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s 34(3) First, to expand the existing Tobacco Strike Team (TST) to a multi-agency Illicit Tobacco Task Force (ITTF) that will target organised crime networks. Second, the implementation of a new permit system so that border force can more effectively distinguish between licit and illicit tobacco imports at the border. Third, the ATO will be provided with additional resources to combat domestic illicit tobacco crops (chop chop).

Key Policy Parameters

- Creation of the ITTF with a start date of 1 July 2018
- Implementation of the permit system with a start date of 1 July 2019
- Additional ATO resources with a start date of 1 July 2018

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Illicit tobacco statistics – Tobacco Strike Team

The table below provides a breakdown of seizures, including duty evaded since the establishment of the Tobacco Strike Team (TST) on 1 October 2015 to 31 January 2018:

Seizures		Amount (\$m) of duty payable of seized tobacco (excluding GST)	
Tobacco	108.8 tonnes	Tobacco	\$88.07m
Cigarettes	247.6 million sticks	Cigarettes	\$158.372m
Total Equivalent by Weight	305 tonnes	Total Equivalent by Weight	\$246.442m

- Working with the Australian Federal Police Criminal Assets Confiscation Taskforce, the Australian Border Force has seized more than \$9 million in cash, two luxury vehicles and un-costed jewellery as proceeds of crime.
- In an operation in air cargo and traveller environments in January 2018, three individuals with links to a highly-organised tobacco smuggling syndicate operating through Melbourne International Airport were arrested and charged.
- More than one million cigarettes with a potential street value of \$682,500 were detected and seized. The total amount of duty evaded exceeds \$730,000.
- In a sea cargo operation, following a referral from the Australian Federal Police and the Australian Criminal Intelligence Commission, five men with links to a Malaysian tobacco smuggling syndicate were arrested and charged.
- The Tobacco Strike Team located and seized more than six million cigarettes concealed in shipping containers. This represents more over \$4 million in evaded revenue.

Background – KPMG illicit tobacco report 2017

- KPMG's Illicit Tobacco in Australia Report, commissioned by Phillip Morris and Imperial Tobacco, estimates that illicit tobacco cost the Government around \$1.91 billion in forgone revenue in 2017.
- The estimate is of a similar magnitude to recent KPMG estimates of the size of the illicit tobacco market.
- According to the KPMG Report:
 - Total consumption of illicit tobacco declined by 1.0 per cent. However, this represents an increase in the proportion of illicit consumption because legal consumption decreased by around 6 per cent.
 - Contraband consumption accounted for the majority of total illicit tobacco consumption at 51.1 per cent of the total. Contraband refers to cigarettes manufactured legally outside of Australia and smuggled into the country.
- Key quote: "We believe there is no denying the link between high excise and the illicit market. As excise on tobacco contributes to increased prices, the attractiveness of the illicit market becomes even more obvious to serious and organised crime".

Defensive talking points

Impact of excise on the size of the illicit market

- The illicit market is driven by a multitude of factors of which the excise duty rate is only one.
- Tobacco excise is among the most effective interventions to reduce the prevalence of smoking and protect the health of Australians.
- Australia's tobacco excise rates are below the World Health Organisation's recommended level. As of 1 September 2017, tobacco excise was estimated to account for between 53 and 62 per cent of the retail price of manufactured cigarettes compared with the WHO's recommendation of 70 per cent.

Difference between the Government's estimate and the KPMG report

- The ATO and Home Affairs estimate of the revenue impact of illicit tobacco is approximately \$600 million per year.
- Though this estimate is significantly lower than the KPMG estimate, any loss of revenue is a serious issue and even more so given the involvement of organised crime in the illicit tobacco market.
- The estimates by the ATO and Home Affairs are based on extensive and high quality data held by these agencies, and use a methodology endorsed by independent experts.
 - The supply-side methodology used by the ATO and Home Affairs has been endorsed by an independent expert panel, comprising: Professor Neil Warren (Professor of Taxation at the University of New South Wales), Mr Richard Highfield (Adjunct Professor with the School of Taxation and Business at the University of New South Wales) and Mr Saul Eslake (Vice Chancellor's fellows at the University of Tasmania).

- Some aspects of the KMPG methodology are considered to be prone to variance such as:
 - The use of empty packet analysis, as it is impossible to estimate and adjust for legitimate overseas imports and the duty free allowance for international air passengers.
 - Questionnaires and surveys suffer from misinterpretation and error.
- Notwithstanding the difference in estimates, the Government agrees that a coordinated strategy is needed to combat illicit tobacco. That is why we are introducing a comprehensive illicit tobacco package, including the creation of the Illicit Tobacco Taskforce, which will combine the resources and capabilities of a number of law enforcement and border security agencies.

Combatting illicit tobacco

SES responsible: Patrick Boneham

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What is the problem?

- Illicit tobacco resulted in almost \$600 million of forgone tobacco duty in 2015-16, about 29 per cent of which reflected leakage from licensed warehouses.

Why is it important?

- The illicit tobacco market undermines Australia's efforts to curb the harmful effects of tobacco consumption and funds organised crime's other illegal activities (eg drugs and guns).

Who?

- As part of the Illicit Tobacco Package announced in response to the Black Economy Report:
 - From 1 July 2019, **tobacco importers** are required to pay duties when they import tobacco, instead of when it enters home consumption. They also need permits to import tobacco.
 - The **ATO and Department of Home Affairs** were resourced and the **Illicit Tobacco Taskforce** was established to combat the illicit tobacco market from 1 July 2018.
- The package was estimated to have a net gain to the budget of \$3.6 billion from 2018-19 to 2021-22, largely due to a bring forward of revenue due to the changed timing of when excise is payable.
- The Black Economy Report was coordinated by Treasury. The **Department of Home Affairs** is responsible for tobacco taxation and compliance at the border, including the tobacco import permit system. The **ATO** is responsible for domestic illicit tobacco compliance.

When?

1 July 2018 – Established the Illicit Tobacco Taskforce and increased ATO funding to combat illicit tobacco.

25 October 2018 – Royal Assent of Customs Amendment ((Collecting Tobacco Duties at the Border) Bill 2018), moving taxing point for imported tobacco to the border from 1 July 2019.

29 November 2018 – Royal Assent of Treasury Laws Amendment ((Black Economy Taskforce Measures No. 2) Bill 2018) and Excise Tariff Amendment ((Collecting Tobacco Duties at Manufacture) Bill 2018) moving taxing point for domestically manufactured tobacco (NB there is no domestic manufacturing).

21 March 2019 – Registered Customs (Prohibited Imports) Amendment (Collecting Tobacco Duties) Regulations 2019, which prohibits tobacco product imports without a permit, and Customs Amendment (Collecting Tobacco Duties) Regulations 2019, which adds duty free refund circumstances for importers.

1 July 2019 – start date for import permit requirements and duty payable upon import.

1 July 2020 – end of the transitional arrangements.

How?

Legislation and regulations have been enacted (as above). The government is providing \$59 million to the **Illicit Tobacco Taskforce** to combat tobacco smuggling and \$9 million to the ATO to combat illicit domestic tobacco from 2018-19 to 2021-22.

TAD approved numbers

	2018-19	2019-20	2020-21	2021-22	Total
\$	-14.9m	3,250.8m	148.0m	193.4m	3,577.3m

Illicit Tobacco Taskforce results

In the 2018-19 financial year, the Illicit Tobacco Taskforce seized more than 202 tonnes of illicit tobacco representing an estimated \$217 million in evaded duty.

Enforcement action towards retailers involved in illicit tobacco supply chains

Illicit tobacco sold in the retail environment is a shared responsibility of a number of Commonwealth, State and Territory departments.

The resources of the illicit Tobacco Taskforce are deliberately targeted towards disrupting organised crime syndicates and cutting off illicit tobacco at its source. Retailers may fall within the scope of Taskforce investigations to the extent they support organised crime and serious actors.

State and territory health and law enforcement authorities are responsible for compliance and enforcement action regarding the sale of illicit tobacco by retailers.

Recent legislative amendments will assist stakeholder agencies including ABF and ATO to work more collaboratively across the entire supply chain.

Questions

Refer any questions to Tax Analysis Division (TAD) regarding revenue matters including accuracy of costing for the 'Black Economy Package – Combatting Illicit Tobacco'.

Refer further questions to the Department of Home Affairs regarding implementation of the new system including importation, the permit system, quotas and compliance issues (including ABF compliance results, payments under transitional arrangements, drawbacks and refunds and tobacco destruction at the border).

Refer further questions to the ATO regarding administration of the previous tobacco system including transitional arrangements. This will include licensing of warehouses, auditing, securities and discussions with the warehouse companies during the implementation process.

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1. What is illicit tobacco?

Tobacco in Australia must satisfy health regulations and tobacco importers must pay duty. Illicit tobacco has avoided these requirements and is sold to consumers through the black market.

Currently there is no legal tobacco manufacture occurring in Australia and, since 2008, no-one is licensed to grow tobacco for commercial sale or personal use.

2. Why is illicit tobacco a problem?

Illicit tobacco is a key source of funding for organised crime and undermines Government efforts to improve public health outcomes by reducing the prevalence of smoking.

Law enforcement agencies have indicated that the illicit tobacco market is dominated by organised crime groups, which use tobacco profits to fund their other criminal activities. Organised crime will continue to operate and potentially expand if the Government does not increase resources for combatting illicit tobacco.

Illicit tobacco undermines the Government's harm prevention efforts by providing access to tobacco at significantly cheaper prices compared with legitimate retail sales and in some cases in counterfeit branded rather than plain packaging.

Based on ATO and Department of Home Affairs research, illicit tobacco results in almost \$600 million of forgone tobacco duty each year. The sale of illicit tobacco also reduces tobacco sales for legitimate retailers.

3. What is the Government doing to combat illicit tobacco?

The Government has implemented its Black Economy Package – combatting illicit tobacco measure announced in the 2018-19 Budget, which consists of five interconnected elements that target the three key sources of illicit tobacco in Australia: smuggling; leakage from warehouses and domestic tobacco crops.

Tobacco smuggling

The Government has funded an **Illicit Tobacco Task Force** from 1 July 2018. The multi-agency Task Force has a full array of powers to effectively investigate, prosecute and ultimately dismantle the international organised crime groups responsible for a large part of the illicit tobacco trade.

The Government has also introduced a **prohibited import control for tobacco**. Since 1 July 2019, permits have been required for all tobacco importations, assisting border officers to quickly and efficiently determine when an offence has been committed. It will no longer be necessary to prove concealment of tobacco and intent to evade duty.

Leakage from warehouses

Since 1 July 2019, importers have been required to **pay all duty liabilities upon importation**. Duties were previously paid when the tobacco leaves a licensed warehouse for the domestic market. This created a risk that criminals may seek to obtain untaxed tobacco via leakage from a warehouse before duty is paid. Moving the tax point has eliminated warehouse leakage by incentivising importers to maintain the integrity of the tobacco storage system and ensure the right amount of duty is paid based on the total amount of tobacco imported.

On **25 October 2018** Royal Assent was received of Customs Amendment ((Collecting Tobacco Duties at the Border) Bill 2018), moving taxing point for imported tobacco to the border from 01 July 2019.

Domestic tobacco

The Government has funded the ATO to **combat domestic tobacco crops** (\$8.8 million from 2018-19 to 2021-22). From 1 July 2018, the Government strengthened ATO enforcement capabilities, including by adding an additional six investigators, to tackle domestic illicit tobacco crops. This is allowing the ATO to undertake additional activity to detect and destroy illicit tobacco and undertake follow up criminal investigations.

The ATO will upgrade and future-proof its **excise and excise equivalent goods* payment systems** beginning 2020-21 to replace the outdated paper lodgement system.

*Excise equivalent goods are imported goods – in this case tobacco – that are subject to customs duty at a rate equivalent to excise duty to ensure they're treated consistently with goods manufactured in Australia.

On **29 November 2018**, Royal Assent was received of Treasury Laws Amendment ((Black Economy Taskforce Measures No. 2) Bill 2018) and Excise Tariff Amendment ((Collecting Tobacco Duties at Manufacture) Bill 2018) moving taxing point for domestically manufactured tobacco (NB there is no domestic manufacturing).

4. What is the budget impact of the package?

The Package is estimated to generate a gain to budget of about \$3.6 billion from 2018-19 to 2021-22, including an increase in revenue of about \$3.7 billion offset by an increase in payments of about \$150 million.

Of the \$3.7 billion revenue gain, most of the \$3.3 billion in 2019-20 arises because of a change in the time that tobacco excise is paid (ie. shifting the taxing point to the point of importation).

This largely reflects a one-off boost to revenue in the first year of the measure as all stock held in warehouses as at 1 July 2019 becomes liable for duty and, at the same time, revenue is received from new tobacco imports due to the earlier taxing point.

5. What is the tobacco Tax Gap? How does it compare with the budget estimates?

The 2015-16 net Tax Gap for tobacco was \$594 million.

