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Senate Select Committee on Red Tape  
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Canberra ACT 2600

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## **RE: THE EFFECT OF RED TAPE ON TOBACCO RETAIL**

### **INTRODUCTION**

Imperial Tobacco Australia Limited (ITA) welcomes the opportunity to participate in the Red Tape Committee's inquiry into the effect of restrictions and prohibitions on business (red tape) on the economy and community, and specifically, the effect of red tape on tobacco retail.

Imperial Tobacco Australia (ITA) is an Australian-based wholly owned subsidiary of Imperial Tobacco Group PLC, 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 60% 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 2015/16 year, ITA delivered almost \$3 billion to the Federal Treasury through excise duties on tobacco products (excluding GST). We employ approximately 360 people in Australia and makes further contributions to government through corporate

taxation, employment taxes and other revenues of approximately \$18 million annually.

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.

**a) the effects on compliance costs (in hours and money), economic output, employment and government revenue;**

**Duty drawback**

The tobacco industry is a significant excise and duty contributor. ITA contributes an annual excise and duty liability of approximately \$3 billion.

We pay duty on tobacco products that have been imported into Australia.

Like the majority of fast moving consumer goods operations, we have some unsaleable stock that is periodically returned from retailers. It may be past the used by date, have minor carton damage or packaging issues.

We absorb the business cost of the lost product, but in order to claim a refund on duty paid on unsaleable stock, we (and other manufacturers who import tobacco products) must re-export that tobacco back to the various points of manufacture. That is, duty paid stock cannot be destroyed locally and a duty refund be obtained following the destruction.

Since approximately June 2012, 100% of product distributed in Australia by ITA is imported. We source our products from a number of factories located in various parts of the globe including the UK, Europe, Asia, the United States and (primarily) New Zealand.

For locally produced products, however, excise levied product is able to be destroyed locally, provided the pending destruction is approved by the Australian Tax Office (ATO). A refund of the relevant excise can then be obtained from the ATO.

Whilst there are associated costs to the business, there are also wider social and economic costs; significant extra transport requirements (trucks on roads, containers

on ships), additional movement of plant material across borders and import/export administrative burdens.

### **Biosecurity Impact**

Tobacco is a plant product. The additional transport occasioned by current re-export demands requires additional transport across Australia of the product. This carries a potential biosecurity risk.

The tobacco beetle is a pest common in tropical climates which can infest tobacco products. The Australian Environmental Pest Managers Association points out that the beetle can be responsible for tremendous damage and economic losses to post-harvest and stored grains and seeds, packaged food products and animal and plant derived items and commodities.

Due to the tropical climate of Queensland, particularly Far North Queensland, a tobacco beetle infestation of tobacco products is not uncommon. In order to prevent spreading and cross-contamination, the infected product must be frozen before transportation. The presence of even one live beetle can cause a re-infestation.

Given the requirement to re-export unsaleable product to the point of manufacture, and ITA's supply chain which sees products returned to the Sydney DC, there is increased potential for wider contamination than if the movement of product was minimized by the ability to destroy product locally.

### **Environmental Impact**

Re-export requirements in these instances involve entirely unnecessary additional transport, which naturally involves additional use of fuels and increased emissions. Aside from the environmental impact of transport from Australia to country of origin, ITA product must be moved from across Australia back to facilities in Sydney. The additional heavy vehicle movements associated with this are entirely unnecessary and could be eliminated with the allowance of local destructions.

### **Impact to ITA**

In this past financial year alone, ITA was forced to re-export 10 shipping containers with an excise refund value of \$15.8 million. The additional compliance costs, or costs to our business for this re-exportation process is approximately \$50,000, but this is an unnecessary business cost which is the consequence of a complex, burdensome and redundant process.

## History

In May 2007, following a public review, the Howard Government announced its intentions to rectify the matter. The reform was to have the effect that all excise and excise-equivalent imported goods could be destroyed with the prior approval of the relevant administering authority, and would not be required to be re-exported to the point of manufacture.

The measure was to have effect from the later of 1 January 2008, or the date of Royal Assent. Unfortunately, this legislation did not take effect as it was not dealt with prior to an election.

## Successful Trial

The regulatory amendment set out in *the Customs Amendment Regulation 2012* (No. 8) allowed for duty paid stock to be destroyed locally and a subsequent Duty Drawback refund. This was an interim measure which came into effect on 9 November 2012, until 30 April 2013. This trial was undertaken to assist with the implementation of plain packaging and the high volume of stock destruction as a result. It was extremely successful and praised by all stakeholders (including government officials), proving that the process can be easily implemented.

## **b) any specific areas of red tape that are particularly burdensome, complex, redundant or duplicated across jurisdictions**

### **The over-regulation of the legal tobacco market vs the almost unfettered illicit tobacco market**

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. We sell only to adult consumers who exercise free choice to use our products. We support strong regulation to prohibit supply or use of tobacco products by those under age.

