



166 William Street
Woolloomooloo 2011
NSW Australia

Locked Bag 6000
Potts Point 1335
NSW Australia

Tel +61 2 9370 1500
Fax +61 2 9370 1188
www.bata.com.au

British American Tobacco Australia Limited's submission to the 2022-23 Federal Budget

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EXECUTIVE SUMMARY

British American Tobacco Australia Limited (BATA) welcomes the opportunity to make a pre-budget submission to the 2022-23 Budget. This submission outlines opportunities for the Australian Government to recover a significant proportion of the billions of dollars on track to be lost over the forward estimates to organised criminal syndicates who grow, smuggle and sell illegal tobacco in Australia.

BATA acknowledges the work done by the Australian Government and its agencies to disrupt the smuggling and distribution of illegal tobacco in Australia, including the establishment of the Illicit Tobacco Taskforce (ITTF). However, with illegal tobacco consumption and lost revenue near an all-time high, there remains an urgent need for the Government to continue allocating resources to address this problem.

According to KPMG, the consumption of illegal tobacco costs Australians an estimated \$2.9 billion in lost revenue from tobacco excise in 2020 alone.¹ As consumption of illegal tobacco products increases, it is estimated that on the back of the current excise on tobacco products, lost revenue for the Government will continue to grow.

KPMG found the consumption of illegal tobacco has increased from 12.8 per cent in 2010 to 16.9 per cent in 2020², a figure which remains near the all-time high figure of 20.4 per cent from 2019.

KPMG's statistics run contrary to the official Australian Government smoking rates, which continue to remain relatively unchanged. Official government smoking rates do not accurately capture the consumption of illegal tobacco and the Australian Taxation Office (ATO) continues to underestimate the size of Australia's illegal tobacco trade. Ignoring the total size of illegal tobacco consumed means the Australian Government may not have an accurate picture of the impact of tobacco control policies.

The Department of Home Affairs has indicated that whilst the demand for illegal tobacco products is driven by multiple factors, one of the major drivers is the high excise rates on tobacco in Australia.³ Australia continues to have the highest cigarette price within the Asia Pacific region.⁴

Law enforcement experts agree that Australia's current tobacco excise has given criminals the opportunity year-after-year to sell cheaper, illegal products that undercut Australian businesses and retailers.

Current enforcement and penalties do not act as a substantial enough deterrent for organised criminals who exploit the situation to make enormous profits, often to fund other criminal activities in Australia and overseas. The Australian Criminal Intelligence Commission (ACIC) has acknowledged the profits made by criminals from selling illegal tobacco far outweigh the penalties if illegal tobacco is detected and disrupted.⁵

Given the growth of illegal tobacco consumption and the urgent need to continue resourcing the multi-agency Illicit Tobacco Taskforce (ITTF), BATA urges the Australian Government to consider several practical measures to recoup the billions of dollars in revenue lost to organised criminals to help Australia recover from the COVID-19 pandemic.

BATA observes the actions required by the Commonwealth Government fall into two distinct policy areas:

1. Policy and resource commitments to reduce illegal tobacco being imported, grown and sold across Australia; and
2. Maintaining a sustainable approach to the rate of tobacco excise increases into the future.

Recouping even a small portion of the \$2.9 billion lost to organised criminals annually could go towards essential government services and programmes, assist with the Federal Budget's pathway back to surplus, or be used to further strengthen our borders against criminal activity.

BATA appreciates the opportunity to work with the Commonwealth Government to develop policy reforms and resourcing solutions to tackle illegal tobacco.

RECOMMENDATIONS

1. Combat the rampant illegal tobacco market and the emerging illicit nicotine vaping market;
2. Increased resourcing of the multi-agency Illicit Tobacco Task Force (ITTF);
3. A nationally collaborative approach to addressing illegal tobacco;
4. The use of technology to develop a supply chain oversight model linking tobacco import declarations through the supply chain to reconcile against retail sales data; and
5. A sustainable approach to tobacco excise removing the incentive for criminals to profit off tobacco.

