

## Transcript – Deadly Industry: Challenging Big Tobacco – Ep. 4, S.1

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**Louis**

Welcome to Deadly Industry: Challenging Big Tobacco, a weekly podcast from the Tobacco Control Research Group at the University of Bath. We are an international and award-winning group that investigates the tactics used by Big Tobacco to maximise its profits at the expense of public health. The evidence we produce helps society to hold this deadly industry to account.

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**Multiple speakers**

The health issues are massive. Globally, each year, tobacco kills 9 million people. That's the equivalent of wiping out the population of London each year. Corporations are out for profit. Anything that is going to harm those profits is going to be unpalatable to them. This is a massive issue globally because if you look at global deaths just four corporate products, cause between a third and two thirds of all global deaths.

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**Louis**

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In this episode, we're talking money, more specifically tax. And if you think tax sounds dry, then prepare to think again because I'm joined by Dr. Rob Branston. Rob is a senior lecturer in business economics at the University of Bath School of Management. His primary research area is the tobacco industry, with a particular focus on taxation and profitability. Welcome, Rob.

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**Rob**

Hello.

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**Louis**

Thanks for joining us today Rob. So probably a good place to start with this conversation is, you know, looking at money in general. The tobacco industry is obviously a hugely profitable industry. Maybe you could set the scene for us with exactly how much money this industry is making?

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**Rob**

Well, the tobacco industry is what I would call inordinately profitable. And by that, I mean it makes profits in a way that very little or very few other industries actually do. So let me give you an illustration of this fact. So in 2018, the most recent year for which I could find all of the relevant figures, the six largest cigarette manufacturers in the world made combined profits of 55 billion American dollars.

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Now, 55 billion is a tremendously large figure, if you think about it. But what is even more stunning is that that combined profitability was larger than the profits made by Coca-Cola, PepsiCo, Nestlé, Mondelez (the chocolate company) Fedex, General Mills (who make a lot of breakfast cereals), Starbucks (the coffee chain), Heineken (the brewer), and indeed Carlsberg (the brewer) and all of those companies combined only made 51 billion American dollars in profit.

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And if you think about all of the different brands that are owned by those companies collectively. So we've got Cadbury's chocolate, we've got Oreo cookies, we've got Pepsi, we've got Coke, we've got Frito Lay crisps, we've got Old El Paso, we've got Jolly Green Giant, we've got a whole host of common household brands that most of your listeners will find in their kitchen cupboards.

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And yet those companies collectively still made less than six large tobacco companies. So we're talking about an industry that makes a large amount of profitability in total. But more than that, they actually make a large amount of profit for each of the unit of tobacco that they sell. So, for example, if we look at the profit margins or the proportion of their revenue that is profit, we can see tobacco companies are incredibly profitable on that measure.

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So, for example, Philip Morris International made,

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profits as a

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proportion of their revenue of 42.6% in 2021, and that actually went up to almost 50% in the EU. So roughly half of the money they get to keep is pure profitability. It's a very similar situation for British American Tobacco (BAT). But they made profit margins of 43.4% in 2021.

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And to illustrate just how large this gets, if we look at Imperial Brands here in the UK, we can see that they made almost 71% profit margin in 2021. So the vast majority, more than two thirds of the money they get to keep, is pure profit. So we're dealing with an industry that makes a large amount of profit for each unit that they sell, and collectively makes a large amount of profit

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given the quantity of tobacco products that they sell. And we have to remember that these products are incredibly addictive, but so are the profits that these companies are making. To again put this in context, if we look at the profit margins that were made by all of those other companies that I just talked about, we're talking about operating profit margins in the region of 15 to 16% on average.

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So we're dealing with an industry that is vastly profitable on every level that you look at it. And this is part of the problem because companies want to keep making these large profits. The profits are as addictive as the products that they make.

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**Louis**

So why are these margins just so high? Is it because it's cheap production?

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**Rob**

Well, I think there is two main reasons for why we can see these large profit margins. Firstly, tobacco products actually cost very little to make. A packet of cigarettes probably costs less than £0.30, less than \$0.30 to make per pack. So we're dealing with something that is very cheap to make, and yet you can sell it for a very high price. In the UK

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now you can go into a shop and you can buy tobacco products for between £11 and £15 for a pack of 20. And yet they cost the manufacturer about £0.30, if that, in manufacturing costs. So there's a huge difference between the retail price and the price it cost the companies to make. And here, of course, we have to recognise that they are products that are subject to tobacco taxation, excise tax.

