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29 November 2019

Committee Secretary
Parliamentary Joint Committee on Law Enforcement
PO Box 6100
Parliament House
Canberra ACT 2600

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RE: PARLIAMENTARY JOINT COMMITTEE ON LAW ENFORCEMENT INQUIRY INTO ILLICIT TOBACCO

INTRODUCTION

Imperial Tobacco Australia Limited (ITA) welcomes the opportunity to participate in the Parliamentary Joint Committee on Law Enforcement's Inquiry into Illicit Tobacco. ITA participates in a range of government consultations that are relevant to our business. We do this on the basis that our views will be considered in an objective manner and that the evidence and views we provide will be properly evaluated, with due regard given to relevant legal and legislative requirements and the principles of best practice regulation.

We would like to re-affirm that we recognise the role of Governments and Public Health Authorities in the regulation of tobacco products and support those measures that are reasonable, proportionate and evidence based.

We would also like to take the opportunity to commend the Committee for initiating such an inquiry, and for considering this serious issue. The previous work of the Committee, the recommendations of the Black Economy Taskforce and the ongoing efforts of the Illicit Tobacco Taskforce have had a significant impact on the illicit tobacco trade, although much remains to be done.

ITA maintains the assertions made in our first submission to this Inquiry, but recognises that the regularly evolving landscape and nature of illicit supply necessitates a responsive and flexible approach. Revised considerations are covered in the sections below.

Imperial Tobacco Australia looks forward to having the opportunity to appear before the Committee, and with the Committee's discretion provide further commercially confidential details, including specific information relating to the already existent illicit tobacco trade in Australia.

BACKGROUND

ITA is an Australian-based wholly owned subsidiary of Imperial Brands, the world's fourth largest international tobacco company.

ITA entered the Australian market in September 1999 at the request of the ACCC to ensure that competition was maintained following the global merger between British American Tobacco (BAT) and Rothmans International.

ITA has a share of approximately 30% of the total tobacco market and approximately 50% of the loose (roll-your-own) market in Australia.

The tobacco industry is an entirely legal business contributing billions of dollars in revenue to Australian governments and employing hundreds of people across the country.

For the 2018/19 year, ITA delivered approximately \$3.2 billion to the Federal Treasury through excise duties on tobacco products (excluding GST). We employ approximately 290 people in Australia and make further contributions to government through corporate taxation, employment taxes and other revenues of approximately \$18 million annually. In totality, the tobacco industry contributes approximately \$17 billion¹ to the Federal Treasury through excise duty.

¹ Budget Strategy and Outlook Budget Paper No.1 2019-20

POLICY AND LEGISLATIVE CHANGE

ITA would like to acknowledge and congratulate the Government for the significant policy initiatives advanced in 2018 and 2019 that target illicit tobacco.

These measures include:

1. *Treasury Laws Amendment (Illicit Tobacco Offences) Act 2018* (Cth) which provided new reasonable suspicion offences, expansion of fault-based offences, new offences for possessing equipment for manufacturing or producing tobacco in Australia, and extension of the *Excise Act 1901* (Cth) forfeiture provisions applying to illicit tobacco.
2. *Customs Amendment (Illicit Tobacco Offences) Act 2018* (Cth) which inserted two new tobacco smuggling offences based on recklessness into the *Customs Act 1901* (Cth) and amendments enabling the investigation and enforcement of the reasonable suspicion illicit tobacco offences introduced by the *Treasury Laws Amendment (Illicit Tobacco Offences) Act 2018* (Cth).
3. *Tobacco Plain Packaging Amendment Act 2018* (Cth) which widened the scope of the authorised persons who may enforce compliance with the *Tobacco Plain Packaging Act 2011* (Cth).
4. *Customs Amendment (Collecting Tobacco Duties at the Border) Act 2018* (Cth) which by requiring payment of import duties and taxes on imported tobacco immediately on arrival in Australia eliminates the risk of illegal distribution of tobacco from warehouses.
5. *Tobacco Plain Packaging Amendment (Track and Trace Identifiers) Regulations 2018* (Cth) which facilitates the track and trace identifiers required by the European Union to combat illicit tobacco on the retail

packaging of tobacco products imported into Australia from the European Union.