The Treasury costing and the tax gap estimate vary as they measure different things.

The ATO tax gap estimate is a theoretical estimate of how much revenue would be raised if all illegal tobacco were to be taxed in 2015-16. The Budget estimate is what will happen in the real world as a result of the policy changes announced by the Government.

A key difference is that tax gap estimates don't estimate how effective any policy will be at reducing illegal tobacco. The Budget estimates recognise that the criminal gangs behind illicit tobacco are sophisticated and well-resourced, and it would be misleading to assume that this package will shut down the entire illicit tobacco market overnight.

A second key difference is that tax gap estimates don't include any behavioural responses, such as reduced smoking due to significant price increases as illegal tobacco is taken off the market. Nor do they include the increased enforcement costs of closing the gap.

Collecting tobacco duties and taxes at the border

6. What is the previous taxing process?

Previously, tobacco was imported by tobacco companies and stored in bonded warehouses. A bonded warehouse was one licenced by the ATO to store Excise Equivalent Goods (in this case tobacco) before excise was paid.

Duty was paid in weekly instalments based on the amount of tobacco that had left the underbond warehouse system and entered the domestic market.

7. What is warehouse leakage? How does it occur?

Warehouse leakage was the unauthorised or illegal removal of tobacco from a storage warehouse prior to the payment of applicable taxes such as excise.

According to DHA and ATO estimates, approximately 250 tonnes of tobacco in licensed warehouses was unaccounted for in 2015-16, and around \$172 million of tobacco duty was lost through leakage from the warehouse system.

Conducting compliance activity to combat this behaviour was extremely difficult as large volumes of tobacco was transferred between networks of licensed warehouses, obscuring the gap between the volume of tobacco on which tax had been paid and the volume that was imported. Criminal gangs were suspected of exploiting these weaknesses to steal tobacco.

Moving the taxing point to when the tobacco enters the country and imposing a permit system should stem this leakage. This puts the onus on the tobacco importers to ensure that the tobacco is secure as tax has already been paid. Any loss of tobacco effectively becomes a loss to the importer.

8. Is this a new tax on tobacco? Will this affect the price of tobacco?

No. This measure does not increase the amount of tobacco duty that importers must pay. It moved the tax point from when tobacco enters the domestic market for consumption to when it enters the country. This will prevent leakage of illicit tobacco from warehouses.

Prices may increase separately in line with standard six monthly changes to tobacco excise and already legislated tobacco excise increases on 1 September 2020.

9. How will this impact the cash flow of tobacco importers?

Importers are now required to pay tobacco duties at the point of importation, earlier than under the current system and in advance of the point of sale.

The measure has a one-off impact on importers as tobacco held in warehouses as at 1 July 2019 will be liable for tax at that time rather than when it enters the domestic market.

There were four broad options to enable tobacco companies to meet their excise liabilities as at 1 July 2019:

1. Reduce the likely inventory outstanding, by not replacing existing stock in warehouses as it was sold, or for aged stock that is at risk of being unsaleable, applying to have it securely destroyed.
2. Start paying duties on imports prior to 1 July 2019, to smooth the cash flow impact across the financial years.

3. Import produce closer to when it is required by customers ('just in time'), such as by importing smaller quantities or staggering deliveries, and holding stock in countries closer to Australia until needed by a customer.

4. Participate in the transitional arrangements.

To smooth the transitional impact on cash-flow, tobacco importers who are eligible to participate in the transitional arrangements are able to pay the outstanding duties in 12 equal instalments over 12 months to Home Affairs, on the basis they have provided an up-front financial security, and make the final payment by 30 June 2020.

The size of the security was determined based on a risk assessment made by the ATO and DHA, and ranges from 25 per cent for small importers to 100 per cent. For small tobacco importers, the security was capped at up to 25 per cent of the liability outstanding on the stock on hand at 30 June 2019, as part of negotiations with Senators to secure the passage of the relevant legislation.

All tobacco importers participating in the transitional arrangements had to make sure their income tax, GST and customs returns and remittances were up to date by 1 June 2019.

10. How did the Government prevent duty evasion ahead of the change in tax point?

The ATO and Australian Border Force conducted stocktakes and reconciled warehoused tobacco prior to 1 July 2019. This ensured an accurate calculation of tax and duty liability for warehoused stock as at 30 June 2019.

The ATO also cancelled permissions for the movement of warehoused tobacco for some warehouses prior to 1 July 2019 to ensure the integrity of the stocktakes. (Movement permissions allowed importers to move tobacco between warehouses without incurring a duty liability.)

11. What impact will this have on the underbond warehousing industry?

As tobacco is a perishable product and has a limited shelf-life, tobacco importers will need to continue to import tobacco and have sufficient stock at hand, in warehouses, in order to meet ongoing demand.

The package means less red-tape for warehouses because duty will already have been paid and so they will no longer be subject to duty control measures.

There have only been a small number of complaints from the warehousing industry, mostly in relation to the measures' negative effect on cash-flow, which we are addressing through transitional arrangements.

12. What consultation was undertaken with the industry?

The Government undertook public consultations from 8 August to 22 August 2018 on the Treasury and the Home Affairs' complementary exposure draft legislation. Consultation was conducted jointly between Treasury and Home Affairs.

Eleven submissions were received. The tobacco industry is broadly supportive. Some submissions raised concerns about the cash flow impact, which are being addressed through the transitional arrangements.

The non-confidential submissions have been published on the Treasury website.

The Taskforce and Permits System

13. How does the permit system work?

Since 1 July 2019, all importers have been required to hold a permit to import tobacco. Importers can apply for a permit through the Department of Home Affairs. As processing applications may take some time, DHA has some flexibility to administer the system during the transitional period.

Permits are valid for set periods with importers required to renew their permits periodically. This allows enforcement agencies to ensure that importers are complying with their obligations under the permit system. A comprehensive consultation and communication campaign has been conducted to notify importers of the changes and their obligations.

14. What are the Illicit Tobacco Task Force's capabilities and powers?

There are three components to the Illicit Tobacco Task Force:

Intelligence: systems analysis and targeting organised crime syndicates to provide accurate information to operational teams.

Enforcement: operational teams to detect and seize illicit tobacco at the border and investigate organised crime using a coordinated multi-agency approach to disrupt supply chains.

Prosecution: the new offences enacted in August 2018 provide the task force with greater ability to prosecute illegal activity by establishing reasonable suspicion offenses and removing the requirement to prove origin.

15. What is the impact on tobacconists, duty free stores and other small retailers/consumers?

Approximately 97 per cent of tobacco entering Australia reflects three main importers.

Most tobacconists and other small-scale retailers and consumers are not affected because they purchase tobacco from another importer rather than importing tobacco directly. If they import the tobacco themselves, they are required to have a permit and pay the duty when the tobacco enters the country.

Duty free stores, providores and catering bonds (entities which store goods to be supplied to international aircrafts or ships) are exempt from the change in tax point. The importers who supply these stores are able to claim a refund of the duty that was paid at the border.

Consistent with existing arrangements, where travellers are found with tobacco at the border above the duty-free threshold (25 cigarettes), they are given the option of paying the duty at the border or forfeiting the tobacco.

16. What is the Government doing to address the delays in refunds and drawbacks for tobacco under the new arrangements?

Since 1 July 2019, one major tobacco importer has raised with Home Affairs that it takes too long to receive a refund of duty paid under the new arrangements for tobacco that is provided to duty free stores or re-exported.

Home Affairs advises that all importers are encouraged to utilise a licensed customs broker on their behalf as a way to facilitate smoother and more efficient processing of refund and drawback claims. Home Affairs will only consider a refund or drawback claim once all relevant information has been provided.

Background

17. Overview of the tobacco importing industry.

Since 1 July 2019, all tobacco imports are taxed at the border.

There were previously only 37 importers of tobacco who stored tobacco under bond in licenced warehouses (before tobacco is entered for home consumption). The largest 3 importers accounted for approximately 97 per cent of all imports.

There are approximately 1000 other small importers who previously paid at the border.

18. What are the different tobacco types?

There are three main types of tobacco consumed in Australia:

Cigarettes/cigars: Cigarettes are the most common form of tobacco consumed in Australia.

Roll Your Own (RYO): Loose leaf tobacco, which people roll into cigarettes using cigarette papers. It is cheaper than buying retail cigarettes.

Molasses (shisha): Molasses tobacco, also known as shisha tobacco, is a syrupy tobacco mix with flavours added to it. It is commonly smoked through a water pipe and can have a tobacco content of anywhere from 30 per cent to 70 per cent.

Other types of tobacco, which are not currently legal in Australia include:

Electronic devices (E-cigarettes): Products that heat 'e-liquids' to form an aerosol, which is then inhaled by the user. E-liquids containing nicotine are illegal and not for sale in Australia.

Smokeless tobacco (snuff or snus): Smokeless tobacco product placed under the lip. It is currently not legal in Australia after being outlawed in 1991.

Chewing tobacco: A smokeless tobacco product which is chewed. It is currently not legal in Australia.

19. How much revenue is raised through tobacco duty?

At the 2019-20 Budget, tobacco receipts for 2019-20 are forecast to be \$17,410 billion, reflecting the commencement of the 2018-19 Budget measure *Black Economy Package — combatting illicit tobacco*, which included the shift in the taxing point to the border. The Final Budget Outcome for tobacco receipts for 2018-19 was \$12,147m.

20. What are the current excise rates for tobacco?

- Tobacco in stick form not exceeding 0.8 grams (e.g. cigarettes): \$0.93653 per stick
- Other tobacco (e.g. loose leaf tobacco): \$1291.77 per kilogram

Tobacco excise rates are indexed to Average Weekly Ordinary Time Earnings. The increases occur on 1 March and 1 September each year.

Tobacco excise rates increased by 12.5 per cent on 1 September 2019 and will increase by an additional 12.5 per cent on 1 September 2020. This reflects the decision taken in the 2016-17 Budget to increase excise rates each year from 2017 to 2020.

The per kilogram rate is being adjusted over four years, from 2017 to 2020, to align the tax treatment of roll your own tobacco and cigarettes. These adjustments occur on 1 September each year.

	March 2012	Sept 2012	March 2013	Sept 2013	March 2014	Sept 2014	March 2015	Sept 2015	March 2016	Sept 2016
Indexation (AWOTE)		1.006	1.016	1.008	1.137	1.139	1.016	1.13	1.012	1.136
Legislated				12.5%*		12.5%		12.5%		12.5%
Excise per kilogram(\$)	433.53	436.13	443.11	446.65	508.01	578.37	587.62	663.70	671.68	763.20
Excise per stick(\$)	0.34681	0.34889	0.35447	0.35731	0.40639	0.46268	0.47008	0.53096	0.53733	0.61054

*December 2013

	March 2017	Sept 2017	March 2018	Sept 2018	March 2019	Sept 2019	March 2020	Sept 2020	March 2021	Sept 2021
Indexation (AWOTE)	1.011	1.132	1.017	1.010	AWOTE	AWOTE	AWOTE	AWOTE	AWOTE	AWOTE
Legislated		12.5%		12.5%		12.5%		12.5%		
Excise per kilogram(\$)	771.60	901.39	916.72	1,076.35	1,090.33	1291.77				
Excise per stick(\$)	0.61726	0.69858	0.71046	0.80726	0.81775	0.93653				

21. How is the 12.5 per cent applied?

The 12.5 per cent is applied at the same time as AWOTE (1 September each year to 2020). It doesn't matter which is applied first as it's multiplicative.

22. What is the price of a pack of cigarettes, and how much is excise?

Product	Recommended retail price	Excise rate (per stick)	Current duty component	GST	Total tax
Example mid-range (pack of 25)	\$37.00	0.93653	\$23.41	\$3.36	\$26.77

23. Is the illicit tobacco market a result of higher excise rates?

According to the World Health Organisation increasing tobacco duty is among the most effective interventions to reduce the prevalence of smoking. Some criminals have chosen to break the law and not pay duty. The Government is continuing to take action to address this criminal behaviour.

The exact amount that the illicit tobacco market can be expected to grow due to an increase in excise rates cannot be accurately measured because the illicit market is driven by a multitude of factors of which the duty rate is only one.

24. Reasons for tobacco excise (and are our tobacco taxes too high?)

There have been significant efforts by governments in recent years to reduce tobacco consumption through a comprehensive suite of tobacco control measures, including staged increases and a swap to wage indexation for tobacco excise.

The taxation of tobacco products helps to pay for essential services such as the delivery of health services and other areas of spending that benefit the whole Australian community.

The World Health Organisation (WHO) identifies price increases through taxation as one of the most effective ways governments can reduce tobacco consumption. Australia is a signatory to the WHO Framework Convention on Tobacco Control, a treaty to address the health, social, environmental and economic consequences of tobacco consumption and exposure to tobacco smoke worldwide.

Australia's tobacco tax rates are nearing the World Health Organisation's recommended level, which recommends that duty should account for 70 per cent of the retail price of tobacco products.

