to the issue of transferring liabilities, we had identified this as both a means of acquitting excise liabilities (and creating a new excise liability), and as a risk to the revenue within the excise

Figure 10. Extract – Excise Tax Return and Schedule for Automobiles and Non-Essential Goods.

**EXCISE TAX RETURN for AUTOMOBILES & NON-ESSENTIAL GOODS**  
**Part III PAYMENTS AND APPLICATIONS**

					<b>Amount</b>
16	Excise tax due				
17	Less: Balanced carried over from previous return	17A			
	Creditable excise tax, if applicable	17B		17C	
18	Net tax due (overpayment)			18	
19	Less: Tax paid on returns previously filed for the same period, if amended			19	
20	Tax still due/(Overpayment)			20	
21	Add penalties				
	Surcharges	21A			
	Interest	21B			
	Compromise	21C		21D	
22	Amount payable			22	
23	Less: Payment made today			23	
24	Balance to be carried over to next return			24	

**Schedule**

	<b>Summary or removals and excise due on:</b>						
			No. Units	No. Units	Sell Price Mk Value	Sell Price Mk Value	Excise Tax Due
ATC XG	<b>Non-essential products</b>	<b>Rate</b>	<b>Exempt / Un Bond</b>	<b>Taxable</b>	<b>Exempt / Un Bond</b>	<b>Taxable</b>	
100	Jewelry, Pearls, Precious and semi-precious stones	20%					
110	Perfumes and toilet waters	20%					
120	Yachts and other vessels for pleasure or sport	20%					
	<b>Total Tax Due</b>						

system. This risk relates to the ability or otherwise to properly track the excise liabilities in the same manner we track liability through a licensed business operation from manufacture to distribution.

In other words, one licensee may acquit their excise liability by way of a bonded sale to another licensee, however, that licensee identified as the customer never receives or accepts into their accounts this new excise liability. Whilst one licensee may have acquitted their liability, our excise taxation system as a whole still has excise liabilities to manage (see Figure 2). It is simply that another licensee has taken possession of that liability and it requires the agency to be able to track this, if required.

As such, we will look at one final type of excise report which relates to the effective transfer of excise liabilities between licensed entities. Such reporting is generally performed prior to the transfer occurring on a ‘permission’ basis, such as in Figure 12 below which comprises a permit for the moving of excisable goods within the Republic of Indonesia.<sup>22</sup> The permit provides sufficient details which evidence an acquittal of excise liabilities from the nominated licensee despatching the goods, and further provides details as to which licensee will be subsequently creating in their records that same liability. The permit also involves a degree of accountability, with the permit holder responsible for the excisable goods moving in accordance with their permission, including the arrival at the nominated destination.

Figure 11. *Extract – Application for Refund/Deduction of Excise Taxes, Canada.*

<p><b>CANADA REVENUE AGENCY</b></p> <p><b>APPLICATION FOR REFUND/DEDUCTION OF EXCISE TAXES</b></p> <p>Enter the reason you are eligible for a refund/deduction of taxes.</p> <ul style="list-style-type: none"> <li>• Export of vehicles</li> <li>• Refund of tax where foreign taxes paid or where</li> <li>• Payment where warranty</li> <li>• Exported goods products for sale in foreign duty free shop (tobacco only)</li> <li>• Use as ships’ stores</li> <li>• Goods in inventory at time of licensing</li> <li>• Diesel fuel used in the generation of electricity</li> <li>• Use by province</li> <li>• Subsequent exempt sale</li> <li>• Tax paid in error</li> <li>• Eligible bad debts</li> <li>• Motor fuel purchased by diplomats</li> <li>• Drawbacks</li> <li>• Other</li> </ul> <p>Note: Only one “Reason for Refund” may be used per application.</p>
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It has been recognised that with the growth in trade of excisable commodities, single movement permit arrangements are a hindrance to business and a drain on the resources of administering agencies.

However, the area of movements of excisable goods remains, universally, a high risk to the revenue, and so other options have been developed to address these issues.

The European Union has these risks multiplied somewhat by the permitted movement of excisable goods across national borders. Its response has been to propose the construction of a computerised system in which licensees would enter details of excisable movements allowing for both real time surveillance of these movements and the ability to enhance enforcement-related activities such as inspections and verifications.<sup>23</sup>

Figure 12: *Republic of Indonesia Permit to move excisable products between licensed premises.*

<p><b>Central Excise Series</b></p> <p><b>Permit for transport of un-manufactured products on which duty has not been paid</b></p> <p>Shri/Messrs.....holder(s) of Licence No.....is/are permitted between .....(hrs.) on the..... day of .....(month) in the year ..... and (hrs.) on the .... day of (month) in the year..... to transport together from Shri/Messrs.....(Name, address and Licence No.) to Shri/Messrs..... (Name, address and Licence No.) the under-mentioned goods:</p> <p>Number of packages: Description of packages: Marks and Numbers: Description: Tariff Classification: Gross weight: Net weight: Manner of transport: Route: Place:.....Date:</p> <p>Signature: .....of Central Excise</p>
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Alternatively, where certain risk factors can be mitigated, a ‘blanket’ type permit can be granted to a licensee to move excisable goods between agreed licensed locations.<sup>24</sup> Such a system introduces a degree of continuity for businesses, whilst allowing risks to be managed through the process of assessing both the licensee seeking the approval, and each of the licensees nominated for receipt of the applicant’s excisable goods. Details of each individual movement, as say, in Figure 12 below, are maintained in the records of both the despatcher and receiver for later compliance activity.