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So the true cost of manufacturer is a bit higher because they cost the companies the tax to sell these products. But fundamentally they have pricing power in the market. So in other words, there is a lack of competition. In most marketplaces we know companies compete aggressively against each other. They progressively lower their prices in order to try and attract customers.

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But that simply doesn't happen in tobacco markets, because we know there is a lack of competition, because we know companies cannot advertise anymore, they can't try and get their brands out there in the same way that they used to, and that we see in other industries. So firms have market power. They can put their prices up, they don't have to worry about their rivals, and they don't have to worry about losing too many of their customers because tobacco products are so terribly addictive.

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**Louis**

So just to pick up on one of those points you mentioned about the issue of competition in advertising. Do you think that's one of the challenges or maybe unintended consequences of that kind of regulation?

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**Rob**

Well, I think unintended consequences is a very nice label for that. We clearly don't allow tobacco companies to advertise for very good reasons. We don't want them to attract new smokers. We don't want their products to seem glamorous. We want to protect the sort of people who don't smoke from picking up that habit. So I think that's a really good rule, and I wouldn't want that to change in any way, shape or form.

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But we do have to recognise that there is this unintended consequence, the idea that the market becomes less competitive as a result. Now, that may not be a bad thing because we know competitive markets equals lower prices and more efficiency. And the last thing we want is cheaper tobacco because that means more people are going to find these products affordable and will use them.

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So higher prices are a good thing, not a bad thing. We just have to recognise that one of the reasons we get those high prices is because a lack of competition and that lack of competition translates to this profitability, and that profitability is incredibly addictive as I've already said. And that is why tobacco companies fight so hard to, oppose any measure that may impact their ability to sell tobacco products.

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**Louis**

Right, I see. So

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you mentioned previously about excise taxes. So taxation is partly what we're here to talk about today. Is taxation one of the ways that you can combat some of these unintended consequences?

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**Rob**

Excise taxes are incredibly important because they do raise the price of tobacco products and we know people do respond, however small, to higher prices. So excise taxes are useful because they get passed on in the form of higher retail prices. We should though recognise that those higher prices, those taxes that create those high prices, are paid by people who smoke rather than tobacco companies themselves.

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So they work because they are passed on to consumers, but equally they are taxes that are paid via tobacco companies but they are not taxes that are paid directly by tobacco companies in terms of coming out of their profits or anything like that. So taxes are certainly important, and they are important because everybody has to respond to price signals.

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So we know there are certain demographics within society who don't necessarily respond to bans on where you can smoke, or they don't respond to advertising bans, but people aren't immune from higher prices in the shops. So those who are addicted are still going to be suffering from these price signals and hopefully that will be the final push that they need in order to quit.

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**Louis**

So I'm aware we're using this term excise tax. Maybe we should just wheel back a bit and explain exactly what we mean by that.

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**Rob**

So excise tax is just a particular name we have for what is also called tobacco duty. It is the idea that you have to pay tax on tobacco products. So it is a unique tax to products like tobacco, but it is also paid on things like alcohol. It is simply a tax paid on a particular product and that tax can take a number of different forms.

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It can be a tax that is based on the selling price. So in the same way that VAT is a proportion of the selling price so we can have similar ad valorem tax on tobacco. Ad valorem being the name that we economists give to a tax that is paid on the value of the selling price, but also we can see that there is another type of excise tax that can exist and indeed that does exist in the UK, which is where you pay a particular amount of tax per unit of the goods sold.

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So per cigarette you have to pay a certain amount of taxation. And again the idea is to simply increase the selling price of these products to deter consumers from using them, and also, of course, raise a large amount of money for the government in the form of tax revenue.

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**Louis**

So you talk there about the sort of deterrence element, and the way that excise tax can affect the price and therefore people's ability to buy, so in that context would you say the tax is being used as part of a tobacco control sort of public health response?

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**Rob**

Well, in the UK we don't really do what we call hypothecated taxation. And that is where we have a specific tax that raises money for a set purpose. So tobacco taxation, just like alcohol taxation, goes into what's called the consolidated fund, which is the government's bank account, if you like and those moneys can be spent on any purpose.