Excise increases announced in the 2016-17 Budget will improve the health of Australians by reducing their exposure to tobacco products and move Australia closer to the World Health Organization's recommended level of tobacco excise.

As of 1 September 2019, tobacco duty was estimated to account for between 60 and 71 per cent of the retail price of four popular brands of manufactured cigarettes sold in Australia.

25. Who has jurisdiction for combatting illicit tobacco?

The Department of Home Affairs is responsible for combatting tobacco smuggling, such as attempts to import tobacco using cargo containers or the international mail without paying customs duty.

The ATO is responsible for combatting illicit domestic tobacco crops.

The way both agencies address illicit tobacco at the retail level is by attempting to cut-off illicit tobacco at the source (domestic crops and smuggling).

State and Territory police forces provide intelligence and protection for ATO and Border Force officers conducting raids on illicit domestic tobacco crops or shipments.

Under the new Illicit Tobacco Task Force, the ATO, the Department of Home Affairs and the New South Wales and Victorian Police Forces, as well as a number of other enforcement agencies, work together as part of a single taskforce to combat tobacco smuggling.

The additional funding for the ATO provides additional investigators to detect and destroy illicit tobacco crops and conduct follow-up criminal investigation activity. These activities will continue to be conducted in partnership with local police forces.

26. What are the new offences in the Illicit Tobacco Offences legislation?

The Government increased offences for illicit tobacco in August 2018.

The new offences include penalties for reasonable suspicion offences (see table below), where it is reasonable to assume that duty has not been paid on the tobacco. This makes it easier for the Illicit Tobacco Taskforce and the ATO to prosecute offenders in instances where more than 5kgs of illicit tobacco is found but it is difficult to prove intent.

A civil penalty has also been introduced for the possession of more than 2kgs of tobacco where there is a lack of documentary evidence to justify the possession of the tobacco. The penalty is a fine of up to \$21,000.

The customs amendments make it an offence to import tobacco where a person is reckless as to whether they are defrauding the revenue. The penalty will be up to 5 years imprisonment and/or a fine of 3 times the duty payable or up to \$105,000.

The law removes the requirement for prosecutors to prove whether the illicit tobacco was grown domestically or imported, which made it difficult to take enforcement action.

The penalties for each tiered offence are:

Penalties	Reasonable suspicion	Intentional offences
5kg or more [Considered a limited commercial use]	The greater of: • \$42,000 fine; or • 5 times duty payable	The greater of: • \$105,000 fine; or • 5 times duty payable
100kg or more [Considered a marketable quantity]	2 years imprisonment or greater of: • \$105,000 fine; or • 5 times duty payable	5 years imprisonment or greater of: • \$210,000 fine; or • 5 times duty payable
500kg or more [Considered a commercial quantity]	5 years imprisonment or greater of: • \$210,000 fine; or • 5 times duty payable	10 years imprisonment or greater of: • \$315,000 fine; or • 5 times duty payable

27. Why is the Government not actioning the Black Economy Taskforce recommendation regarding track-and-trace, as noted in a recent World Bank report?

The World Bank released the report ‘Confronting Illicit Tobacco Trade – A Global Review of Country Experiences’ on 23 January 2019. It recognises the significant measures announced by Government to strengthen both enforcement capabilities and tobacco tax administration following the work of the Black Economy Taskforce.

A key criticism in the World Bank report ‘Confronting Illicit Tobacco Trade – A Global Review of Country Experiences’, 23 January 2019 concerns Australia’s lack of track-and-trace. It notes:

“The Black Economy Taskforce offered a number of recommendations that have either been “noted” or explicitly “disagreed with” by the Government, the most salient being the use of track-and-trace technology (Treasury 2017: 310-311). Regarding track-and-trace, the Government has opted for a wait-and-see approach, preferring to review at a later date the success or otherwise of the other control measures...” (Treasury 2018: 35).”

It is expected that the 2017-18 and 2018-19 Budget measures will have a significant impact on the illicit tobacco market in Australia and the Government will assess the impact of these measures before determining whether Australia should adopt track and trace and become a Party to the Protocol.

Most countries do not currently use a track-and-trace approach. Two countries that have adopted track-and-trace in recent years include Brazil, which began operating a track-and-trace system in 2008, and Ecuador, which implemented track-and-trace for domestically produced cigarettes in 2017. In addition to these countries, EU member states are poised to introduce an EU-wide tracking and tracing system by May 2019.

28. Potential registration of tobacco license holders on a public register

The major tobacco importers have also suggested a register of permit holders be published to assist retailers in identifying suppliers of illicit tobacco.

Treasury and Home Affairs is concerned about privacy issues for tobacco permit holders who may wish not to be publicly identified.

As with track and trace, Home Affairs and Treasury consider the Government should monitor the impact of the illicit tobacco package before considering further measures.

29. KPMG 'Illicit Tobacco in Australia' Report 2018

KPMG's Illicit Tobacco in Australia Report, commissioned by Philip Morris and Imperial Tobacco, estimates that illicit tobacco cost the Government \$2.02 billion in forgone revenue in 2018.

- The KPMG estimate of forgone revenue is significantly larger than the Australian Taxation Office (ATO) and Department of Home Affairs (DHA) tax gap research, which estimated illicit tobacco represented around \$600 million of forgone revenue in 2015-16. An explanation of the differences between these estimates is at Additional Information.

KPMG also found that consumption of illicit tobacco declined by 11.1 per cent between 2017 and 2018. As a proportion of all tobacco consumption, consumption of illicit tobacco fell from 15.0 per cent in 2017 to 14.1 per cent in 2018.

Contraband accounted for 53.7 per cent of illicit tobacco consumption. Contraband refers to cigarettes manufactured legally outside of Australia and smuggled into the country.

KPMG's estimates differ from the tax gap analysis prepared by the ATO and Home Affairs, in part because they measure different things and use different methodologies.

- The KPMG methodology primarily uses a consumption model based on a consumer survey; and an empty pack survey analysis. The ATO and Home Affairs methodology uses a supply side model.

Some aspects of the KPMG methodology are considered to be prone to variance including

- The use of empty packet analysis, as it is impossible to estimate and adjust for legitimate overseas imports and the duty free allowance for international air passengers.
- Surveys suffer from misinterpretation and error.
- A change in the methodology through a new panel of respondents.

The estimates by the ATO and Home Affairs are based on extensive and high quality data held by these agencies, and use a methodology endorsed by independent experts.

30. Why is the Government not actioning the Black Economy Taskforce recommendation to reduce taxes and duties on molasses tobacco (shisha)?

Molasses tobacco, also known as shisha tobacco, is a syrupy tobacco mix with flavours added to it. It is commonly smoked through a water pipe and can have a tobacco content of anywhere from 30 per cent to 70 per cent.

The addition of flavours and water to the tobacco leaves makes it difficult to determine the actual tobacco content of molasses tobacco without special scientific instruments.

Reflecting this, changes were made in 2008 so that molasses tobacco was taxed on its total weight, not just its tobacco content. This made it significantly easier for Border Force personnel to determine the duty payable on the tobacco.

Reversing that change would be a significant impost on the Border Force and would divert resources from higher risk border security activities such as stopping illicit drugs and guns.

The additional resources dedicated to combating tobacco smuggling and the introduction of the new permit system will address illicit shisha tobacco imports.

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BACKPOCKET BRIEF – ILLICIT TOBACCO OFFENCES BILL

Key issues

What does this Bill do?

The Bill was introduced on 15 February 2018 and strengthens penalties relating to illicit tobacco as announced in the 2016-17 Budget by:

- Resolving an issue where illicit tobacco offences could not be prosecuted because it was unclear whether the illicit tobacco was grown domestically or imported. Prosecutors will now only need to prove, or demonstrate reasonable suspicion, that excise has not been paid.
- Adding tiered offences to give prosecutors more flexibility to bring charges against persons who have committed an illicit tobacco offence, including where it is difficult to establish criminal intent.
- Removing inconsistencies between the offences and penalties under the customs and excise regimes.

What are the new offences in this Bill?

The offences in this Bill are for possessing, buying, selling and the making (including possessing equipment used in the process) of illicit tobacco.

There will be tiered offences (ie higher quantities of illicit tobacco will attract higher penalties) where there is a reasonable suspicion that duty has not been paid. There will also be tiered offences for intentionally selling, possessing or making illicit tobacco.

The penalties for the reasonable suspicion offences are lower than the penalties for the intentional offences, reflecting the lower standard of proof (as prosecutors do not need to establish criminal intent).

The Bill also introduces a civil penalty for the possession of tobacco where there is a lack of documentary evidence to justify the possession of the tobacco.

What are the changes to penalties?

The current law has a maximum penalty of 2 years imprisonment or a \$105,000 fine. This maximum penalty will be increased to 10 years imprisonment, a fine of \$315,000 or five times the duty payable (this would be over \$2 million on 500kgs of illicit tobacco).

What consultation was undertaken?

Consultation was undertaken with the Department of Home Affairs, Australian Taxation Office, Department of Health, Attorney-General's Department, Commonwealth Department of Public Prosecutions and law enforcement agencies.

These consultations helped to ensure relevant definitions (eg 'tobacco') were aligned with the Criminal Code Act 1995, penalties were consistent with Commonwealth guidelines and offences were framed in a way to best facilitate effective prosecution.

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Targeted consultation on some elements of the legislation was also undertaken with key industry participants, namely, the Law Society of New South Wales, the Law Institute of Victoria, The Law Council of Australia, the Australian Retailers Association, Alliance of Australian Retailers, Australasian Association of Convenience Stores Limited and tobacco companies.

Why are we introducing reasonable suspicion offences?

Under the current law, all offences require prosecutors to prove criminal intent. Introducing reasonable suspicion offences will give prosecutors more flexibility to bring charges against persons where there is a reasonable suspicion that duty has not been paid. There is a list of factors that will give rise to this reasonable suspicion. The defendant has defences to these offences if they can show they had a reason to believe that duty had been paid. For example, the defendant can show an official record for the tobacco they possessed such as a tax invoice or bill of lading.

What are the penalties?

The offences are tiered based on the quantity of tobacco (5kg or more, 100kg or more or 500kg or more). Penalties will range from a \$42,000 fine or 5 times duty payable to up to 10 years imprisonment.

For example, a person caught with 5kg of illicit tobacco will face a fine up to \$42,000. A person caught with 100kg of illicit tobacco can face a penalty up to \$450,000 (which is 5 times duty payable) or 5 years imprisonment. A person caught with 500kg of illicit tobacco can face a penalty just over \$2 million (which is 5 times duty payable) or 10 years imprisonment.

There is also a civil penalty of up to \$21,000 for people caught with more than 2kg of illicit tobacco, which is approximately 2,800 cigarettes.

Penalties	Reasonable suspicion	Intentional offences
5kg or more = 7,000 cigarettes [Considered a limited commercial use]	The greater of: <ul style="list-style-type: none">• \$42,000 fine; or• 5 times duty payable (\$22,535 on 5kg)	The greater of: <ul style="list-style-type: none">• \$105,000 fine; or• 5 times duty payable (\$22,535 on 5kg)
100kg or more = 140,000 cigarettes [Considered a marketable quantity]	2 years imprisonment and/or greater of: <ul style="list-style-type: none">• \$105,000 fine; or• 5 times duty payable (\$450,695 on 100kg)	5 years imprisonment and/or greater of: <ul style="list-style-type: none">• \$210,000 fine; or• 5 times duty payable (\$450,695 on 100kg)
500kg or more = 700,000 cigarettes [Considered a commercial quantity]	5 years imprisonment and/or greater of: <ul style="list-style-type: none">• \$210,000 fine; or• 5 times duty payable (\$2.25 million on 500kgs)	10 years imprisonment and/or greater of: <ul style="list-style-type: none">• \$315,000 fine; or• 5 times duty payable (\$2.25 million on 500kgs)

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How will the new reasonable suspicion offences work?

For the reasonable suspicion offences, the Bill includes a list of factors that will indicate a reasonable suspicion (for example, the price is substantially lower than the excise plus GST price of the tobacco). This list can inform people, investigators and the courts on circumstances when reasonable suspicion may be taken to exist.

What are the factors for reasonable suspicion that will lead to the claim that tobacco is illicit tobacco?

A reasonable suspicion that tobacco is illicit tobacco can be determined from any one or all of the factors listed below:

- (a) whether the tobacco is in proper retail packaging
- (b) whether it is compliant with tobacco information and safety standards in the Competition and Consumer Act 2010;
- (c) whether the tobacco complies with a relevant safety standard or interim ban;
- (d) whether the price of the tobacco is consistent with the sum of excise and GST payable;
- (e) whether it is sold in accordance with a law of a particular State or Territory;
- (f) Whether the person has, or can get, a tax invoice, bill of lading or customs declaration.

How has the proof of origin issue been resolved?