6. *Customs (Prohibited Imports) Amendment (Collecting Tobacco Duties) Regulations 2019* (Cth) which prohibits the importation of tobacco products into Australia without a permit.
7. *Customs Amendment (Immediate Destruction of Illicit Tobacco) Act 2019* which empowers Customs to immediately destroy tobacco products that have been imported without a permit.
8. The creation of the Illicit Tobacco Task Force (ITTF) on 1 July 2018 comprising of the Australian Border Force (ABF), Australian Taxation Office (ATO), Department of Home Affairs, Australian Criminal Intelligence Commission, Australian Transaction Reports and Analysis Centre (AUSTRAC), and the Commonwealth Director of Public Prosecutions, to increase resources and capabilities for targeting organised crime involved in illicit tobacco.
9. Additional resources for the Australian Tax Office (ATO) to tackle the issue of illegal tobacco farms found in the Eastern States, and more recently the Northern Territory.
10. Funding to update the ATO's excise and excise equivalent goods payment system beginning 2020-21 to replace the paper lodgement system.

In totality these measures will:

1. Enhance the powers of law enforcement bodies focused on the issue of illicit tobacco and organised crime more broadly.
2. Improve prospects for convictions in illicit tobacco criminal prosecutions through the removal of loop holes and technicalities.

3. Stop of leakage from domestic warehouses, without the payment of excise, identified by the Black Economy Taskforce Team.
4. Increase seizures and destruction of illicit tobacco in the mail channel and generally due to the expansion of the forfeiture provisions in the *Customs Act 1901* (Cth) to reasonably suspected illicit tobacco and the empowering of Customs to destroy tobacco products imported without a permit.
5. Better enforcement outcomes at the border and disruption overseas by the ITTF who have detected and seized significant amounts of illicit tobacco since it was established.
6. Better enforcement outcomes of illegal domestic crops through improved resourcing and systems at the ATO.

The measures were finalised on 1 July 2019, so it is still too early to measure their impact on the illicit trade in tobacco which had declined in the 2018 *KPMG Illicit tobacco in Australia* report by .9% to 14.1%. This was largely driven by the work of the ABF led ITTF who made more than 285,000 seizures, weighing more than 633 tonnes during the FY 2018 which represents \$670 million in evaded duty. This is in excess of the ATO's 2017/8 tax gap estimate of \$647 million².

In the Q2 research for the 2019 KPMG report we have seen significant increases in the consumption of Chop Chop (or loose tobacco) and contraband cigarettes. The research was done before the changes were finalised and ahead of the 12.5% excise hike so the current research and result of the 2019 report will be more telling in terms of its impacts.

Regardless of the result it remains a significant problem with 1 in 7 cigarettes being consumed illegally³ and approximately \$2 billion lost if it had been consumed legally

² Proof Committee Hansard – SENATE Legal and Constitutional Affairs Legislation Committee, Estimate 21/10/19

³ KPMG "Illicit Tobacco in Australia" 2018 Full Year Report, 3 May 2019

in 2018. We therefore urge the Government to maintain its focus on the issue and consider additional measures that we will cover as part of this submission.

RETAIL ENFORCEMENT

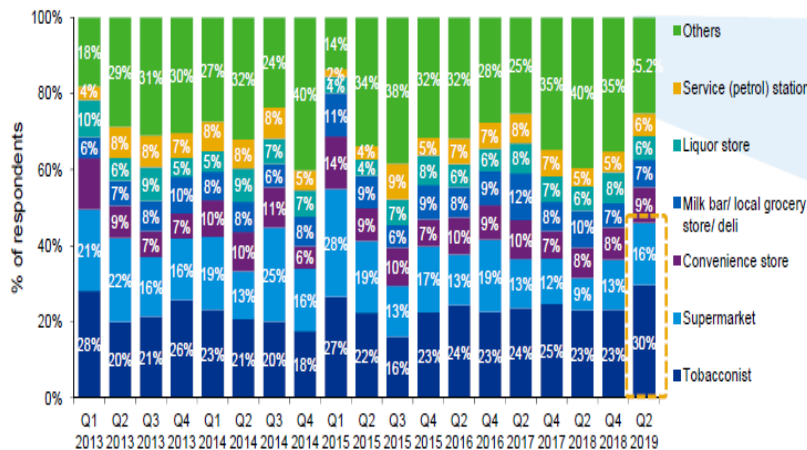
The most pressing area of policy reform is law enforcement at the retail level. It is our experience that there is only minimal enforcement and action taken against those retailers selling illicit products. In the survey conducted by Roy Morgan Research (Q2 2019) consumers of illicit products are asked a number of questions on their purchasing habits. These include:

- A question on how hard it is to buy these products, to which 65% said that it was easier or the same, and
- To the question on awareness, 50.1% respondents were aware of the illicit tobacco category

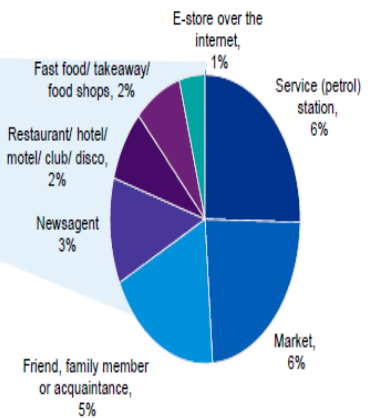
The above indicate a strong supply and availability from regular sources of supply.

Respondents were also asked where they obtained their illicit products. Around 46% purchased from tobacconists (including the ‘pop up’ category) and Asian supermarkets; but the most telling factor this is that the ‘Others’ category is often the biggest, indicating these products are widely available.

Major supply outlets for unbranded tobacco, Q1 2013 – Q2 2019^{(1)(a)(b)}



Breakdown of ‘other’ outlets, Q2 2019⁽¹⁾



This information is in line with the intelligence we receive through the ITA Illicit Tobacco Hotline.

It is very much a question of risk versus reward with much higher margins than the legal supply chain and a low risk of enforcement.

The equation is similar for consumers, with street prices of illicit products remaining relatively flat for the last 3 – 5 years, particularly in the Chop Chop and pre-filled tubes categories. Where half a kilo of Chop Chop is available for around \$100 - \$140, and 100 tubes prefilled with Chop Chop at \$30 - \$35. In the case of Chop Chop the excise alone is around \$645 and a consumer can save around \$750 on an equivalent legal purchase.

4.5 Relative price of illicit tobacco

Figure 4.5.1: Prices of illicit tobacco products and Winfield 25s, June 2013 – December 2018^{(1)(a)(b)(c)(d)(e)}

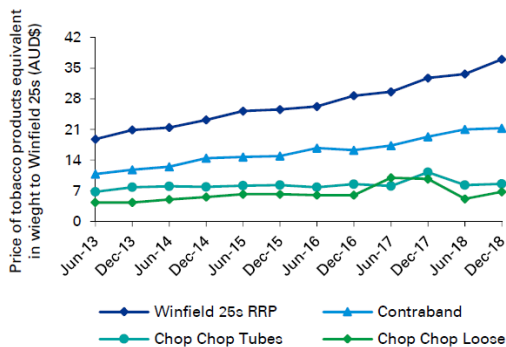
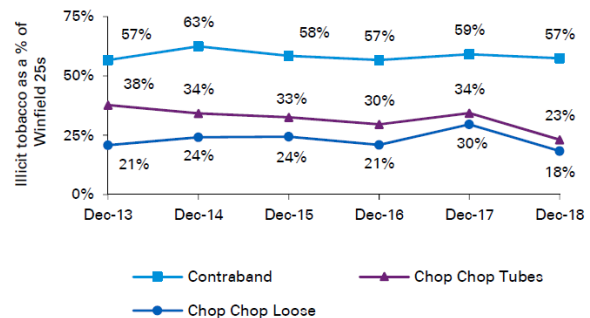


Figure 4.5.2: Illicit tobacco prices as a proportion of Winfield 25s, December 2013 – December 2018^{(1)(a)(b)(c)(d)(e)(f)}



The above charts are from the 2018 KPMG Report and show the price of a packet of Winfield 25s between 2013 and 2018 against the illegal categories. The first chart shows the absolute price over time, and it can be clearly seen that the gap between legal and illegal products is widening. In the second chart a packet of Winfield 25s is compared to the illicit categories as a proportion of Winfield 25s. In 2018 it can be seen that not only has the absolute gap increased between legal and illegal products but the illicit categories are also become proportionally cheaper.

What seems to exist is a perfect storm for supply and demand, where involved retailers and consumers both benefit from the availability of these products. The Government has put in place a number of measures that will target supply but it is

now imperative to tackle the issue from a 'bottom up' perspective and cut demand at retail level.