In addition to the above recommendations, BATA appreciates the Government's consideration of several of the recommendations made by the Parliamentary Joint Committee on Law Enforcement (PJCLE) final report into illicit tobacco.⁶ Whilst BATA notes there are several committee recommendations the Government has chosen not to support, BATA would welcome the opportunity to continue working with the Government to develop and implement practical policy measures designed to reduce the size of the illegal tobacco market and increase Government revenue.

POLICY BACKGROUND

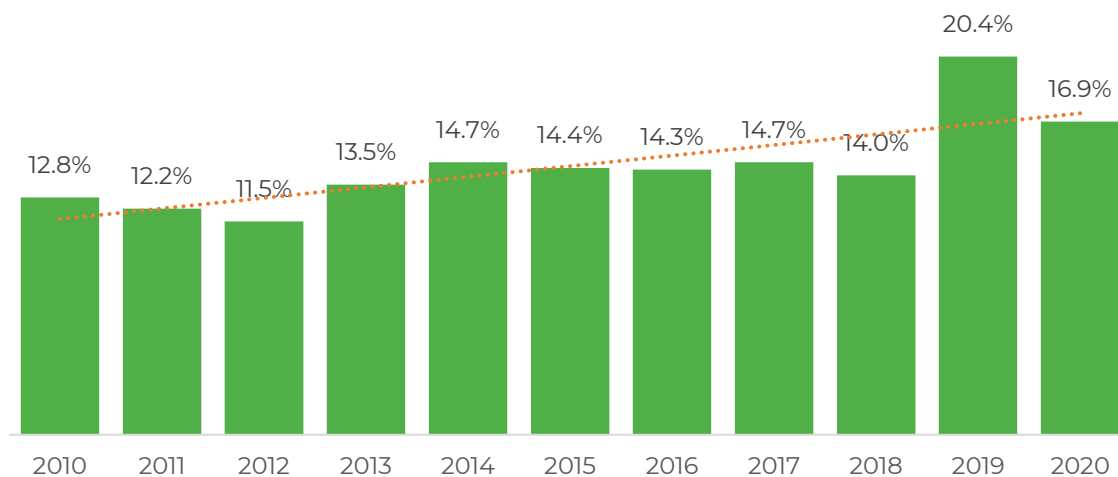
Illegal tobacco consumption in Australia is increasing

Illegal tobacco consumption in Australia remains high, hurting Australia's economy, fuelling criminal enterprise and resulting in billions of dollars in lost excise. A recent report by KPMG on illegal tobacco found 16.9 per cent of all tobacco consumed in Australia in 2020 was illegal.⁷ This figure is the second-highest on record. As a result, in 2020, the Australian Government is estimated to have lost \$2.9 billion in tobacco excise.⁸ KPMG's findings are consistent with the industry view that the illegal market continues to grow strongly, affecting retailers and independent businesses who are being undercut by criminal organisations. By comparison, analysis from Oxford Economics in 2021 estimates around \$4.9 billion in revenue was lost by Australia's legal economy to the illicit economy by the illicit tobacco trade alone in 2019. Of this, some \$3.8 billion of excise duties and GST receipts were notionally evaded by the illicit trade in tobacco (the "tax gap") in calendar year 2019.⁹

Figure 1¹⁰ shows how illegal tobacco has grown from 12.8 per cent of consumption in 2010 to 16.9 per cent of total consumption in 2020.

Figure 1 - The market share of illegal tobacco in Australia

KPMG estimates of the illegal tobacco market share (kg based measure)



KPMG Illicit Tobacco in Australia

The most recent Tobacco tax gap published by the ATO estimated that in the 2019-20 financial year approximately 770 tonnes of illegal tobacco went undetected in Australia, representing estimated \$909 million in lost excise revenue. In the 2020-21 financial year illegal tobacco seizures by the Australian Border Force (ABF) and Australian Taxation Office (ATO) increased by 741 tonnes which equates to more than 95% of the gap estimated for the previous financial year.

BATA is encouraged by the increase in the amount of illegal tobacco seized by authorities last year, however, given illegal tobacco has remained easily accessible in the retail environment throughout 2020-21, despite effectively eliminating the tobacco tax gap, it is observed that the ATO estimate significantly underrepresents the size of Australia's illegal tobacco trade. To this end, it is likely that there would be considerably more than \$909 million in lost excise revenue that could be recouped through reducing illicit tobacco consumption. Additionally, market reports indicate Australia is the 20th largest market globally for e-cigarettes despite there being no legal commercial market. BATA observes this illicit nicotine vaping market is growing due to the current unrealistic parameters of the TGA governed prescription-only model for liquid nicotine.