The new law means that enforcement officials no longer need to prove whether the illicit tobacco was imported or grown domestically before an offence can apply.

Why does this Bill reverse the onus of proof?

So that prosecutors no longer need to establish whether the tobacco was imported or domestically produced, which made it difficult to successfully prosecute tobacco offences. Instead, prosecutors will need to establish reasonable suspicion that duty has not been paid. As a defence to these provisions, defendants will be required to provide evidence, such as a tax invoice or bill of lading, that they had a reasonable belief that duty had been paid.

If asked: Why introduce ‘reasonable suspicion, and not ‘recklessness’?

An offence based on reasonable suspicion that duty has not been paid is justified given the circumstances surrounding the illegal trade in illicit tobacco and in particular the evidentiary issues regarding proof of origin.

Under normal circumstances, persons possessing, buying or selling significant quantities of tobacco products would be expected to only have tobacco products as part of their legitimate wholesale or retail tobacco sales business or themselves comply with the requirements specified (as appropriate) in the reasonable suspicion factors.

In these circumstances, recklessness is considered inappropriate, as the mind of the defendant becomes relevant. While in other drug offences, recklessness can be proven because possession of illicit drugs is an offence in itself, it is difficult to prove recklessness regarding the payment of duty. There was a concern that defendants involved in the illicit

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tobacco trade would be able to argue that they were not reckless as to whether duty was paid by arguing they were ignorant of the intricacies of the tobacco duty system.

Reasonable suspicion overcomes this problem.

How does the Bill affect people who may have inadvertently purchased illicit tobacco for their own consumption?

The Bill is unlikely to affect people that have inadvertently bought illicit tobacco for personal use.

The lowest penalty is the civil penalty and only applies to the possession of tobacco weighing 2 kilograms or more (approximately 2,800 cigarettes).

The civil penalty contains a personal use defence.

For the reasonable suspicion and fault-based offences, the lowest threshold is 5 kilograms (approximately 7,000 cigarettes). It is unlikely anyone would inadvertently possess 5 kilograms of illicit tobacco.

Will the tobacco equipment offence catch farmers who are using equipment for a legitimate purpose?

The tobacco equipment offence will only apply where the equipment has been used to make illicit tobacco, or has been designed or adapted to produce or manufacture illicit tobacco. Equipment used in legitimate farming practices will not be affected.

It will apply if a person is reckless as to whether the equipment will (or was) used to manufacture or produce illicit tobacco even where they have lent the equipment to another person. There is a defence where the person who owns the equipment allowed it to be used by another person and the owner had no reasonable grounds to consider that the equipment would be used to manufacture or produce illicit tobacco.

What is the financial impact of this change?

The impact of this measure is an unquantifiable gain to revenue over the forward estimates period.

If asked: What is Treasury's estimate of the tax gap?

Treasury is not undertaking a tax gap analysis of the illicit tobacco market. Treasury understands that the ATO is undertaking such an analysis. Refer further questions to the ATO.

What will happen if the Bill is not passed?

The illicit tobacco industry will continue to operate and potentially expand. The ATO and Department of Home Affairs will continue to find it difficult to prosecute due to the need to prove the origin of the tobacco and a lack of access to tiered offences.

The Black Economy Taskforce has recommended that illicit tobacco offences be strengthened and modernised.

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Not passing this Bill will allow illicit tobacco to continue to damage the health of Australians by undermining the Australian government's efforts to reduce smoking through increasing tobacco excise and other measures

As the illicit tobacco market is dominated by organised crime, not combating this sector would be detrimental to legitimate taxpayers.

This measure was announced in the 2016-17 Budget. Why is it only legislated now?

Due to a very tight legislative agenda and limited drafting resources, this measure is being introduced now.

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Backpocket – Other illicit tobacco issues

What is illicit tobacco?

Illicit tobacco is where duty, or excise-equivalent duty, has not been paid or the appropriate licence has not been obtained.

Why is illicit tobacco a problem?

Each year smoking kills 15,000 people. It costs Australia \$31.5 billion.

Illicit tobacco undermines the Government's harm prevention efforts by providing access to tobacco at significantly cheaper prices. It also threatens the revenue base as no tax is paid.

The ATO has indicated that the illicit tobacco market is dominated by organised crime groups, which use tobacco profits to fund their other criminal activities.

How is the Government combating illicit tobacco?

In the 2016-17 Budget the Government provided an extra \$7.7 million of funding for the Tobacco Strike Team, the Border Force team responsible for combatting illicit tobacco smuggling. The Tobacco Strike Team has seized 400 tonnes of illicit tobacco with an estimated dutiable value of around \$300 million.

The ATO has also undertaken 16 investigations on domestically grown illicit tobacco since 1 July 2016 resulting in the seizure and destruction of almost 120 tonnes of illicit tobacco, with an estimated duty forgone of over \$91 million.

The Government has established a Black Economy Taskforce to develop a forward-looking whole-of-government strategy to combat the black economy. A Final Report is being considered now.

The government has introduced legislation to strengthen penalties relating to illicit tobacco. The legislation:

- Resolves an issue where illicit tobacco offences could not be prosecuted because it was unclear whether the illicit tobacco was grown domestically or imported. Prosecutors will now only need to prove (or demonstrate reasonable suspicion) that excise has not been paid;
- Adds tiered offences to give prosecutors more flexibility to bring charges against persons who have committed an illicit tobacco offence, including where it is difficult to establish criminal intent.
- Removes inconsistencies between the offences and penalties under the customs and excise regimes.

What is shisha/molasses tobacco and how is it taxed?

- Molasses tobacco, also known as shisha, is flavoured tobacco that is commonly smoked through water pipes.
- Since legislative change in 2008 shisha tobacco is taxed in the same way as loose leaf tobacco – by its total weight. This includes the weight of non-tobacco ingredients.

If asked about a high proportion of the shisha (molasses) tobacco market being illicit

- A relatively high proportion of the shisha market is thought to be illicit as declared imports of shisha are low.
- Because shisha contains other ingredients that add to its weight critics believe it is over-taxed compared to other tobacco products.
- It has been suggested that shisha be taxed only on its tobacco content (rather than gross weight) to encourage importers to enter the legal market.
- However, because molasses tobacco has varied tobacco content in different products this change would be extremely difficult to implement.
- The legislative change in 2008 was introduced due to the difficulties in calculating the percentage of tobacco content in molasses, which would require laboratory testing at the border.
- A change to the duty calculation method would not address the key issue—which is the false declarations of molasses tobacco (e.g. as herbal molasses' or non-tobacco molasses) due to the similar appearance, to avoid paying the duty.
- Reducing the rate is unlikely to change behaviour as the incentive to conceal and falsely report would still be high.

Are our tobacco taxes too high?

Australia taxes tobacco below the World Health Organisation's recommended level of tobacco excise, which is that excise should account for 70 per cent of the retail price of tobacco products.

As of 1 September 2017, tobacco excise was estimated to account for between 53 and 62 per cent of the retail price of five popular brands of manufactured cigarettes sold in Australia.

Who is responsible for stopping illicit tobacco?

The Commonwealth and the States and Territories share responsibility for illicit tobacco.

Commonwealth departments including the Australian Federal Police, Australian Border Force, the ATO, the Australian Crime Commission and the Australian Transaction Reports and Analysis Centre (AUSTRAC) work with State and Territory police to combat illicit tobacco importation and cultivation.

The ATO is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products. The ATO is also responsible for ensuring that businesses, such as tobacco retailers, are correctly declaring income and sales for income tax purposes and GST reporting.

- Where crops are identified the ATO takes action to disrupt those operations, however most illicit product is thought to be imported. Refer further questions on combating domestically grown illicit tobacco to the ATO.

Department of Home Affairs is responsible for preventing illicit tobacco from being imported into Australia and collecting customs duties and taxes on imported tobacco products.

If asked about combating illicit tobacco in the retail environment

The Department of Home Affairs and the ATO focus their resources on cutting off the imported and domestic supply of illicit tobacco at the source as opposed to individual retail outlets, which would not be cost effective.

If asked about track and trace technology

There are no current plans to introduce this type of technology.

Track and trace systems require significant law enforcement resources to be effective since retail products would need to be manually scanned and checked. Additionally, a high proportion of illicit tobacco is relatively easily identifiable as illicit once it is discovered.

A more effective approach is to target the sources of illicit tobacco: smuggling and domestically grown tobacco, and the organised crime groups responsible for these activities.

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Background: Recent excise changes

As part of the 2016-17 Budget, the Government announced four annual 12.5 per cent tobacco excise increases, beginning 1 September 2017. The excise increases are in addition to the biannual indexation to average weekly ordinary time earnings.

As part of the 2017-18 Budget, the Government announced it would adjust the taxation of roll your own (RYO) tobacco so that manufactured cigarettes and RYO tobacco cigarettes receive comparable tax treatment. The adjustments will be phased in over four years from 1 September 2017 to 1 September 2020.

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How else is the Government combating illicit tobacco?

In the 2016-17 Budget the Government provided an extra \$7.7 million of funding for the Tobacco Strike Team.

The tobacco strike team has seized 400 tonnes of illicit tobacco with an estimated dutiable value of around \$300 million.

What has been done to combat illicit tobacco prior to the introduction of this legislation?

The ATO has undertaken 16 investigations since 1 July 2016 resulting in the seizure and destruction of almost 120 tonnes of illicit tobacco, with an estimated duty forgone of over \$91 million. Since 1 July 2011 the ATO has conducted 26 investigations seized illicit tobacco with an estimated duty forgone of \$160 million.

The ATO focuses on domestic growing and production and due to constraints with the current law (the proof of origin concept) is limited to being able to seize illicit tobacco and prosecute people caught growing it.

Are our tobacco taxes too high?

Australia taxes tobacco below the World Health Organisation's recommended level of tobacco excise, which is that excise should account for 70 per cent of the retail price of tobacco products.

As of 1 September 2017, tobacco excise was estimated to account for between 53 and 62 per cent of the retail price of five popular brands of manufactured cigarettes sold in Australia.

As part of the 2016-17 Budget, the Government announced four annual 12.5 per cent tobacco excise increases, beginning 1 September 2017. These increases will bring Australia closer to meeting the World Health Organisation's target.

– The excise increases are in addition to the biannual indexation to average weekly ordinary time earnings.

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Has increasing the excise rate resulted in more illicit tobacco?

Treasury has not estimated how much revenue has been lost due to the consumption of illicit tobacco in Australia.

Background: The 2017 KPMG *Report into Illicit Tobacco* estimated that \$1.61 billion more in revenue would have been received in 2016 if all illicit tobacco consumption had been legal consumption. Philip Morris Ltd and Imperial Tobacco Australia Ltd commissioned the report.

Given government has increased the taxation of tobacco, what is the government doing to combat illicit tobacco?

The Government has established a Black Economy Taskforce to develop a forward-looking whole-of-government strategy to combat the black economy.

- A Final Report is being considered now.

In the 2016-17 Budget, the Government announced an additional \$7.7 million in funding to expand the Tobacco Strike Team, and reforms to the *Customs Act 1901* and *Excise Act 1901* to provide enforcement officers with access to tiered offences.

- The expansion of the Tobacco Strike Team has taken place, and legislation to implement tiered offences continues to be progressed.

- Since October 2015, the Australian Border Force has stopped more than 400 tonnes of illicit tobacco (valued at \$294 million) from reaching the black market. Refer questions on the Tobacco Strike Team to DEPT OF HOME AFFAIRS.

Who is responsible for stopping illicit tobacco?

The Commonwealth and the States and Territories share responsibility for illicit tobacco.

Commonwealth departments including the Australian Federal Police, Australian Border Force, the ATO, the Australian Crime Commission and the Australian Transaction Reports and Analysis Centre (AUSTRAC) work with State and Territory police to combat illicit tobacco importation and cultivation.

Treasury is responsible for setting excise taxation rates. Treasury does not engage in enforcement activities.

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The ATO is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products. The ATO is also responsible for ensuring that businesses, such as tobacco retailers, are correctly declaring income and sales for income tax purposes and GST reporting.

- Where crops are identified the ATO takes action to disrupt those operations, however most illicit product is thought to be imported. Refer further questions on combatting domestically grown illicit tobacco to the ATO.
- *Background:* Since 2006 no-one has been licensed to grow tobacco in Australia.

Department of Home Affairs is responsible for preventing illicit tobacco from being imported into Australia and collecting customs duties and taxes on imported tobacco products.

If asked about illicit tobacco in the retail environment

The Department of Home Affairs and the ATO focus their resources on cutting off the imported and domestic supply of illicit tobacco at the source as opposed to individual retail outlets.

BACKPOCKET BRIEF – ILLICIT TOBACCO

Key issues

Why is illicit tobacco a problem?

Each year smoking kills 15,000 people. It costs Australia \$31.5 billion.

Illicit tobacco undermines our harm prevention efforts by providing access to tobacco at significantly cheaper prices. It also threatens the revenue base as no tax is paid.