As manufacturers we seek action to be able to compete on a level playing field with legitimate competitors and not organised crime, which is effectively the fourth biggest player in the Australian market. However, it is the plight of the legitimate retailer that is often overlooked. The impact on their business can be nothing short of catastrophic as they continue to lose customers and see their sales drop. The outcome of which is:

- Staff need to be let go
- Their health and wellbeing suffers
- The value of their business diminishes to the point where they can no longer sell it and have to close down
- Retirement is no longer possible and plans are shelved

There are many example of this and the case of Ballarat is a particularly sad one where seven illegal outlets are driving down the business of legitimate retailers. We have included a letter from one of these outlets as a **Confidential Attachment** and would draw the committee's attention to it as a typical example of the impact that is being felt by many legitimate businesses in a similar situations.

A high level summary of this business is as follows:

- The outlet's sales halved between September 2014 till current. This is well above any decline in smoking rates
- During this time the government has lost an estimated \$2.1 million in excise from a single outlet
- Foot traffic between March 2016 and July 2019 reduced from 5,164 to 2,901 with a reduction of 565 sales per week

This case and others in Ballarat are unfortunately not isolated incidents.

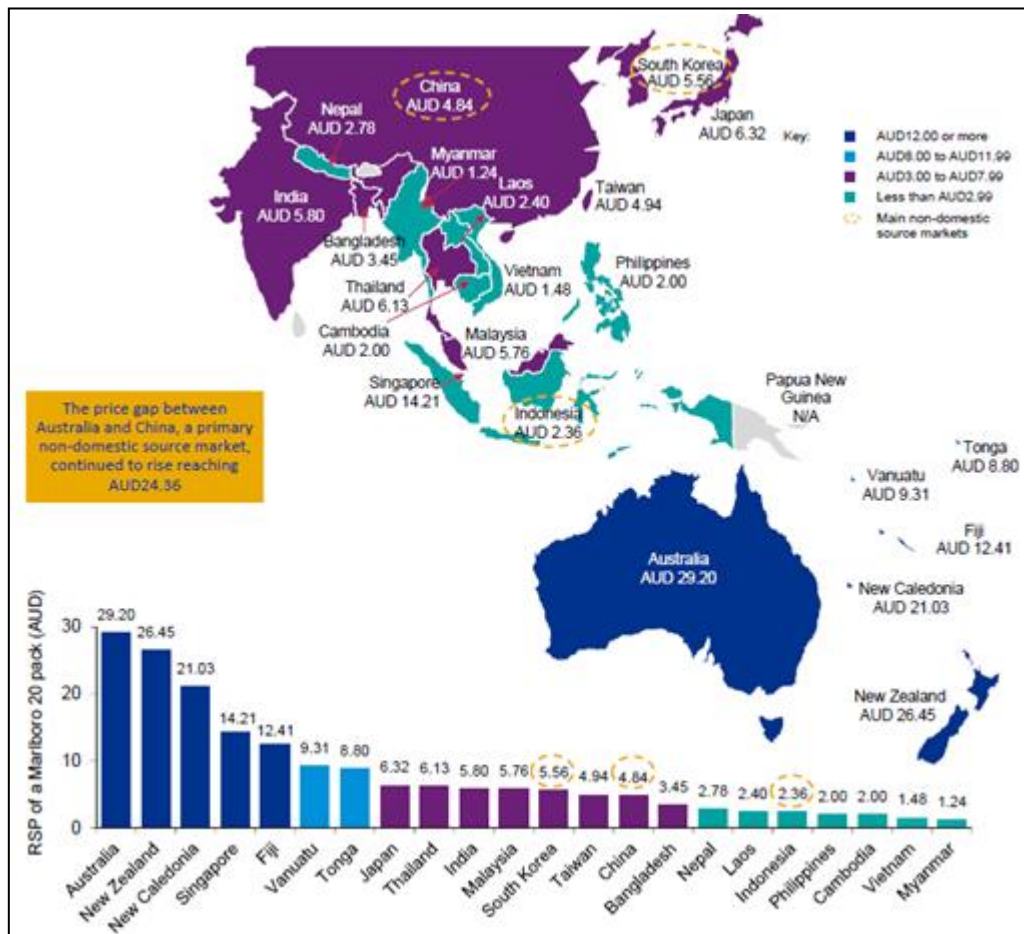
RECOMMENDATION

1. Increase law enforcement at retail level to ensure the current 'top down' approach is complemented by a 'bottom up' approach. Key to this is a more co-ordinated approach by Federal and State Governments similar to what we have seen used by Operations Trident and Polaris to deal organised crime at the waterfront.
2. Address inadequacies in State and Territory legislation and enforcement especially where it concerns retailers. This requires insertion into tobacco control legislation specific strict liability offences for possession of or dealing with illicit tobacco, search and seizure provisions (like those found in NSW) that specifically target illicit tobacco, better use of the existing enforcement provisions in State and Territory tobacco control legislation to detect and seize illicit tobacco, and better education of State and Territory enforcement officers about identifying illicit tobacco at retailers and using the enforcement powers already at their disposal. ITA is able to provide a more detailed breakdown of the potential options for reform upon the Committee's request.
3. Increase other resources to law enforcement, such as scanning equipment and sniffer dogs.
4. Excise is a key growth driver for the trade in illegal tobacco. Tobacco taxation policy necessarily requires a balanced approach with consideration given not only to public health objectives, but also revenue optimisation and avoiding the emergence, or encouraging the growth, of illicit trade. Australia is a high tax environment for tobacco products, made even more so by the cumulative effect of the successive annual 12.5% excise increases running from 2013-2020 and initiated by a one off 25% excise increase in 2010. Such excise increases are resulting in exorbitantly high prices, ultimately encouraging the movement of consumers out of the legal market and into the illicit market.

These large excise increases also fuel the black market by making it even more lucrative for organised criminals to smuggle illegal tobacco into