Over the years, tobacco has been singled out for a plethora of regulation specifically designed to place limits on the free choice of informed adult consumers so as to approximate illegality. Such has been the rush of regulators to claim their stake in restricting access to the product that policies have stumbled over one another to achieve blatantly perverse outcomes.

The legion of regulators who would dictate to Australian adults what they can consume, how and where they can consume it and, indeed, where and how they can

obtain a legal product generally justify their actions on the basis of “protecting” individuals.

The central tenet of a large proportion of tobacco regulation is that a restriction of supply will – contrary to the fundamental principles of economics – result in contraction in supply. The concept that curtailing supply automatically cancels demand is both logically and factually absurd. Prohibition of alcohol in the United States (and in Russia and Scandinavia) famously didn’t work.

The achievement of excess tobacco regulation has been to remove the free choice of adult consumers and to increase the demand for illicit tobacco.

Demand is not affected by a reduction in one channel of supply. Consumers simply search either for a new method of supply or, more likely, avail themselves of an existing alternative.

The KPMG Illicit Tobacco in Australia report confirms that the illicit tobacco market has grown dramatically in this country in recent years. In Australia, illicit trade currently sits at approximately 14.0% of the total market representing \$1.49 billion dollars in lost revenue to the Government with lost revenue instead funding organised crime<sup>1</sup>. Instead of paying tax to the Australian Government, criminal gangs are profiting from this illegal tobacco trade at the expense of Australian taxpayers and law-abiding retailers.

We recognise the role of the Health Department. However, what we would like them to do is to treat illicit tobacco at least with the same degree of animosity as they do the tobacco companies.

While the legitimate Australian tobacco industry has continued to comply with the numerous regulatory impositions and excise increases, the illegal trade in tobacco is, as is the nature of an illicit product, not subject to the same regulatory and excise requirements.

The subsequent growth and established foothold illicit tobacco has gained in Australia is not surprising. What is surprising however, is the lack of understanding, enforcement or consideration shown by the Department of Health in what has been identified by numerous other government departments and agencies as a serious problem in Australia.

The Department of Health and Ageing is one of the principal Commonwealth agencies which has the power to make an immediate impact on illicit trade since the

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<sup>1</sup> KPMG “Illicit Tobacco in Australia” 2015 Full Year Report, April 2016

majority of illicit tobacco remains in coloured, branded packaging. This is in breach of plain packaging and graphic health warning laws creating the potential for DoHA to seek serious and significant penalties for breach of these laws. Unfortunately this does not happen.

Rather than implement their own measures against illicit tobacco – by even something as simple as enforcing plain packaging laws against retailers selling branded illicit packs – or even supporting the measures of others to combat illicit tobacco, the Health Department has instead directed its resources towards thwarting any industry led, retailer supported measure at every turn. This ideological based opposition towards industry efforts to assist the Government to combat illicit tobacco means the entirety of the problem will fall upon the Government – and the cost upon the taxpayer.

Anti-tobacco activist, non-government organisations can be driven by ideology. Surely we ought to expect Departments tasked with enforcement to act with at least a measure of practical reality in the interests of taxpayers.

Late last year British American Tobacco Australia, Imperial Tobacco Australia and Philip Morris submitted an anti-illicit tobacco cooperation deed to the Australian Competition and Consumer Commission. This deed, if authorised, would see these three companies take unprecedented action against the retail trade in illicit tobacco.

The action is based on the simple premise that trade in illicit tobacco has become, in many instances, embedded within the legal retail trade. The deed, if it were authorised, would see the signatories cease selling legal product to retailers who were engaged in illegal activity—that is, the industry would simply stop supplying product to retailers who were doing the wrong thing.

This industry was, and is, prepared to curtail its own sales of legal product to assist the Australian and state governments to combat the scourge of illicit trade. That surely is the greatest disincentive to a retailer who thinks that they can get away with it. There is no doubt in our minds that it would put a serious dent in the retail end of the illicit trade of tobacco. The ACCC, as it is required to do, conducted a consultation process to seek the views of those impacted. Retailers and their representative groups overwhelmingly supported the proposal.

Surprisingly, the department that is tasked with reducing tobacco consumption, that wants excise increased on legal tobacco, which is charged with enforcing plain-packaging laws, chose to frustrate this measure to reduce the supply of illicit tobacco.

To our Disappointment, the ACCC published a draft determination to reject the application. At a public meeting prior to the final determination, retailers and their representative groups attended in person to plead with the Commission to alter its decision and to approve the application. The Department of Health attended. Its sole contribution was to question the validity of the application.

At the public hearing of the Parliamentary Joint Committee on Law Enforcement for its inquiry into illicit tobacco held on 22 March 2017, the DoHA determined that they were the primary Government agency tasked with dealing with illicit tobacco<sup>2</sup>.