The ATO has indicated that the illicit tobacco market is dominated by organised crime groups.

What does this Bill do?

It strengthens penalties relating to illicit tobacco as per our announcement in the 2016-17 Budget. It addresses the following issues:

- Currently, the customs and excise illicit tobacco provisions are difficult to enforce as it has to be proven whether the tobacco was imported or grown domestically.
- Furthermore, there are currently inconsistencies between the offences under the customs and excise regimes.

What is illicit tobacco?

Illicit tobacco is where duty has not been paid on it or the appropriate licence has not been obtained.

What are the different offences in this Bill?

The offences in this Bill are for possessing, buying, selling and the making (including possessing equipment used in the process) of illicit tobacco. There will be tiered offences where there is a reasonable suspicion that duty has not been paid. There will also be tiered offences for intentionally selling, possessing or making illicit tobacco.

The penalties for the reasonable suspicion offences are lower than the penalties for the intentional offences.

There is also a civil penalty for the possession of tobacco where there is a lack of documentary evidence to justify the possession of the tobacco.

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Why are there tiered offences?

Introducing tiered offences will give prosecutors more flexibility to bring charges against persons who have committed an illicit tobacco offence. The offences are tiered based on the quantity of tobacco (5kg or more, 100kg or more or 500kg or more). Penalties will range from a \$42,000 fine or 5 times duty payable to up to 10 years imprisonment.

There are offences where there is a reasonable suspicion that duty has not been paid and more severe intentional offences. This will give investigators flexibility as to what actions to bring. The penalties will apply from the day after the Bill receives Royal Assent.

For example, a person caught with 5kg of illicit tobacco will face a fine up to \$42,000. A person caught with 100kg of illicit tobacco can face a penalty up to \$450,000 (which is 5 times duty payable) or 5 years imprisonment. A person caught with 500kg of illicit tobacco can face a penalty just over \$2 million (which is 5 times duty payable) or 10 years imprisonment.

There is also a civil penalty of up to \$21,000 for people caught with more than 2kg of illicit tobacco, which is approximately 2,800 cigarettes.

Penalties	Reasonable suspicion	Intentional offences
5kg or more [Considered a limited commercial use]	The greater of: <ul style="list-style-type: none">• 200 penalty units; or• 5 times duty payable	The greater of: <ul style="list-style-type: none">• 500 penalty units; or• 5 times duty payable
100kg or more [Considered a marketable quantity]	2 years imprisonment; or Greater of: <ul style="list-style-type: none">• 500 penalty units; or• 5 times duty payable	5 years imprisonment; or Greater of: <ul style="list-style-type: none">• 1,000 penalty units; or• 5 times duty payable
500kg or more [Considered a commercial quantity]	5 years imprisonment; or Greater of: <ul style="list-style-type: none">• 1,000 penalty units; or• 5 times duty payable	10 years imprisonment; or Greater of: <ul style="list-style-type: none">• 1,500 penalty units; or• 5 times duty payable

What are the changes to penalties?

The new law means that enforcement officials no longer need to prove whether the illicit tobacco was imported or grown domestically before an offence can apply.

For the reasonable suspicion offences, the Bill includes a list of factors that will indicate a reasonable suspicion. This list can inform people, investigators and the courts on circumstances when reasonable suspicion may be taken to exist.

The current law does not have tiered offences with differing penalties. The maximum penalty was 2 years imprisonment or \$105,000.

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What are the factors for reasonable suspicion that will lead to the claim that tobacco is illicit tobacco?

A reasonable suspicion that tobacco is illicit tobacco can be determined from any one or all of the factors listed below:

- (a) whether the tobacco is in proper retail packaging
- (b) whether it is compliant with tobacco information and safety standards in the Competition and Consumer Act 2010;
- (c) whether the tobacco complies with a relevant safety standard or interim ban;
- (d) whether the price of the tobacco is less than the sum of excise and GST payable;
- (e) whether it is sold in accordance with a law of a particular State or Territory;
- (f) Whether the person has, or can get, a tax invoice, bill of lading or customs declaration.

Why does this Bill reverse the onus of proof?

Due to the proof of origin concept it was considered the most appropriate option would be to require that people needed to provide evidence that they believed that excise had been paid on the tobacco.

The reasonable suspicion offences provide a guide as to what would be considered illicit tobacco. But if the person can show that they had reasonable grounds to suspect that duty had been paid then this becomes a defence to these provisions. If the person can provide some sort of official receipt under GST law or a bill of lading, for example, it may indicate that they have reasonable grounds to believe that applicable duty had been paid.

How does the Bill affect people who may have inadvertently purchased illicit tobacco for their own consumption?

The lowest penalty is the civil penalty and only applies to the possession of tobacco weighing 2 kilograms or more. For most people, they will not possess more than 2 kilograms as this would produce approximately 2,800 cigarettes.

The civil penalty does contain a personal use defence.

For the reasonable suspicion and fault-based offences, the lowest threshold is 5 kilograms. It is unlikely anyone would inadvertently possess 5 kilograms of tobacco. There are defences where they can produce a licence or official document.

Will the tobacco equipment offence catch farmers who are using equipment for a legitimate purpose?

The tobacco equipment offence will only apply where the equipment has been used to make illicit tobacco. Equipment used in legitimate farming practices will not be affected.

It will apply if a person is reckless as to whether the equipment will (or was) used to manufacture or produce illicit tobacco. There is a defence if they had a reasonable ground to consider that the equipment would not have been used to produce or manufacture illicit tobacco.

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It will be an offence to possess equipment that is designed or adapted to produce or manufacture illicit tobacco.

What is the financial impact of this change?

The impact of this measure is an unquantifiable gain to revenue over the forward estimates period.

What will happen if the Bill is not passed?

The illicit tobacco industry will continue to operate and potentially expand. The ATO and Department of Home Affairs will continue to find it difficult to prosecute due to the need to prove the origin of the tobacco.

The Black Economy Taskforce has recommended that illicit tobacco offences be strengthened and modernised.

Not passing this Bill will continue to allow illicit tobacco to damage the Australian health system as it will hamper the government's commitment to reducing smoking rates which it has done through implementing excise rate increases and other measures in the legitimate tobacco market.

As the illicit tobacco market is dominated by organised crime, not combating this sector would be detrimental to legitimate taxpayers.

Who is responsible for stopping illicit tobacco?

The Commonwealth and the States and Territories share responsibility for illicit tobacco.

Commonwealth departments including the Australian Federal Police, Department of Home Affairs, the ATO, the Australian Crime Commission and AUSTRAC work with State and Territory police to combat illicit tobacco importation and cultivation.

This measure was announced in the 2016-17 Budget. Why is it only legislated now?

Due to a very tight legislative agenda and limited drafting resources, this measure is being introduced now.

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How else is the Government combating illicit tobacco?

In the 2016-17 Budget the Government provided an extra \$7.7 million of funding for the Tobacco Strike Team.

The tobacco strike team has seized 400 tonnes of illicit tobacco with an estimated dutiable value of around \$300 million.

What has been done to combat illicit tobacco prior to the introduction of this legislation?

The ATO has undertaken 16 investigations since 1 July 2016 resulting in the seizure and destruction of almost 120 tonnes of illicit tobacco, with an estimated duty forgone of over \$91 million. Since 1 July 2011 the ATO has conducted 26 investigations seized illicit tobacco with an estimated duty forgone of \$160 million.

The ATO focuses on domestic growing and production and due to constraints with the current law (the proof of origin concept) is limited to being able to seize illicit tobacco and prosecute people caught growing it.

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Has increasing the excise rate resulted in more illicit tobacco?

Treasury has not estimated how much revenue has been lost due to the consumption of illicit tobacco in Australia.

Background: The 2017 KPMG *Report into Illicit Tobacco* estimated that \$1.61 billion more in revenue would have been received in 2016 if all illicit tobacco consumption had been legal consumption. Philip Morris Ltd and Imperial Tobacco Australia Ltd commissioned the report.

Given government has increased the taxation of tobacco, what is the government doing to combat illicit tobacco?

The Government has established a Black Economy Taskforce to develop a forward-looking whole-of-government strategy to combat the black economy.

- A Final Report is being considered now.

In the 2016-17 Budget, the Government announced an additional \$7.7 million in funding to expand the Tobacco Strike Team, and reforms to the *Customs Act 1901* and *Excise Act 1901* to provide enforcement officers with access to tiered offences.

- The expansion of the Tobacco Strike Team has taken place, and legislation to implement tiered offences continues to be progressed.

- Since October 2015, the Australian Border Force has stopped more than 400 tonnes of illicit tobacco (valued at \$294 million) from reaching the black market. Refer questions on the Tobacco Strike Team to DEPT OF HOME AFFAIRS.

Who is responsible for stopping illicit tobacco?

The Commonwealth and the States and Territories share responsibility for illicit tobacco.

Commonwealth departments including the Australian Federal Police, Australian Border Force, the ATO, the Australian Crime Commission and the Australian Transaction Reports and Analysis Centre (AUSTRAC) work with State and Territory police to combat illicit tobacco importation and cultivation.

Treasury is responsible for setting excise taxation rates. Treasury does not engage in enforcement activities.

The ATO is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products. The ATO is also responsible for ensuring that

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businesses, such as tobacco retailers, are correctly declaring income and sales for income tax purposes and GST reporting.

- Where crops are identified the ATO takes action to disrupt those operations, however most illicit product is thought to be imported. Refer further questions on combatting domestically grown illicit tobacco to the ATO.
- *Background:* Since 2006 no-one has been licensed to grow tobacco in Australia.

Department of Home Affairs is responsible for preventing illicit tobacco from being imported into Australia and collecting customs duties and taxes on imported tobacco products.

If asked about illicit tobacco in the retail environment

The Department of Home Affairs and the ATO focus their resources on cutting off the imported and domestic supply of illicit tobacco at the source as opposed to individual retail outlets.

s 22



Illicit tobacco – Brief Timeline

May 2016 – Budget announcement

September 2017 – drafting began

December 2017 – first draft sent to MRFS

January 2018 – MRFS approved the measure with one addition (equipment offence)

January 2018 – drafting of additional equipment offence

January 31 2018 – PM&C briefed the PM advising to approve the measure

February 1-2 2018 – Final Bill and EM sent to MRFS for approval that includes the equipment offence

February 12 2018 – Bill slated for introduction into Parliament

March 26 – Anticipated introduction of Customs Act amendments

Key Facts

The Bill includes offences for possessing, selling, buying and making (including possessing equipment used in the process) illicit tobacco.

There are fault-based offences and reasonable suspicion offences.

- AGD and CDPP raised some concerns with reasonable suspicion but realised that this was the most appropriate option considering the nature of the proof of origin concept.
- The Senate Scrutiny of Bills Committee may take a close look at these issues but they are clearly explained in the EM.

Maximum penalties will increase to 10 years imprisonment or \$315,000 (or 5 times the duty payable – this is over \$2 million for 500kg of tobacco) from 2 years imprisonment or \$105,000. The penalties will apply from the day after the Bill receives Royal Assent.

- AGD noted that the fines are higher than recommended by the Commonwealth Guide to Framing Offences. The EM states that this is necessarily proportionate considering the duty foregone.

Consultation was undertaken with the ATO, Dept of Home Affairs, Dept of Health, AGD, CDPP, The AFP, The Law Council of Australia, Law Society of NSW, Law Institute of Victoria, Australian Retailers Association, British American Tobacco (equipment, too), Imperial Tobacco, Phillip Morris and Richland Express. Confidentiality agreements were obtained.

There are tiered offences based on the weight of tobacco – 5kg, 100kg or 500kg.

There is a civil penalty for possessing more than 2kg of illicit tobacco.

1 kg of tobacco produces approximately 1,400 cigarettes.

The financial impact is an unquantifiable gain to revenue over the forward estimates.

The equipment offence will apply if a person is reckless as to whether the equipment will (or was) used to manufacture or produce illicit tobacco.

- There is a defence if they had a reasonable ground to consider that the equipment would not have been used to produce or manufacture illicit tobacco.
- It will be an offence to possess equipment that is designed or adapted to produce or manufacture illicit tobacco.

The Commonwealth, States and Territories share responsibility for combating illicit tobacco.

The tobacco strike team has seized 400 tonnes of illicit tobacco with an estimated dutiable value of around \$300 million.

MEETING WITH MAJOR TOBACCO IMPORTERS ON ILLICIT TOBACCO PACKAGE – 9 MAY 2018

Overview of meeting (PB)

- **Explain the rationale for the package (PB)** — Part of the Government's response to the Black Economy report, and consistent with its key recommendations. Aimed at the integrity of the tobacco excise and duty regime, which in turn supports better health outcomes (i.e. it is not a revenue raising measure).
- **Outline the five elements of the package (PB)** —
 - moving the taxing point to the border (from 1 July 2019);
 - : Transitional arrangements— 12 months to pay duty on stock in warehouses on 1 July 2019 (This will be new information, it is only briefly referred to in measures description);
 - introducing an import permits system (from 1 July 2019);
 - funding the Illicit Tobacco Taskforce (from 1 July 2018);
 - funding for the ATO's domestic tobacco enforcement (from 1 July 2018); and
 - modernising the ATO's excise system (from 2020-21).
- **Answer high-level questions (All)**— noting that the details will be settled as the legislation is drafted.