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So it could fund schools, it could fund road building, it could fund the NHS, it could fund the Army, could fund anything, and funds for public health tend to come from the health grant that exists within government spending and tobacco control measures have to make a case, like any other expenditure, that they represent good value for money.

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So it is not the case that tobacco taxation directly funds public health measures, but they certainly part of the funding that allows those things to be supported.

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**Louis**

It goes into the pot, as it were. We've mentioned the UK here, is the UK fairly representative in terms of excise tax globally?

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**Rob**

The UK, I think it's fair to say, has some of the highest tobacco taxes in the world. Countries like Australia and New Zealand have slightly higher taxes than the UK. And so if you look on global league tables, they'll have the highest cost of buying tobacco products. You'll often see, a measure of a particular brand, and how that sort of costs in different countries.

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But certainly in Europe, the UK has probably the highest taxation, the highest cost of tobacco products. Other countries with higher tobacco costs are Ireland, France, Norway. Clearly, the balance between those prices will change slightly with exchange rates but certainly we're up there amongst the global leaders with the highest prices of tobacco products.

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So in many ways, the UK is a leader in terms of tobacco taxation and indeed tobacco control more broadly. And that is because in recent years we have had a political commitment towards tobacco taxation in the form of what is called the tobacco tax escalator, always hard to say that one. Now, this is where successive governments have committed to increasing tobacco taxation every year by 2% above inflation.

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So, in other words, tobacco is progressively getting more expensive over time. Now this is good because it means we have continually increasing prices of tobacco in the shops. So smokers or those people who are thinking about becoming smokers know that they are going to face increasing prices both now and in the future, and that's an incredibly powerful deterrent for starting, but also for quitting these deadly habits.

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So that in many ways is a very powerful signal, because in other countries, tobacco taxation happens very infrequently. We've recently done some work looking at tobacco prices in Spain and we've seen over the last ten or so years, tobacco prices have actually gone down in real terms, in terms of consumers ability to buy these products, simply because taxes have not been increased.

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So the ability to have a political commitment where there is this expectation to increase taxes successively year on year, is a really strong signal and helps make tobacco an increasingly unaffordable product and that is key, I think, to addressing the deadly nature of the product.

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**Louis**

This issue of affordability is obviously an effective way of decreasing purchase. What would you say, playing devil's advocate for a moment, to people who criticise that saying that it's unfair on people who are already impoverished?

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**Rob**

Well, I can understand why people make that argument, but I think it slightly misses the point of what taxation is supposed to do. We know in society that, unfortunately, tobacco use is now increasingly stratified by different socio-economic groups. Simply put, those who are from a less well-off background, those who are least well-educated, tend, on average, to smoke more.

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But we also know those types of individuals tend to be the most responsive to price signals. So tax increases are actually very much pro-poor, because those individuals are the ones who are most likely to quit in response to the higher prices. So yes, those people who continue to smoke are going to be in more financial difficulties. But that is why it is imperative that any extra money the government gets from increasing taxes is spent to help those individuals.



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Ideally, it would help them quit their tobacco habits, but equally it could be spent in other ways to help those disadvantaged communities so individuals are not impoverished by higher prices. It is simply sending the signal that they should spend their scarce resources, their limited wealth, in a different way, in a way that will help them cut off their tobacco habit.

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**Louis**

I see, thank you. That's really interesting. So, it's kind of, these communities are already shouldering the large burden of tobacco usage.

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**Rob**

Yeah, absolutely. So there have been studies coming out of, from Action on Smoking and Health in London looking at the total cost of tobacco use. And we see those who smoke are associated with lower wages, lower work productivity, greater ill health, lower life expectancy. So tobacco use is one of the biggest factors behind inequalities in society.

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So if we address tobacco use we will go a long way to helping disadvantaged communities or to address the so-called former levelling up agenda, we will help those communities that need to be raised in terms of their prosperity, to give those communities more advantages and opportunities in life.

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**Louis**

Just to bring it back to the industry again. So presumably tobacco companies, we've spoken a lot on this podcast with various guests about the ways that the industry interferes in regulation, interferes in science. Presumably these companies aren't happy about some of these tax proposals imposed on them. How do they tend to respond?