**Senator ABETZ:** *I am asking about the health department. As I have been led to believe, you are the prime agency to deal with illicit tobacco.*

**Dr Southern:** *Yes, we are.*

When asked about the Departments level of engagement and involvement with interdepartmental government committees tasked with combatting illicit tobacco, the DoHA response was underwhelming and frustratingly pointed to a lack of understanding or interest in the illicit tobacco problem

**Senator ABETZ:** *..... What is the contribution and involvement of your department to the illicit tobacco IDC and the tobacco stakeholder group run by the Australian Taxation Office?*

**Dr Southern:** *The illicit tobacco IDC was chaired by the Department of Immigration and Border Protection and we were a member of that IDC, and then at about this time last year there was a discussion about broadening the IDC out. So the IDC which we now chair on tobacco control effectively replaced the IDC on the illicit tobacco. In relation to the other committee—sorry, I missed that one.*

**Senator ABETZ:** *The tobacco industry advisory group and the tobacco stakeholder group run by the ATO.*

**Dr Southern:** *We are no longer members of that group.*

**Senator ABETZ:** *Why is that?*

**Dr Southern:** *I will have to take that on notice. I have never attended any of those meetings.*

**Senator ABETZ:** *If you are the head agency for the government, one would hope that you would be sitting on every single committee that might be dealing with this. If you are no longer involved, to me, without the chair determining what we might decide as a committee, that enhances the need for a national illicit tobacco strategy, with an organisation that has*

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<sup>2</sup> Proof Committee Hansard, Parliamentary Joint Committee on Law Enforcement Illicit Tobacco, public hearing, Wednesday 22 March, 2017

*specialist focus that would want to be proactively sitting on anything that has to do with tobacco so we can fight illicit tobacco. One would imagine that the ATO's interest in having a tobacco stakeholder group et cetera is to ensure that all the revenue comes in, to ensure all the revenue comes in, one wants to stamp out the illicit trade. You are the lead agency to deal with illicit tobacco trade and you are not on this committee. I find that disappointing, if I might say, unless you can disabuse me of that view.*

The Departments criticisms of attempts made to quantify the size of the illicit tobacco problem in Australia were also brought into question and again, the Departments response frustratingly pointed towards a predisposition to oppose the industry regardless of the issue or market reality.

**Senator ABETZ:** *Have you ever considered undertaking your own research? You are willing to be sceptical of KPMG and other assessments, but have you ever set about to try to get a methodology or to find for yourselves, over the past 10 or 20 years, what the actual trade is in illicit tobacco?*

**Dr Southern:** *Not that I am aware of over that period of time, but what I would say is that we—*

**Senator ABETZ:** *Wouldn't that be a fundamental starting point, as the lead agency for the government, to get a proper handle on the size of the problem so you could then reliably make submissions, for example, to the ACCC to say that, 'Our own research over 20 years built on whatever evidence suggests that this is the figure, or within these parameters'? But it appears that we are willing pick holes in other people's assessments but we have never undertaken our own assessment.*

The ACCCs final determination on the industry's application authorising the applicants to cease selling legal product to retailers engaged in the illicit trade is expected to be handed down in July 2017. With proposed amendments made to the initial agreement which addressed initial concerns we are hopeful for a positive outcome which would allow tobacco manufacturers to put a serious dent in the retail end of the trade in illicit tobacco.

The other twin aspect would be to see the DoHA take a proactive interest in fighting the illicit tobacco trade with the same level of antagonism they show the legal tobacco trade.

## **CONCLUSION**

### **Duty Drawback**

We submit that the local destruction of stock and drawback of duty be implemented permanently.



The requested measure is not new – only the permanence is. The regulatory amendment set out in the *Customs Amendment Regulation 2012* (No. 8) allowed an interim Duty Drawback refund, which came into effect on 9 November 2012. It permitted imported stock to be destroyed locally until 30 April 2013. This measure was implemented to deal with the high level of stock destruction occasioned by the implementation of plain packaging.

The process was extremely effective and praised by government officials and the industry.

Making the process permanently available is a relatively straightforward task, carries demonstrable benefits for government, Australian businesses, the environment and the Australian public. ITA understands that there is cross-party support for the measure.

### **The illicit tobacco trade**

We appeal to the Department of Health and Ageing, the primary agency tasked with tobacco control, to consider the illicit market with at least the same level of animosity shown to legitimate tobacco manufacturers and consider the unintended consequences of Government intervention, over regulation and red tape bureaucracy.

We are hopeful that the ACCC will permit the industry to boycott supply to retailers engaged in illicit trade. Authorisation of the anti-illicit cooperation deed would create a serious disincentive to a retailer engaged in illegal activity and put a serious dent in the retail end of the illicit trade of tobacco.

Opposition based on ideology, simply for the sake of opposition is an unnecessary waste of taxpayer resources, an unnecessary increase in red tape for tobacco retailers and industry and the achievement of blatantly perverse outcomes.

ITA would welcome the opportunity to discuss this submission in further detail and clarify any questions that you might have.