Possible questions

- **Timelines for implementation (Tsy and HA)** — Treasury and Home Affairs will prepare legislation on the change in taxing point and permits system 'over the coming months'. Timing will be subject to Government's legislative agenda and availability of drafting resources, noting start date of 1 July 2019.
- **Details of permit system (HA)/change in taxing point (HA/ATO)** — (Not in a position to discuss finer details until further into the legislative drafting process.)
- **Transition arrangements (ATO)**— Audits of stocks; provision of financial security (e.g. deposit or bank guarantee worth a percentage of value of stock); 12 months to pay. (This will be new information).
- **Industry consultation (Tsy/HA)** — The Government has made a considered policy decision. We expect to consult on specific aspects in the usual way, for example, through Exposure Draft legislation.
- **Special treatment e.g. Trusted trader/deferred duty (HA)**— The policy is for all duty to be paid at the time of importation, with no exceptions, consistent with it being an integrity measure.
- **Details of enforcement (HA/ATO)** — E.g. what will they focus on, what will they do differently, whether retail trade will be targeted.
- **Revenue raised (PB)**— Acknowledge some revenue is a one-off 'bring forward', but there is also new ongoing funding and revenue from enforcement. It is an integrity measure, not revenue measure. (This will be new information as the announcement and Budget don't breakdown the costing).
- **Other measures e.g. track and trace, banning imports not in approved packaging** — This package, with stronger penalties, provides a comprehensive and considered response. Focus will be on implementing these measures. (DHA could talk about how the permit system could cover parts of these suggestions.)

Tobacco Excise Reform

Reform is needed to address illicit tobacco

Undermines
Government Revenue



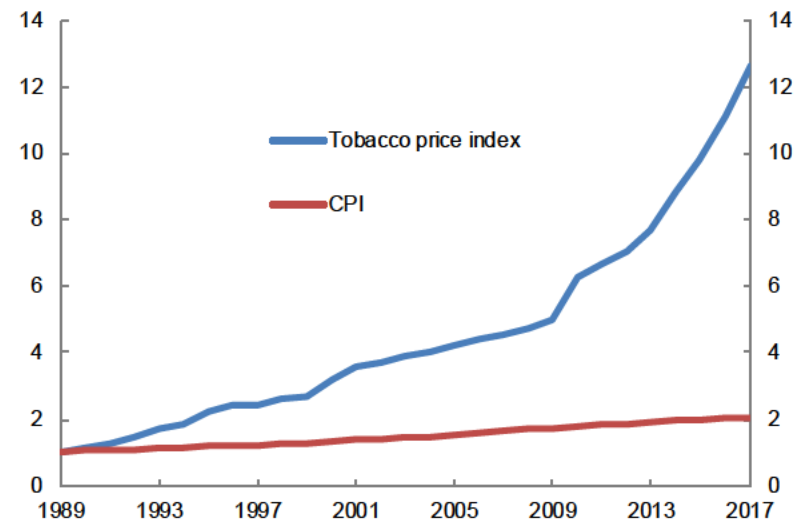
Undermines policies to
reduce smoking rates



Provides funding for
organised crime and
terrorist organisations



- Australia's excise system makes it too easy for illicit tobacco to be smuggled into the country, and we have too few law enforcement resources devoted to addressing the problem.
- We expect the problem to worsen without intervention as cigarette prices continue to increase, including due to excise increases.



What will the reforms do?

The package will:

- Respond to the core recommendations of the Black Economy Taskforce regarding illicit tobacco.
- Deliver [**\$1.4 billion**] in revenue to the Budget over the forward estimates.
- Protect future tobacco excise revenue and promote the health and wellbeing of Australians by reducing the size of the illicit tobacco market.
- Remove a key source of funding for organised crime and terrorism.
- Reduce red tape for businesses and administrative costs for government.

Summary of the Package

Warehouse leakage

Moving the tax point to the border

- Tobacco will be taxed at the border rather than being stored domestically in a pre-tax state.
- This will deliver [~\$1.4 billion] to the Budget over the forward estimates.
- Eliminate a significant source of illicit tobacco by abolishing the warehouse system.
- Reduce red tape and provide a deregulatory saving for the ATO.

Smuggling

Create a cross-agency tobacco taskforce

- Create a cross agency team with additional capabilities to more effectively combat illicit tobacco, particularly through targeting organised crime.
- Deliver unquantifiable gains to revenue by reducing the incidence of illicit tobacco.

Introduce a permit system to better control tobacco imports

- Importers of tobacco will be required to hold a permit.
- This will make it easier for the Border Force to determine if tobacco is illicit and will reduce administrative costs.

Domestic Production

Additional funding to investigate and destroy domestic crops

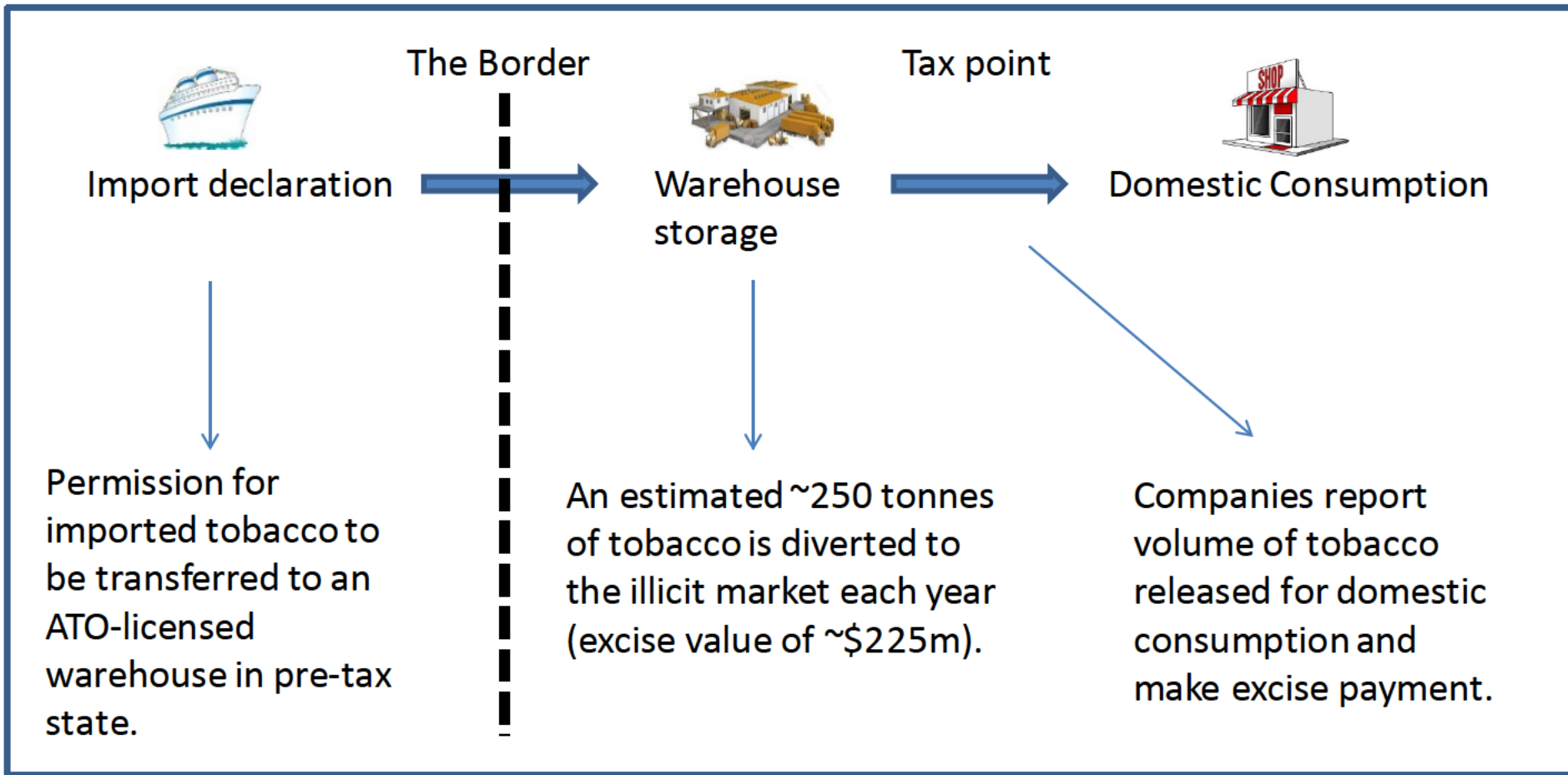
- Equip the ATO with extra investigators to detect and destroy domestic illicit tobacco crops and conduct follow up criminal investigation activity.
- Fund additional prosecutions by the Commonwealth Director of Public Prosecutions.

Upgrade IT systems

- Digitise and integrate ATO's excise payment systems with its corporate systems.
- This will provide a holistic view of clients' tax performance and compliance behaviours and improve efficiency by moving from the legacy paper-based system.

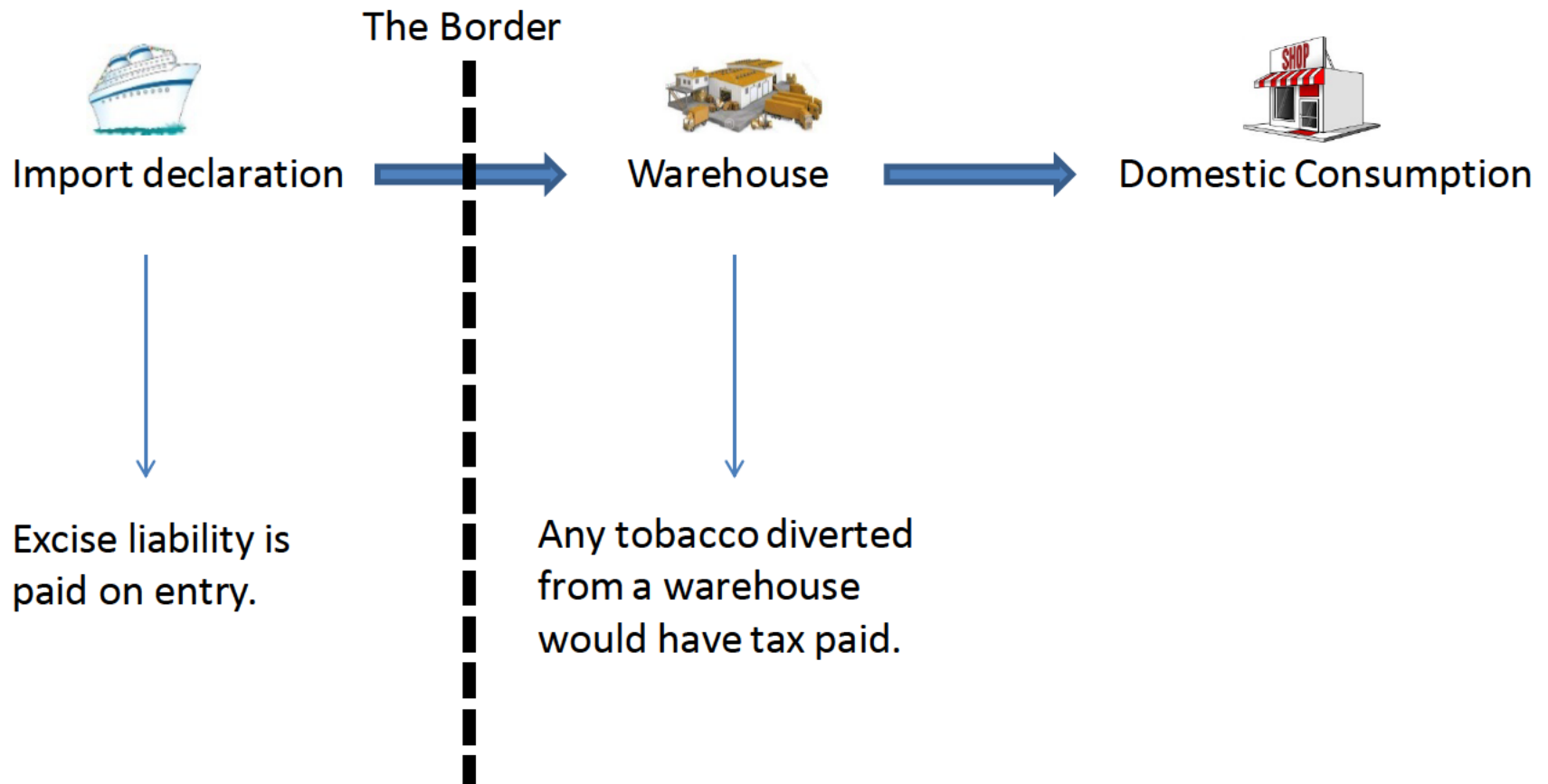
Moving the tax point: Current System

When tobacco enters the country it is initially stored in warehouses in a pre-tax state. This provides an opportunity to divert tobacco into the illicit market prior to excise being paid.