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**Rob**

Well we know the industry has a whole playbook that they look to deploy whenever tobacco excise is going to be changed or even talked about being changed. And their first strategy, of course, is to try

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and suggest that it shouldn't happen in the first place. So you'll often see comments about how tobacco tax increases will drive the market for illicit tobacco

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and that kind of behaviour. But we know this simply isn't true. There are many examples of where tobacco taxation has gone up, whilst at the same time the rate of illicit tobacco has gone down. So there isn't the direct link between prices and illicit behaviour that the industry would have us all believe? The issue of illicit tobacco is one of enforcement,

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it is about making sure the law is followed. The issue of taxation is a public health measurements, it's a tax raising measure. Clearly you have an incentive to engage in illicit behaviour whenever there is a tax, whenever there is money that can be avoided. But whether you're paying £8 a pack in taxation or £9 a pack, it doesn't fundamentally change that incentive.

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So the industry starts by trying to sort of whip up fears about the illicit market which I think are unfounded. The UK has a really good track record of addressing illicit tobacco. And if you look at the most recent statistics, the rate of illicit tobacco has actually been falling in the UK. So I think we're in a relatively good position in that regard.

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but then beyond that, we know the industry has a range of tactics that they look to deploy in order to mitigate or offset the impact of tobacco taxation.

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**Louis**

You mentioned illicit there. So next episode we're going to be speaking with Dr. Allen Gallagher about the illicit trade and the ways that the industry uses the fear of illicit trade to undermine regulation. Is this an example of that sort of behaviour?

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**Rob**

It is. So I won't talk about illicit too much because clearly you're going to have plenty of time to talk about more detail later on but I would say the best example of industry's behaviour to try and undermine sort of regulation and rules designed to protect the public health is simply the tactics they adopt to undermine tobacco taxation.

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And we've found, broadly speaking, that they adopt six strategies that are designed to minimise the impact of tobacco taxation.

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So number one is what we call differentially shifting the tax increase. In other words, cheaper products are kept cheap by having a small increase in their price whereas those products that are very expensive have the full tax increase

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and more so it's about keeping a variety of prices on the market. Option number two is that the industry likes to introduce new brands or brand versions or segments into the marketplace to help people who smoke down trade or to stay as a smoker but buy a cheaper product. So that might be launching a new economy version of a brand you already use, that might be launching a roll-your-own hand rolling tobacco version of a previously factory made cigarette,

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that is number two. Number three is

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the idea of

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price smoothing. So this is the idea that instead of having just one price increase that is created because of the tax increase, the industry looks to drip feed the higher prices into the marketplace. So many small price rises rather than one big one. And the idea there is hopefully to stop smokers noticing, and therefore quitting.

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The fourth option the industry has been known to use is what we have called shrinkflation. This is the idea that we all know from buying chocolate bars and so on, it's the idea that you pay the same price for the product, but you just get less for your money.

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The industry tries to disguise the price increase by selling what was previously a 20 stick pack as 19 or an 18 or even a 17 stick pack, but for the same price so you simply don't notice each item is now more expensive. The fifth option that we've seen globally is

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the idea of

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price discrimination and price related promotions.

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Simply put, it's the idea that you sell the same product at different prices at different locations. So it might be you offer cheaper prices to those in poorer areas versus those in richer areas in order to satisfy the consumers in those locations and the need, if you like, for lower prices. The sixth and final, and perhaps the most cynical strategy we've seen, is that the industry engages in a process where it changes the product attributes of its products

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or the way it produces them in order to find loopholes in the regulations. So a good advantage here would be the sale of cigarillos in the UK. These are technically cigars, but in the UK we now see cigarette-like cigarillos. So these are effectively a cigarette but in a brown wrapper. So they legally classify as a cigar,

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that means they have lower taxation and less regulations. But ultimately for a consumer they still appeal and the lower price, means that they can be, attractive to consumers.

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**Louis**

So is there any idea of how, of the scale of this kind of tax avoidance? And I'm sure that is one small aspect of it. Presumably there's other tactics that tobacco companies employ to avoid tax.

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**Rob**

Yeah. So earlier in the podcast we were talking about the vast profits the industry makes collectively. I mentioned the \$55 billion US dollar figure and actually that

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profit should be subject to corporate taxation. In the UK we have what we call corporation tax, which is effectively income tax for companies. It is the idea that companies should pay a certain proportion of that profit as tax.