Without Australia following the progressive policies of countries such as the United Kingdom and New Zealand, to properly regulate e-cigarettes in a retail commercial setting, and recognise their role in aiding people to quit smoking, BATA observes the illicit e-liquid nicotine market will dramatically increase over time.¹¹

The continued growth in illegal tobacco is driven by organised criminals rapidly innovating in response to the Australian Government's enforcement efforts. For example, shifting to high volumes of small packages imported through the mail stream or growing more tobacco locally when ABF are focused on container seizures. Addressing this style of smuggling can be resource-intensive but is necessary given commentary from the 2020-21 Home Affairs Annual Report suggesting that the majority of illegal tobacco detections were from the international mail stream, and as a whole total tobacco detections increased by 36% vs 2019-20.

In March 2020, the Australian National Audit Office highlighted criminals are adjusting their activities in response to law enforcement techniques, making it harder for them to be prosecuted.¹²

Mail centre employees previously assisted law enforcement by detecting and setting aside illegal tobacco for law enforcement officers to investigate and destroy. As an unintended consequence of a legislative change made in 2019 to the Customs Act to classify tobacco as a "prohibited import", these employees are now prohibited from doing this. As tobacco is now treated in the same category as drugs, drug paraphernalia and weapons, an 'authorised person' permitted to give this assistance is now limited to customs officers, police officers, or members of the Australian Defence Force.

This is compounded by a 39 per cent reduction in international mail item inspections from 2016-17 to 2020-21¹³ and an understanding that only 20 per cent of all parcels are inspected.¹⁴

BATA has identified several other examples which demonstrate the problem of illegal tobacco is getting worse:

- Marketplace intelligence has identified more than 700 stores across Australia selling illegal tobacco in the past 12 months alone, with a particular rapid growth across South East Queensland;
- Legitimate retailers are now informing BATA on a regular basis that their stores are losing several thousand dollars a week to illegal tobacco operators in their vicinity; and,
- Despite the recent prohibition on tobacco entering Australia through mail channels, BATA has observed there is more tobacco than ever making it through this method.

Illegal tobacco consumption is funding organised crime

As illegal tobacco consumption increases, so does funding for other areas of serious and organised crime in Australia. Tobacco products are one of the most smuggled products in the world, and tobacco smuggling is a form of transnational organised crime. The illegal trade in tobacco, including cigarettes, has been linked to the financing of terrorist organisations.¹⁵ In most cases, smugglers deal in tobacco and other illegal commodities or activities, such as drugs, weapons, money laundering and counterfeit goods.

The involvement of organised criminals in the illegal tobacco trade has been well documented, including by Australian Border Force Commissioner, Michael Outram, who said at a Senate Estimates hearing:

“What we're seeing is that the organised criminal groups who have sometimes been involved in the trafficking of other illicit commodities, some are now focusing on just tobacco. They are retargeting Australia from a number of other countries in order to get their tobacco through the border.”¹⁶

ATO Assistant Commissioner Ian Read has previously said criminal syndicates are using the proceeds of illegal tobacco sales to fund their criminal behaviour:

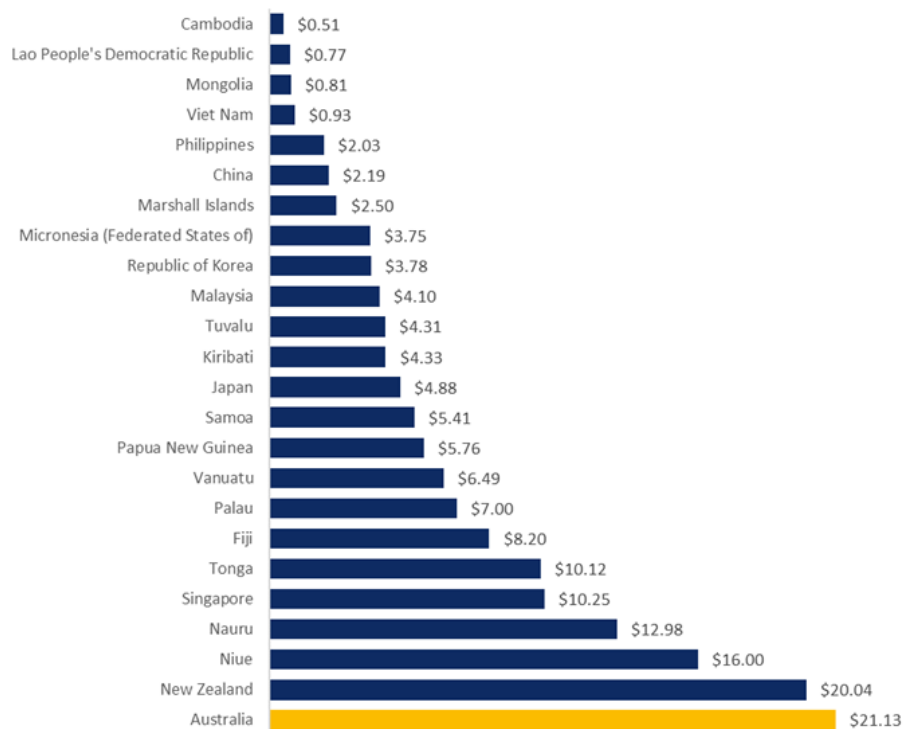
“Removing illicit tobacco from crop to shop creates a level playing field and also helps to stop organised crime syndicates from funding other activities.”¹⁷

Australia's current tobacco excise is amongst the highest in the world

Australia has amongst the highest tobacco taxes in the world, contributing to the steady rise in illegal tobacco consumption. Data published by the World Health Organization (WHO)¹⁸ shows that cigarette prices in Australia were the highest globally in 2020 (\$USD). The WHO's database also indicates the price of cigarettes is more than five times higher in Australia than the global average.

The below graph (Figure 2) shows in 2020, cigarette prices in Australia were the least affordable in the whole of the Western Pacific region. In US dollar terms, the price of cigarettes was over 220 per cent higher than the Western Pacific regional average. Tobacco prices in Australia have continued to increase significantly relative to the global average.

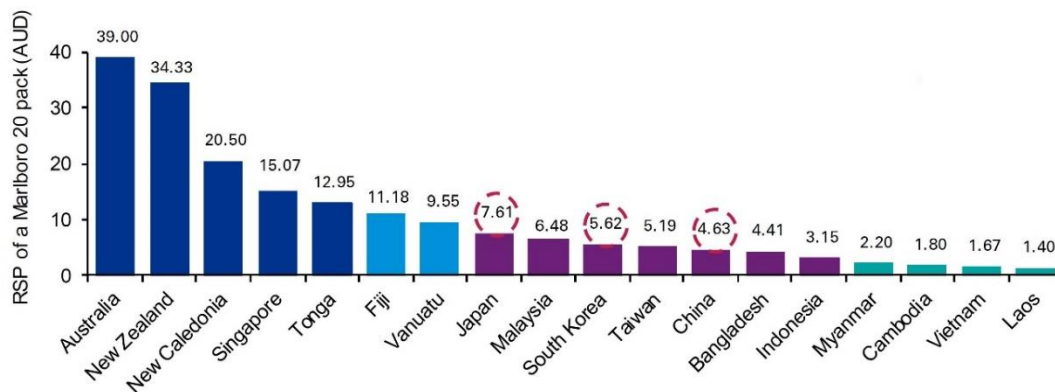
Figure 2 - WHO data on the retail price for a pack of 20 cigarettes in the Western Pacific region (in \$USD)



Source – WHO Global Health Observatory Data Repository (Western Pacific Region), Tobacco control

Figure 3 shows the price difference between cigarettes in Australia compared to other markets in the South East Asia region. Aside from New Zealand and New Caledonia, prices of cigarettes in Australia are over 159% higher than any other market within the region. KPMG note the price disparity between Australia and other markets in the region creates an environment for illicit trade.

Figure 3 – KPMG price analysis of a pack of 20 Marlboro cigarettes – Australia and selected markets, 2020.