Moving the tax point: The solution

Under the new system, tobacco will not be released from the border until the excise liability has been paid. Tobacco from warehouses will no longer be a source of illicit tobacco as excise will already have been paid.



Tackling Illicit tobacco

Comprehensive action to address smuggling and illegal trade in tobacco

For the first time, the Government is introducing a holistic, multi-pronged approach to tackling illicit tobacco that not only targets the three main sources of illicit tobacco: smuggling, warehouse leakage and illicit domestic tobacco crops, but will also work to dismantle illicit tobacco supply chains.

The Issue

Illicit tobacco represents approximately \$600 million in forgone tobacco duty every year. The illicit tobacco market is dominated by organised crime groups, which use tobacco profits to fund their other criminal activities. It also undermines the Government's harm prevention efforts.

While the government has taken action over recent years to increase enforcement of illicit tobacco, a new and integrated approach is required to dismantle illicit tobacco operations.

The details

The Government is creating a permanent multi-agency enforcement team – the Illicit Tobacco Taskforce – with resources dedicated to combating the illicit tobacco trade. This new team, led by the Australian Border Force and comprising representatives from a number of State and Commonwealth law enforcement agencies, will tackle smuggling activity at the border and work to dismantle the supply chains for the trade in illicit tobacco. These additional resources will be complemented by a new permit system for tobacco imports.

Additional funding for the ATO will bolster its resources to investigate and destroy domestically grown tobacco crops. The ATO will upgrade and future-proof its excise and excise equivalent goods payment systems to replace the outdated paper lodgement system.

The Government will target the leakage of tobacco from warehouses, which has been a significant source of illicit tobacco, by requiring importers to pay tobacco duty at the border from 1 July 2019.

These measures build on the action the Government has already taken, including additional funding for the Tobacco Strike Team and legislation before Parliament to create tougher penalties for illicit tobacco offences.

The additional resources and capabilities, coupled with tough new penalties and offences, will enable these agencies to pursue the organised crime syndicates at the heart of the illicit tobacco trade.

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COMBATting ILLICIT TOBACCO

Key message

- The Government is introducing a comprehensive package of measures to bolster enforcement agencies' ability to combat the illicit tobacco trade and protect the integrity of Australia's tobacco excise system. The package will target the three main sources of illicit tobacco (warehouse leakage, smuggling and domestic crops).

Key facts and figures

- This package of measures will address the tax gap, promote the health of Australians by supporting the existing tobacco control policies, and remove a key source of funding for organised crime.
 - From 1 July 2019, tobacco importers will be required to pay excise when tobacco enters the country, rather than when it enters the domestic market, eliminating leakage from warehouses to the black market.
 - From 1 July 2018, a new multi-agency Illicit Tobacco Taskforce, led by the Australian Border Force (ABF). The Taskforce will leverage whole-of-government capabilities and powers from multiple agencies to effectively investigate, prosecute and ultimately dismantle the international organised crime groups responsible for a large part of the illicit tobacco trade.
 - From 1 July 2018, the ATO will be provided with additional resources, including an additional six investigators, to fight domestic illicit tobacco crops.
 - From 1 July 2019, permits will be required for all tobacco importations, assisting border officers to quickly and efficiently determine when an offence has been committed.
 - Beginning 2020-21, the ATO will upgrade and future-proof its excise and excise equivalent goods payment systems to replace the outdated paper lodgement system.
- Financial Impact - The package is estimated to have a net gain to the Budget of \$3.6 billion over the forward estimates period including an increase in revenue of about \$3.7 billion offset by an increase in payments of about \$150 million.
- A large portion of the revenue impact (\$3.3 billion) is due to moving the taxing point for tobacco to the border, which results in tobacco duty being collected earlier than it otherwise would have been.
 - The costing also includes a revenue gain of about \$400 million over the forward estimates due to improved enforcement and because the change in taxing point permanently removes the risk of warehouse leakages.

Background brief: Meeting with Master Grocers Australia (MGA), Australian Border Force (ABF) and the Chair of the Black Economy Advisory Board (Dr Michael Schaper)

- MGA is a national registered employer industry association that is a representative of Australian independent retailers including grocery, liquor and other retail outlets.
- This meeting arose from a recent black economy meeting between Dr Michael Schaper (Chair of the Black Economy Advisory Board) and ABF Group Manager Customs/Deputy Comptroller-General of Customs, Dr Bradley Armstrong. Dr Schaper raised illicit tobacco as an ongoing concern voiced to him by industry, to which ABF representatives noted the enduring commitment to mitigate the illicit tobacco threat at the border.

MGA concerns

- MGA may raise (as previously expressed to ABF) concerns with ABF's role in countering the illicit tobacco trade, and focus on:
 - a perceived financial burden on legitimate tobacco retailers as a result of illicit tobacco in Australia, and;
 - that the Commonwealth is not doing enough to enforce against illicit tobacco sales in the retail space.
- ABF advised that these are issues which are raised fairly consistently, and to which ABF are comfortable responding in support of their ongoing program of work to address illicit tobacco in both the operational and policy space. There will also be a member of the Illicit Tobacco Taskforce joining the meeting on the day, which will support an authoritative voice on the operational response.

Illicit tobacco in retail space background

- At the 25 June 20 ABF led Illicit Tobacco Industry Group (ITIG) meeting attended by MGA, ITTF encouraged industry and retailers to provide information of illicit tobacco activity through Border Watch which may be used to conduct further research, targeting or enforcement activity.
- Illicit tobacco sold in the retail environment is a shared responsibility of a number of Commonwealth, State and Territory departments.
 - The resources of the Illicit Tobacco Taskforce (ITTF) are deliberately targeted towards disrupting organised crime syndicates and cutting off illicit tobacco at its source. Retailers may fall within the scope of Taskforce investigations to the extent they support the activities of organised crime syndicates and serious actors.
 - State and territory health and law enforcement authorities are generally responsible for compliance and enforcement action regarding the sale of illicit tobacco by retailers.

Tobacco tax background

- Tobacco tax rates influence the attractiveness of the illicit tobacco market (If asked about Government's current policy on new tobacco excise increases, suggest responding the position remains unchanged).
- Tobacco in Australia is taxed in one of two ways: a per stick (cigarette) rate (\$1.10360) applying to cigarettes containing no more than 0.8 grams of tobacco; and a per kilogram rate (\$1576.57) applying to other forms of tobacco such as loose leaf tobacco (also known as roll-your-own), molasses and cigars.
- Tobacco rates are indexed biannually to an index of average weekly ordinary time earnings (AWOTE) on 1 March and 1 September every year. In addition to this, the Government announced four annual 12.5 per cent increases occurring on 1 September every year from 2017 to 2020 inclusive. This continued a series of annual 12.5 per cent increases since December 2013.
- From 1 July 2019 all customs duty for imported tobacco is paid to Home Affairs when it arrives at the border. Tobacco manufacturing in Australia ceased in 2015.
- As at 2019-20 MYEFO, the forecast tax receipts for tobacco excise equivalent customs duty in 2020-21 are \$15.7 billion.

KPMG 'Illicit Tobacco in Australia' 2019 full year report released May 2020

- KPMG's Illicit Tobacco in Australia Report, commissioned by Philip Morris and Imperial Tobacco, estimates that illicit tobacco cost the Government \$3.41 billion in forgone revenue in 2019.
 - The KPMG estimate of forgone revenue is significantly larger than the Australian Taxation Office (ATO) and Department of Home Affairs (DHA) taxgap research, which estimated illicit tobacco represented around \$647 million of forgone revenue in 2017-18. An explanation of the differences between these estimates is below.
- KPMG also found that the proportion of illicit tobacco consumed increased by 6.6% per cent between 2018 and 2019. As a proportion of all tobacco consumption, consumption of illicit tobacco increased from 14.1 per cent in 2018 to 20.7 per cent in 2019.
- Contraband accounted for 52.8 per cent of illicit tobacco consumption in 2019. Contraband refers to cigarettes manufactured legally outside of Australia and smuggled into the country.

Differences between KPMG and ATO/Home Affairs illicit tobacco taxgap estimates

- KPMG's estimates differ from the taxgap analysis prepared by the ATO and Home Affairs, in part because they measure different things and use different methodologies.
 - The KPMG methodology primarily uses a consumption model based on a consumer survey; and an empty pack survey analysis. The ATO and Home Affairs methodology uses a supply side model.
- Some aspects of the KPMG methodology are considered to be prone to variance including
 - The use of empty packet analysis, as it is impossible to estimate and adjust for legitimate overseas imports and the duty free allowance for international air passengers.
 - Surveys suffer from misinterpretation and error.
- The estimates by the ATO and Home Affairs are based on extensive and high quality data held by these agencies, and use a methodology endorsed by independent experts.

Black Economy Package – Combatting Illicit Tobacco (2018-19 Budget) background

- The Government is committed to combatting illicit tobacco. In the 2018-19 Budget it announced a comprehensive package which targets the three key sources of illicit tobacco in Australia: smuggling; leakage from warehouses and domestic tobacco crops.
- The package included the funding and establishment of the Illicit Tobacco Taskforce, and new funding for tackling domestic crops, from 1 July 2018.
- Two further elements of this package – a new permit regime for tobacco imports and the taxation of tobacco imports at the border – commenced on 1 July 2019. The package also included funding for the ATO to upgrade its excise system from 2020-21.
- Overall, the package is estimated to have a net gain to the Budget of \$3.6 billion from 2018-19 to 2021-22, including an increase in revenue of about \$3.7 billion, offset by an increase in payments to various departments of about \$150 million.
- The package complements action taken in August 2018 to strengthen penalties for the possession, manufacturing or importation of illicit tobacco.
- The Government will continue to monitor the impact of the new arrangements before considering substantial additional tobacco control measures.

From: s 22
To: [Fraser, Bede](#); [Thompson, Hector](#)
Cc: s 22; [Boneham, Patrick](#); s 22
Subject: RE: Briefing invitation - Illicit Tobacco in Australia [SEC=OFFICIAL]
Date: Friday, 13 March 2020 4:11:03 PM
Attachments: s 22

OFFICIAL

Hi Bede and Hector

Further to s 22's email, I suggest the meeting with Imperial tobacco be declined and that they be asked to provide the update on the KPMG UK Illicit tobacco in Australia report at the bi-annual Illicit Tobacco Industry Group (ITIG) meeting facilitated by Australian Border Force (ABF) which is to be scheduled for around June 2020. I just called Lachlan from ABF who said they received a similar request from Imperial Tobacco and he said they advised Imperial the same thing.

I expect the tobacco industry will be very keen to provide an update on the KPMG UK illicit tobacco report (which is funded by the tobacco industry) at the next ITIG meeting as well as provide feedback on the Government's illicit tobacco reforms. A terms of reference for the ITIG meeting including membership is attached.

There is a very high bar to meeting with the tobacco industry. The Department of Health have issued guidance for public agencies and officials on interactions with the tobacco industry under Article 5.3 of the World Health Organisation (WHO) Framework Convention on Tobacco Control (FCTC) – refer second attachment.

Broadly, the Article 5.3 guidance says consultation with the tobacco industry should be limited to what is necessary for public officials or agencies to enact effective tobacco control measures and do not engage in any interaction that creates the perception of partnership or cooperation.

There is also a range of new administrative requirements such as recording interactions/meetings with tobacco industry and making them public – eg say on the Treasury website if Treasury were to meet with the tobacco industry outside of the ABF led IITG meeting.

Regards

s 22

Analyst, Indirect Tax and Not for Profit Unit
Individuals and Indirect Tax Division
The Treasury, Langton Crescent, Parkes ACT 2600
phone: +s 22
email: s 22@treasury.gov.au

OFFICIAL

From: s 22
Sent: Thursday, 12 March 2020 5:13 PM
To: Fraser, Bede ; Thompson, Hector
Cc: Boneham, Patrick ; s 22
Subject: FW: Briefing invitation - Illicit Tobacco in Australia [SEC=OFFICIAL]

OFFICIAL

For your consideration – Treasury generally doesn't agree with the methodology employed in this report, but the briefing could be an opportunity to get feedback on how the Illicit Tobacco reforms are progressing and to discuss issues around the forecasts (depending on the timing of the meeting).