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Companies sharing the wealth, if you like, with the societies in which they operate. What we found, though, is that tobacco companies once again have a range of tactics that they use in order to bypass or minimise the extent to which they are liable for tax in particular countries. So this idea of tax avoidance on the product, like the cigarillo, really is just the tip of the iceberg. We see

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so many examples of how the industry uses its international structure in order to minimise the corporate tax or the profit tax that it has to pay, not just in the UK but all over the world. And there are a number of different mechanisms they use to do that.

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**Louis**

If you were going to give us one of those mechanisms, sort of one of the most effective that they employ globally.

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**Rob**

Okay. So there's a really good example of this from BAT in South Korea. So BAT sell cigarettes in South Korea and actually they make cigarettes in South Korea. And what they do is they have a number of companies set up in Korea to allow them to minimise their tax obligations. So there's one company who makes the cigarettes in South Korea, and that company doesn't actually sell them in South Korea,

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it sells them to another BAT subsidiary in the Netherlands, which is a sort of a low tax jurisdiction for international business. That Dutch company, that increases the price of those cigarettes and then resells them back to a different BAT subsidiary in South Korea. So these cigarettes have never left South Korea. They've just been sold on paper to a Dutch company and then back to a different South Korean company.

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But by doing that the company is able to avoid something like €98 million in profit tax in Korea and then those cigarettes are finally sold by that second company in South Korea. So the cigarettes are resident in South Korea, they've never left the country, but somehow a lot of the value of that sale is shipped out of the country tax free because of these clever international structures.

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**Louis**

That's a totally legal approach?

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**Rob**

So that is absolutely legal, there are various international rules that companies have to follow about how they declare these transactions, so I wouldn't want it to be taken that I'm implying that BAT is doing anything illegal. I think tobacco companies are very good at actually making sure that they comply with the letter of the law, but it's certainly not what the law intends.

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I think most citizens would want companies that produce a product in a country to pay the tax that is due on the sale of that product in that country, and not use these international loopholes to try and avoid taxation.

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**Louis**

It's a fascinating example there in South Korea. Are there any similar UK examples of tax avoidance?

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**Rob**

Well, I think the biggest headline from the UK is just how little profit-based taxation British based tobacco companies are actually paying. So one of the biggest is British American Tobacco (BAT). And actually, if you look in the last few years, you can get a really good snapshot of the situation. So in 2021, the company made more than £10 billion in global profits.

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So a huge sum of money being made by the industry here. And actually in the UK, they received, what is effectively a refund on corporate taxation of £25 million. So their tax bill was -25. Now you could say that's a one off and just an exceptional thing. But actually, if you look in, 2022, the year later, they got another refund.

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Okay, it was only £3 million this time. But it shows that having made another £10 billion in profits, they still didn't pay anything in terms of profit-based taxation. And this story is very much the case with British American Tobacco. If you look back over many, many years, they have made tens of

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of billions of

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pounds in profits globally and paid virtually nothing.

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Many years, have received a refund. And that is because of all of the loopholes that exist in the corporate tax system. Profits are channelled through low tax jurisdictions. They make sure they're reported in countries beyond the UK tax authorities. They're always reported where their tax liabilities are going to be the lowest possible. And that means they can, as I've said, get away with paying virtually nothing in countries like the UK, even though they're based here, even though their head office is in this country, they still don't get held to account by the UK tax authorities because of the loopholes that exist.

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**Louis**

I mean, that is totally shocking. Zero or even minus taxes paid here. That's not to mention presumably the costs on just the health care system alone of these products as well.

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**Rob**

Well, yes. I mean, you're right, of course, to mention the health care costs. And here I would point out that BAT is not the biggest participant in the UK market, but they certainly do sell cigarettes in the UK. They do have, you know, sales of hundreds

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of millions

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of pounds in this country. So even based on the UK only sales, they should be paying more, I think, than they currently do

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on the figures that I've just talked about. Fundamentally we should recognise, as I've said already, that the companies do look to pay their tax liabilities in those jurisdictions that have the lowest tax rates. So I'm not saying that BAT pays no corporate tax on its profits. It does. if you look at the accounts that you can see they are paying tax, the point is it's not in the UK where they're based.