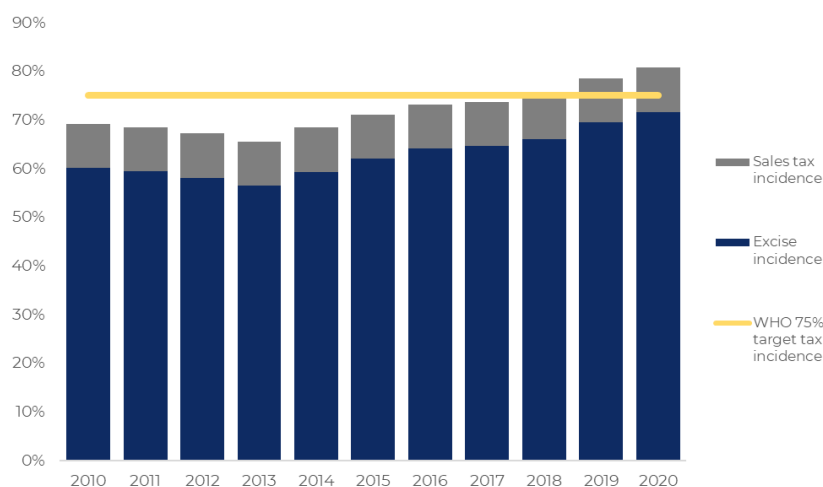
Source: KPMG Illicit Tobacco in Australia

Illegal tobacco consumption driven by high tobacco excise

The demand for illegal tobacco is largely driven by the consistent year-on-year increase in price of legal, duty-paid tobacco. Higher taxes and prices on legal tobacco create a larger arbitrage opportunity for criminals smuggling these products into the country or growing it here, leading to an overall demand-driven growth of illegal products.

The tax incidence on cigarettes in Australia, on average, has increased significantly over the last decade (see Figure 4). Not only does the tax share of cigarette prices exceed the WHO target for the most brands sold, it also does for the entire market.

Figure 4 - The tax incidence on cigarettes in Australia compared to the WHO's target



The excise policy employed by the Government means Australia is one of the countries with the least affordable cigarettes globally, whether measured by prices, prices adjusted for purchasing power, or in terms of the excise incidence. This opens Australia up as a target country for illegal tobacco products, diverting billions in much needed tax revenue for the Government.

Further ad hoc increases in tobacco excise rates will not deliver higher tax revenues

The rapid shift of smokers to illegal tobacco and to illegal e-cigarettes over recent years alongside the fact the Government has revised down forecasts of tobacco excise receipts has led BATA to believe Australia may have reached a stage whereby raising the tobacco excise through ad hoc means in addition to AWOTE per annum will create a decline in overall receipts from tobacco.

Figure 5 highlights the significant \$5.72 billion tobacco excise revenue write down across forward estimates in the Mid-Year Economic and Fiscal Outlook 2021. With the consumption of illegal tobacco products near an all-time high, tobacco excise revenue will continue to be significantly impacted as consumers substitute legal tobacco for untaxed illegal products.

Figure 5 -Revenue write down in projected tobacco excise

	2021-22	2022-23	2023-24	2024-25	Total
Budget 2021-22 (\$m)	14,750	14,610	14,970	15,340	59,670
MYEFO 2021-22 (\$m)	13,300	13,150	13,550	13,950	53,950
Change on Budget (\$m)	-1,450	-1,460	-1,420	-1,390	-5,720
Change on Budget (%)	-9.8	-10.0	-9.5	-9.1	-9.6