Australia. With the exception of New Zealand and New Caledonia, Australian prices are over 90% higher than surrounding markets within the Asia Pacific region. A pack of 20 cigarettes is up to 12 times more expensive in Australia than Indonesia, for example (See Figure 1 below).⁴ These high profit margins can provide an attractive and valuable source of income for organised crime. Stabilisation of the excise environment, and return to AWOTE only excise increases, should be considered.

Figure 1. Regional Tobacco Prices



SUMMARY

The illicit tobacco trade is a serious issue in Australia. The illicit market currently sits at approximately 14.1% of total consumption, representing approximately \$2.02

⁴ KPMG "Illicit Tobacco in Australia" 2018 Full Year Report, 3 May 2019

billion dollars in foregone excise to the Government, with lost revenue instead funding organised crime.⁵

We are encouraged by the recent Government initiatives aimed at disrupting the illicit tobacco trade. The adoption of the Black Economy Taskforce recommendations, the previous work of this committee and the ongoing efforts of the ITTF have made significant inroads in the battle against the plague of illicit tobacco. It is imperative that the Government maintains this focus and continues to implement policies that strengthen the ability of Government Departments and Agencies to combat the problem. A more coordinated approach from Federal and State Governments and an increase in law enforcement at the retail level will help address ongoing areas of concern.

The legislative framework, and the enforcement of such, are equally important foundations for effectively, efficiently, and appropriately dealing with the illicit tobacco trade. There currently exists opportunities to close “loopholes” and/or to make more effective the various pieces of legislation which deal with illicit tobacco, specifically State and Territory legislative frameworks. As intimated earlier in this submission, ITA is able to provide a more thorough analysis should the Committee see fit.

Excise is a key driver of the illicit tobacco trade. As excise increases continue to drive the price of legitimate tobacco products up, the demand for illicit tobacco will similarly see a continued increase as consumers seek more affordable alternatives. Those criminals involved in the illicit tobacco market do not pay taxes, and therefore illicit tobacco will always be quite significantly cheaper.

Excessive excise increases are the stimulus to encourage both the supply and demand side of this problem. Stabilisation of the excise environment, and return to AWOTE only excise increases, should be considered.

The demand for tobacco products is better met by well governed, tax-paying and responsible businesses that will work in partnership with stakeholders, rather than criminals who operate in the illicit market.

⁵ KPMG “Illicit Tobacco in Australia” 2018 Full Year Report, 3 May 2019

ITA submits that the size and scope of the problem, and the direct causal link between excessive taxation and the illicit tobacco trade warrants a stabilisation of the excise environment, and return to AWOTE only increases.

We thank the Committee for the invitation to update our submission and look forward to appearing before the Committee to provide a better insight into the illicit tobacco trade in Australia and its devastating social and economic impacts.

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