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It's not in other so-called high tax environments. It's in tax jurisdictions that allow them to keep as much of their profits as they possibly can and, you know, they use markets like Ireland, the Netherlands, and interactions between those different jurisdictions as a way of minimising and legally minimising their tax liabilities.

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**Louis**

Presumably this isn't restricted to tobacco alone, are other industries using similar avoidance methods?



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**Rob**

You're absolutely right, this is not a unique tobacco phenomenon, this is something that all big companies will look to do to varying degrees. Investigations have suggested that tobacco companies are not the worst in in this regard, but they are certainly not the best. They are not voluntarily paying more tax than they have to. They are not saying "we are based in the UK, so we're going to pay our fair share".

00:29:38:23 - 00:29:52:08

They are using the law to it's advantage or to the advantage of their shareholders, ultimately, and that is how they can pay such little rates of tax despite being based here.

00:29:52:08 - 00:29:58:03

**Louis**

Are there any cases you can think of of full-on tax evasion? So just the illegal avoidance of tax.

00:29:58:05 - 00:30:25:03

**Rob**

The trouble is with tax evasion, it's by definition illegal. So how do you prove? So we know there are various court cases across the world involving tobacco companies where tax authorities have been pursuing tax, what is perceived to be tax owed by tobacco companies. Sometimes these have been won by the tobacco industry. Sometimes these have been won by the tax authorities of particular countries.

00:30:25:05 - 00:30:46:14

The bottom line is the industry is going to look for any and all loopholes that they can use. And there are plenty of those that are legal. So the industry doesn't have to, you know, resort to illegal evasion techniques, to avoid paying large amounts of tax, whether they want to go and use illegal techniques as well

00:30:46:14 - 00:31:03:22

is clearly the subject of ongoing research. We certainly have some suspicions where figures don't necessarily line up, but we haven't yet sort of caught the smoking gun, if you like, the information where we can definitively say that they've engaged in illegal activities.

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00:31:03:24 - 00:31:16:11

**Louis**

So this kind of spirit of the law of tax avoidance, in your view, are there other methods we could be employing, even nationally or at global level, that could help clamp down on some of this?

00:31:16:13 - 00:31:39:19

**Rob**

Well, I mean, the bottom line is there is always more we can do. So the OECD, for example, is sort of working across member states to try and put in place minimum rates of taxation, corporate taxation here I mean, and that will make it hard for companies to use low tax jurisdictions because they will have to pay, if everyone is sort of charging at that sort of minimum rate, if you like.

00:31:39:21 - 00:32:11:10

There are techniques that you can use to pursue transactions that are on paper only. So certainly there are more things we can do. But each of those measures is time consuming, costly, and, you know, has advantages and disadvantages. Personally, I think we can and should do more. I think it is terrible that an industry that causes so much death, disease and misery as the tobacco industry, that is making so much profit doesn't pay what I would regard to be its way, it doesn't pay its fair share.

00:32:11:12 - 00:32:34:02

So I would definitely be in favour of the industry being held to account more and certainly that is what we are looking to do in countries like the UK with a variety of measures. We're certainly pushing something that we call the polluter pay levy, this idea that we can limit the profits that the industry is able to make and transfer the profits that were previously made in the form of higher taxes to government.

00:32:34:04 - 00:32:53:09

**Louis**

Thank you, Rob. Just to round things out here, is there anything for listeners maybe quite new to the issue of taxation or who are less familiar with some of these financial issues you've mentioned, what's the one thing that you'd like people to come away from in this discussion today remembering?

00:32:53:11 - 00:33:22:17

**Rob**

The one thing I would encourage our listeners to keep in mind is simply the vast profit the tobacco industry earns. So it's often reported that tobacco is a very heavily taxed product but that doesn't

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stop the industry making its large profits. Those high taxes are paid by people who smoke, not the tobacco industry. So I think we need to do more about the tobacco industry's profitability if we are to truly do something about the global tobacco academic.

00:33:22:19 – 00:33:24:23

**Louis**

Dr Rob Branston, thank you very much for joining me.

00:33:25:00 - 00:33:26:07

**Rob**

Thank you for having me.

00:33:27:04 - 00:33:32:18

**Louis**

We'll be back next week, where we'll be joined by Dr. Allen Gallagher to talk about the illicit trade of tobacco products.

00:33:32:18 - 00:33:38:15

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00:33:48:18 - 00:33:57:07

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