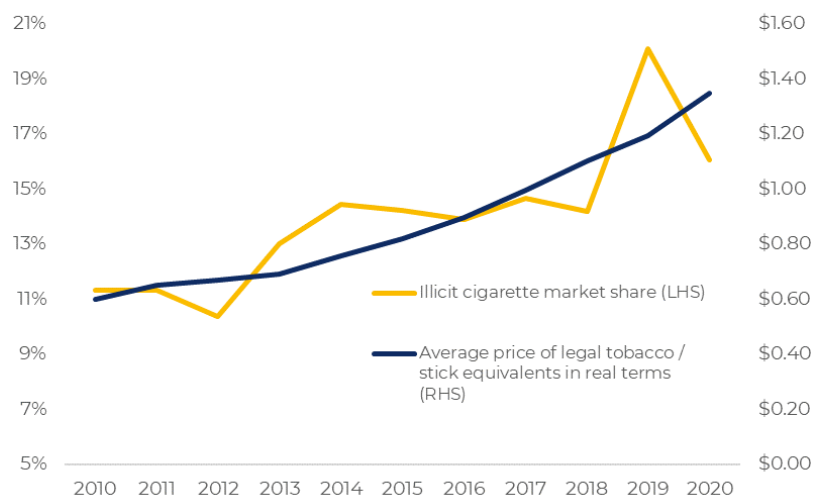
Source: Budget Strategy and Outlook Budget Paper No. 1 2021-22, Mid-Year Economic and Fiscal Outlook 2021-22

The reason for this outcome is clear. As the price of cigarettes increases in real terms, so does consumers' price sensitivity to those price changes. There will, correspondingly, be an increasingly negative impact of any tax rate (and price) increase on legal volumes. Consumers will instead be forced to consider the cheaper, illegal products. Figure 6 reveals over the past decade there has been an 80% correlation between the legal tobacco price and the illicit tobacco market share.

As the price of legal tobacco goes up, and the price gap between it and illicit tobacco widens, consumers have an increasing incentive to switch to cheaper, illegal, types of tobacco. Illicit tobacco undermines both tobacco control measures by providing access to tobacco products at significantly cheaper prices,

as well as significantly impairing the Australian Government budget position as no tax is paid on illicit tobacco.

Figure 6 -The price of legal tobacco vs the illicit tobacco market share



Source: Modelled from KPMG Illicit Tobacco in Australia

DETAILED RECOMMENDATIONS

1. Combat the rampant illegal tobacco market and the emerging illicit nicotine vaping market;
2. Increased resourcing of the multi-agency Illicit Tobacco Task Force (ITTF);
3. A nationally collaborative approach to addressing illegal tobacco;
4. The use of technology to develop a supply chain oversight model linking tobacco import declarations through the supply chain to reconcile against retail sales data; and
5. A sustainable approach to tobacco excise removing the incentive for criminals to profit off tobacco.

Recommendation 1

Combat the rampant illegal tobacco market and emerging illegal nicotine vaping market.

BATA recommends the Australian Government address the growing issue of illegal tobacco and illegal nicotine vaping products through the mail, either by increasing current authorised personnel, authorising other groups or using

technology solutions to remove illegal tobacco and nicotine vaping products from the supply chain.

A regulatory change intended to prevent tobacco shipments through the mail in 2019 has had the unintended consequence of opening it up as a key supply stream for criminals. Mail centre employees previously assisted law enforcement, by detecting and setting aside illegal tobacco for investigation and destruction. Under new laws, they are prohibited from doing so as those authorised to handle prohibited goods are limited to customs officers, police officers, or members of the Australian Defence Force.

BATA's solution for the Australian Government to increase the number of individuals in mail centres able to remove illegal tobacco could be achieved by:

1. Permitting those who previously assisted law enforcement to do so once more;
2. Authorising existing personnel in mail centres, such as bio-security officers, to deal with illegal tobacco;
3. Significantly increasing the number of ABF officers in mail centres; or
4. Using scanning technology to remove tobacco from the supply stream to be dealt with by law enforcement officers.

Recommendation 2

Increased resourcing of the multi-agency Illicit Tobacco Task Force (ITTF)

BATA considers the ITTF to be an effective means of addressing illegal tobacco at Australia's border and BATA recommends the Government should continue funding the ITTF in this year's Budget. In 2020-21 the ITTF detected 130 instances of revenue evasion through detection and seizures, related to the protection of approximately \$312.1 million (ex. GST) in potential revenue evasion. This was a significant increase on the 76 instances of revenue evasion in 2019-20 and 61 instances in 2018-19.¹⁹

It is clear the ITTF is playing a more important role year on year, and it would only be advantageous for criminal syndicates if the Government discontinued resourcing the ITTF.

BATA also recommends the Australian Government work with operators of Australian-based marketplace websites to remove illegal tobacco and illicit vaping product listings and shut down those Australian websites exclusively selling illegal tobacco.