## Conclusions

To conclude, we return to Figure 2 which outlines the relationship between the risks in administering a successful excise system and the key controls of licensing and licensee recording and reporting. We see that it is important to identify all liabilities entering the excise system, and this is achieved primarily through the legal requirement to register or license all excisable dealings. In this way the relevant body administering the excise system has knowledge of or about all those entities which will be creating excise liabilities. With this knowledge in place, the appropriate recording and reporting of those activities provide for the ability for administering agencies to track these liabilities from creation to acquittal, with the further ability to monitor and identify potential risks to the revenue from any aspect of the excise system.

## Endnotes

- 1 OECD 2004, Classification of taxes and interpretative guide, paragraph 61, classification sub-heading 5121.
- 2 OECD 2004, Classification of taxes and interpretative guide, paragraphs 53-58, classification heading 5100, sub-headings 5110-5113.
- 3 In addition to a broad-based Value Added Tax, China has a Consumption Tax applicable to refined oil, motor vehicles, motor cycles, tyres, skin care products, certain wood products, watches, golf products, tobacco, and liquors.
- 4 In addition to a broad-based Value Added Tax Viet Nam has a Special Consumption Tax on liquor, tobacco, motor vehicles, refined oil, beverages, air conditioners, playing cards, gambling, golf memberships, massage and karaoke.
- 5 Australia has a Fuel Tax in addition to a Goods and Services Tax, whilst Chile has a Fuel Tax in addition to its Value Added Tax.
- 6 Chile has a Tobacco Tax in addition to the Value Added Tax.
- 7 OECD 2004, Classification of taxes and interpretative guide, paragraph 62, classification 5123.
- 8 Paragraphs 1, 2 and 4 GATT Article III 'National Treatment on Internal Taxation and Regulation'.
- 9 For example, Section 10 *Excise Act 2001* (Canada); Sub-section 8(1) *Excise Act 2058* (Nepal); Section 16 Sales Tax, *Customs & Excise Act 2000* (Bhutan); Sections 60 *Customs & Excise Act 1964* (South Africa); Section 26 *Excise Act 1901* (Australia); etc.
- 10 See examples of the authority for the making of conditions for excise licenses, as follows: *United Provinces Excise Act 1910* Part I Chapter VI (Uttar Pradesh India); *Excise Act 1958* sub-section 5(2) (Nepal); *Excise Tax Law 2001* Part II Article 5 (Montenegro); *Excise Act 1901* Section 39D (Australia).
- 11 See [http://www.customs.gov.bz/excise\\_regulations.pdf](http://www.customs.gov.bz/excise_regulations.pdf).
- 12 See [http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile%3FcontentID%3D3DHMCE\\_CL\\_000452](http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile%3FcontentID%3D3DHMCE_CL_000452).
- 13 Traditionally, excise factories had a permanent Customs or Excise officer located on site for which all receipts and deliveries were processed by this officer. This arrangement does still exist in some countries for certain commodities, for example, petroleum refineries in Thailand, but is becoming rare.
- 14 Both the United States Alcohol & Tobacco Tax & Trade Bureau, and the Australian Taxation Office have a dual payment 'pre-payment' and 'periodic payment' system, with higher risk operations or non-compliers likely to be restricted to a pre-payment/pre clearance arrangement.
- 15 Tax strip stamps, revenue stamps or fiscal stamps are common to central and eastern Europe, many Asian jurisdictions and becoming increasingly common in Africa.
- 16 United Kingdom House of Commons *Hansard* 30 March 2004, see 'Spirits tax'.
- 17 The Duty Stamps (Amendment of Paragraph 1(3) of Schedule 2A to the *Alcoholic Liquor Duties Act 1979*) Order 2006.
- 18 See, for example, the United States which in 1985 repealed its 1954 tax stamp legislation for marking distilled spirits.
- 19 See [ftp://ftp.bir.gov.ph/webadmin1/pdf/107792200%20AN\(Aug\)%20complete.pdf](ftp://ftp.bir.gov.ph/webadmin1/pdf/107792200%20AN(Aug)%20complete.pdf).
- 20 Apart from Canada Figure 6, see also, for example: Regulations 60-64 Customs & Excise Regulations 1996 (New Zealand); Regulation 50 Excise Regulations 1925 (Australia) paragraphs (1)(a) – (1)(zzd); or beer under Sub-part T, clauses 25.181 – 25.284 Code of Federal Regulations (United States); or Central Excise Rules 2002 / Export of Service Rules 2005, Customs and Central Excise Duty Drawback Rules 1995 (India).
- 21 See <http://www.cra-arc.gc.ca/E/pbg/ef/n15/n15-06e.pdf>.
- 22 See <http://www.beacukai.go.id/en/cukai/status.php>.

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- 23 Decision No. 1152/2003/EC of the European Parliament and of the Council of 16 June 2003 on computerising the movement and surveillance of excisable products.
- 24 See, for example, section 61A *Excise Act 1901* (Australia) which provides for a provision to permit movements of excisable goods. Such permissions are available in 'single' or 'continuing' format, with continuing movement permissions structured to allow a licensee to move excisable goods on a continuing basis to approved locations listed in a schedule to the permission. Applicants must demonstrate a commercial relationship exists with the nominated licensees in the schedule.

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