Note that there are certain requirements under a WHO protocol on interaction between

governments and tobacco companies that we will need to be cognisant of – Andrew has more info on these.

s 22

OFFICIAL

From: s 47F <[redacted]@impbrands.com>
Sent: Thursday, 12 March 2020 4:00 PM
To: Boneham, Patrick <Patrick.Boneham@TREASURY.GOV.AU>
Cc: s 22 <[redacted]@TREASURY.GOV.AU>
Subject: Briefing invitation - Illicit Tobacco in Australia

Hi Patrick and Susan,

The 2019 KPMG UK *Illicit tobacco in Australia* report will be released shortly. Ahead of the public release, we are offering briefings to provide key stakeholders with the latest trends and findings. Based on recent trends we are still seeing a significant amount of illicit tobacco being consumed in Australia.

The KPMG UK *Illicit tobacco in Australia* report is the most detailed publication released on this topic in Australia, and serves as key reading for policy-makers with an interest in taxation, law enforcement, border security, organised crime, and retail issues.

In 2018 KPMG estimated that the illicit tobacco market cost the Commonwealth \$2.02bn in lost revenue. Based on the findings for 2019, this figure is set to considerably increase.

Tobacco smuggling not only threatens one of the Commonwealth Government's largest sources of revenue, but has been shown to have much broader consequences:

1. Finances criminal activity including, organised gangs, and foreign extremist activity;
2. Undermines government health policy objectives;
3. Harms local business; and
4. Impacts community safety and wellbeing.

Without a doubt over the last few years there has been increased attention and resourcing given to the issue of illicit tobacco, but more needs to be done. Illicit retailers are selling cheap cigarettes and chop chop tobacco which is robbing honest, hard-working small business owners. These criminal operators are doing so blatantly with stores being identified in all major cities, as well as rural and regional towns and there is minimal enforcement and action being taken against those retailers selling illicit products.

We will be in **Canberra** during the s 22 [redacted] and during s 22 [redacted] and would like to offer you a briefing.

Please note: participation will be subject to the usual confidentiality provisions of an 'embargo' until the report is officially released.

We thank you for considering our invitation, and look forward to hearing from you.

Regards,

s 47F

[redacted] Regulatory & Legal Compliance Manager | **Imperial Brands Australasia**
p +s 47F [redacted] | m +s 47F [redacted] | e: s 47F [redacted]@au.imptob.com
Level 4 4-8 Inglewood Place Norwest NSW 2153 | PO Box 7800, Norwest NSW 2153

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KPMG Illicit Tobacco in Australia 2018: Summary of Findings Note: The final report will be released around June 2019.

1. Illicit tobacco consumption **declined** by 0.9 percentage points to 14.1 per cent of total tobacco consumption in 2018 (compared to a 0.7 percentage point rise in 2017).
 - This decrease is due to a decline in all categories of illicit tobacco: contraband (representing 53.7 per cent of all illicit tobacco), counterfeit (1.9 per cent) and unbranded loose tobacco (44.4 per cent).
2. Illicit manufactured cigarette consumption volumes decreased by 7.07 per cent.
3. Unbranded tobacco declined by 15.72 per cent from 2017 to 2018. This decline in consumption of unbranded tobacco was driven by the fall in number of users, quantity and frequency of purchase. Report data sources:
 - Unbranded tobacco was estimated using a Consumption Model (Roy Morgan consumer survey of 2,100 respondents).
 - Illicit manufactured cigarettes were estimated using Empty Pack Survey Analysis (approx 12,000 packs).
 - Analysis of rolling papers
 - (Usually seizure data from AFP is considered, but was not available for 2018)

NB: Change to Methodology Roy Morgan implemented a new panel of respondents in Q4 2018, the new panel constituted 65% of total respondents for that quarter. It is unclear how this may have impacted the results.

4. KPMG estimates the tobacco tax gap to be AUD 2.02 billion at the average excise rate for 2018.
5. Australia has the highest cigarette prices in Asia-Pacific region. The price gap between Australia and China (Australia's primary non-domestic source market) continued to rise, reaching AUD 24.36 (for a 20 cigarette pack of Marlboro or comparable premium brand)
6. The price differentials between legal and illicit products have widened over 2018.
7. There was a decline in total tobacco consumption of 5.4 per cent in 2018, compared to 2017. The overall level of tobacco consumption in Australia was estimated to be 14.8 million kilograms. Illicit tobacco consumption declined faster than that of legal consumption.
8. The growth in the non-domestic incidence of illicit tobacco was driven by increases in Sydney, Melbourne and Adelaide. In particular, non-domestic incidence in Adelaide grew from 7.4 per cent in Q4 2017 to 16.8 per cent in Q4 2018. (Separately, we were advised sample size in Adelaide was approximately three hundred empty packs)
9. The increase in non-domestic incidence from 2017 (8.7 per cent) to 2018 (9.7 per cent) is driven by the flows of Marlboro, Benson & Hedges and Esse, which together represent 43 per cent of non-domestic brand flows into Australia.

10. In 2018, there was a decrease in flows of both Domestic Illicit Plains and Illicit Whites
11. Asian countries were the primary source of inflows of non-domestic manufactured products into Australia. In 2018, flows of China (including China duty free) origin remained the largest component of non-domestic incidence. Flows from New Zealand re-emerged as one of the top country flows in 2018 after 2016.

From: [Boneham, Patrick](#)
To: [Brine, Matthew](#)
Cc: [Purvis-Smith, Marisa](#); [RG TAD SES](#); s 22
Subject: RE: Tobacco package costings [SEC=UNCLASSIFIED]
Date: Tuesday, 15 May 2018 9:32:40 AM
Attachments: s 22

Michael has been in the media correcting what he sees as misreporting. I am aware of him being worried about some reporting on the cash limit but I was not aware of this one.

From: Brine, Matthew
Sent: Monday, 14 May 2018 6:26 PM
To: s 22
Cc: Boneham, Patrick; Purvis-Smith, Marisa; s 22
[RG TAD SES](#); s 22
Subject: Tobacco package costings [SEC=UNCLASSIFIED]

Hi s 22,

We have prepared a response to the costing questions that s 22 raised with Patrick in his discussion earlier today. The answer to question 3 draws on the dot points that s 22 circulated. Hopefully this is of assistance. Happy to discuss.

Kind regards, Matt

Matthew Brine

Division Head

Tax Analysis Division

The Treasury, Langton Crescent, Parkes ACT 2600

phone: + 61 2 6263 4417

mobile: +s 22

email: matthew.brine@treasury.gov.au

Question 1: a breakdown of the costing to how much is related to the bring forward and how much is due to rest of the package

- The Illicit Tobacco Package is estimated to generate a gain to budget of about \$3.6 billion over the forward estimates period, including an increase in revenue of about \$3.7 billion offset by an increase in payments of about \$150 million.
- Of the \$3.7 billion revenue gain, about \$3.3 billion arises because of a change in the time that tobacco excise is paid (ie. shifting the taxing point to the point of importation). There is an additional revenue gain of about \$300 million over the forward estimates that arises because the change in taxing point permanently removes the risk of warehouse leakages.
- The additional revenue gain (about \$100 million) arises from the other elements of the package.

Question 2: the amount of revenue we are expected to generate from enforcement

See above.

Question 3: why Treasury's numbers are below the ATO tax gap numbers

- These two estimates are measuring different things.
- The ATO tax gap estimate is a theoretical estimate of how much revenue would be raised if all illegal tobacco were to be taxed in 2015-16.
- The Budget estimate is what will happen in the real world as a result of the policy changes announced by the Government.
- A key difference is that tax gap estimates don't estimate how effective any policy will be at reducing illegal tobacco. The Budget estimates recognise that the criminal gangs behind illicit tobacco are sophisticated and well-resourced, and it would be foolish to assume that this package will shut down the entire illicit tobacco market overnight.
- A second key difference is that tax gap estimates don't include any behavioural responses, such as reduced smoking due to significant price increases as illegal tobacco is taken off the market.

Question 4: How have forecast tobacco excise receipts changed in MYEFO and Budget?

Tobacco receipts for 2017-18 were revised down by \$250 million (2.2 per cent) to \$11.4 billion at the 2017-18 MYEFO. At the 2018-19 Budget tobacco receipts for 2017-18 were revised up by \$140 million (1.2 per cent) to \$11.5 billion, reflecting stronger than expected collections since MYEFO.

From: s 22
To: Mrakovic, Maryanne; Purvis-Smith, Marisa; s 22; Boneham, Patrick; s 22
Subject: RE: Tobacco package - disaggregated costing figures, update to Strike Team seizure numbers
Date: Friday, 4 May 2018 1:06:16 PM

Hi Phil

No we would need to say the package of enforcement measures (the new permit system, the Additional ATO resources and the Taskforce) is estimated to bring in \$120 million over the forward estimates. The costing was done assuming interactions between the enforcement measures.

Would also just like to flag that this is an estimate which makes assumptions about how effective the enforcement measures will be so it's prone to a lot of variance.

It may also invite questions about difference between the tax gap (\$600m) and the additional revenue we are estimating. We've prepared the below to answer that question:

Question: given the illicit tobacco tax gap is \$600m per year and this package is designed to tackle the illicit tobacco market, why doesn't it result in an ongoing \$600m per year in revenue?

The measure has an ongoing gain to revenue due to improved enforcement across the three sources of illicit tobacco – smuggling, warehouse leakage and domestic tobacco crops.

The Budget estimates recognise that the criminal gangs behind illicit tobacco are sophisticated and well-resourced, and the package will not be able to shut down the entire illicit tobacco market overnight.

The estimate also takes into account a reduction in the overall level of smoking among smokers who currently source their tobacco from the illicit market – as this measure successfully removes cheap illicit tobacco from the market, some smokers will choose to quit smoking or smoke less given the higher price of licit (i.e. legal) tobacco. This will reduce the size of the illicit market and improve health outcomes for Australians, without contributing to Government revenue.

Kind Regards
Cameron

s 22
 Individuals and Indirect Tax Division
 Indirect Tax and Not-For-Profit Unit
 phone: s 22
 email: s 22 @treasury.gov.au

From: s 22
Sent: Friday, 4 May 2018 12:29 PM
To: s 22
Cc: s 22
Subject: FW: Tobacco package - disaggregated costing figures, update to Strike Team seizure numbers

s 22 – can we say the IT/TF will bring in \$120 m over FE?

From: s 22
Sent: Friday, 4 May 2018 12:25 PM
To: s 22
Cc: s 22
Subject: FW: Tobacco package - disaggregated costing figures, update to Strike Team seizure numbers

This are the full figures for the illicit tobacco package.

s 22 – I think you were interested in the expected gain to revenue from the enforcement action – forecast at \$120m over the FEs.

The various enforcement elements will cost \$98.2 over the FEs.

From: s 22
Sent: Friday, 4 May 2018 12:06 PM
To: s 22
Cc: s 22; Mrakovic, Maryanne; Purvis-Smith, Marisa; Boneham, Patrick; s 22
Subject: Tobacco package - disaggregated costing figures, update to Strike Team seizure numbers

Hi Bianca

Following up on your call with Susan last night, please see the disaggregated numbers for the tobacco package. The figures can be made public.

		Fiscal balance (\$ millions)					
		2017-18	2018-19	2019-20	2020-21	2021-22	Total FEs
Collecting tobacco duties and taxes at the border	DHA - Revenue	0.0	0.0	3,255.0	140.0	180.0	3,575.0
	ATO - Revenue - GST	0.0	0.0	3.5	8.0	12.0	23.5
	Treasury - Expense - GST	0.0	0.0	-3.5	-8.0	-12.0	-23.5
	DHA - Payments	0.0	-2.2	0.0	0.0	0.0	-2.2
	Sub-total	0.0	-2.2	3,255.0	140.0	180.0	3,572.8

		Fiscal balance (\$ millions)					
		2017-18	2018-19	2019-20	2020-21	2021-22	Total FEs
Coordinated enforcement response	s 22						
	ATO - Revenue - GST	0.0	1.0	2.0	4.0	5.0	12.0
	Treasury - Expense - GST	0.0	-1.0	-2.0	-4.0	-5.0	-12.0
s 22							

		Fiscal balance (\$ millions)					
		2017-18	2018-19	2019-20	2020-21	2021-22	Total FEs
ATO excise systems upgrade	ATO - Expense	0.0	0.0	0.0	-7.4	-10.1	-17.5

	Sub-total	0.0	0.0	0.0	-7.4	-10.1	-17.5
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Please note that the revenue estimate for the enforcement measures (\$120m over the forward estimates) was costed as the combined effect of the permit system, Taskforce and ATO domestic resources. That is, the additional revenue cannot be attributed to any of those measures individually.

The \$68 million figure you asked Susan about referred to the combined cost of the Taskforce (\$58.8m) and the Additional ATO funding (\$8.8m). It did not include the funding for the new permit system (\$30.6m).

DHA also updated their Tobacco Strike Team seizure numbers and sent them through last night, so I've reflected that update in the Q&A and DHA statistics document (attached).

Kind Regards
Cameron

S 22
Individuals and Indirect Tax Division
Indirect Tax and Not-For-Profit Unit
phone: **S 22**
email: **S 22** [@treasury.gov.au](mailto:S 22@treasury.gov.au)