Websites selling illegal tobacco like, cheapcigarettes.com.au, cheapsmokesonline.com.au and cigaustralia.com have recently seen significant increases in traffic towards their websites, which offer delivery. The tobacco products offered at these sites are below the minimum excise rates + GST for cigarettes and other tobacco products. BATA understands that traffic to sites averages 70,000 visits per month throughout 2021.

With delivery offered from these websites, they are hurting Australian retailers with sites peddling 'free delivery' for the illegal products, with little or no age verification offered.

BATA believes there is an opportunity for government to invest in an online education campaign for consumers, highlighting the impact their illegal purchase has on society by way of supporting criminal syndicates and forgone social infrastructure.

Recommendation 3

A nationally collaborative approach to addressing illegal tobacco.

As a matter of priority, BATA recommends the Australian Government adopt a comprehensive, national approach in the 2022-23 Budget to deal with the rise in illegal tobacco consumption.

A national approach involves introducing a uniform federal law for adoption by states and territories as well as providing education and support to state and territory governments in return for their commitment to retail enforcement, strict licensing of tobacco retailers, amending laws to give police requisite enforcement powers and increasing penalties.

A national approach was a key recommendation made in the final report from the PJCLE in November 2020, and BATA understands the Government 'noted' this recommendation.

BATA submits that the Australian Government should further consider the harmonisation of state and territory legislative provisions to address illegal tobacco. A review of state and territory provisions could still be undertaken through a National Cabinet reform committee process.

Enhancing state and territory legislative provisions would clarify the role of state and territory agencies to respond to illegal tobacco, particularly where it exists at a retail level. A consistent, national strategy would provide greater opportunity to raise revenue and prevent it being lost to criminals dealing in illegal tobacco.

Furthermore, the Australian Government should call on all Australian jurisdictions to provide police with increased powers to investigate and seize illegal tobacco.

Evidence shows when the Australian Government allocates more resources to tackle illegal tobacco, it can bring in more revenue. The Australian Government's own 2018-19 Budget papers estimate that for every dollar spent on illegal tobacco border control, an additional \$26 is raised in tax revenue.²⁰ Allocating more resources will in turn yield higher revenues for the Government.

A further opportunity also exists for the Australian Government to continue funding through the ITTF to provide education and resources, where appropriate, to manage illegal tobacco.

Recommendation 4

The use of technology to develop a supply chain oversight model linking tobacco import declarations through the supply chain to reconcile against retail sales data .

BATA recommends the Government utilise the latest available technology to compare retail sales data against tobacco import declarations in order to more effectively track the sales of legal tobacco and the origin of imported tobacco products.

Blockchain technology (or similar) could be used to link available data from federal tobacco import permits to state wholesale and retail licenses and allow reconciliation of import data all the way through to retail sales data. Using this data effectively would demonstrate existing gaps that are being filled by illegal tobacco sales. This could also be used as an enforcement tool to exclude criminal networks known to be dealing in illegal tobacco from Australia's entire supply chain.

Recommendation 5

A sustainable approach to tobacco excise decreasing the incentive for criminals to profit off tobacco.

BATA recommends the Government increase excise based on average weekly ordinary time earnings (AWOTE), with no additional ad hoc excise increases. Increasing tobacco excise in line with wage inflation annually will help the Government achieve long-term tax revenue increases as well as helping stem the rise of illegal tobacco. Increasing excise on an ad hoc basis will only lead to more illegal tobacco consumption (as demonstrated in Figure 6).

Conclusion

BATA appreciates the opportunity to make a pre-budget submission to the Commonwealth Government's 2022-23 Federal Budget. While the efforts of the Australian Government to introduce tougher restrictions on illegal tobacco through enforcement measures have been commendable to date, there is more work to be done.

BATA strongly recommends the ITTF is adequately resourced over the coming years as an effective way to detect and disrupt illegal tobacco sales.

The Government should also note the importance of a national approach in stemming the rise in illegal tobacco consumption. Maintaining a rise in tobacco excise based only on AWOTE is also critical to reducing the incentive for organised criminal syndicates to grow and sell illegal tobacco in Australia.

BATA welcomes any opportunity to further discuss the suggestions outlined in this submission.

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