



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 2020-21 Budget

Contents

EXECUTIVE SUMMARY	3
RECOMMENDATIONS	5
POLICY BACKGROUND.....	5
Illegal tobacco consumption in Australia is increasing	5
Illegal tobacco is funding organised crime.....	7
Australia’s current tobacco excise is amongst the highest in the world	7
Illegal tobacco consumption driven by high tobacco excise.....	8
Further increases in tobacco excise rates will not deliver higher tax revenues	9
DETAILED RECOMMENDATIONS.....	10
Recommendation 1.....	10
Recommendation 2.....	10
Recommendation 3.....	11
Recommendation 4.....	11
Recommendation 5.....	12
Recommendation 6.....	12
Conclusion.....	12
References	13

EXECUTIVE SUMMARY

British American Tobacco Australia Limited (BATA) welcomes the opportunity to make a pre-budget submission to the 2020-21 Budget. This submission provides the opportunity to recover a significant proportion of the \$14 billion the Government is on track to lose over the forward estimates to organised criminal syndicates and their illegal tobacco enterprises.

BATA acknowledges the work done by the Federal Government and its agencies to disrupt the smuggling and distribution of illegal tobacco in Australia, including the establishment of the Illicit Tobacco Taskforce (ITTF) and additional funding used to tackle illegal tobacco introduced in the 2018-19 Budget. However, with illegal tobacco consumption and therefore lost revenue at an all-time high, there is an urgent need for further action to address this growing problem.

According to KPMG, the consumption of illegal tobacco cost Australians \$3.4 billion in lost revenue from tobacco excise in 2019 alone.¹ As excise rates and consumption of illegal tobacco continue to grow, this number will only increase each year. This is money that should be going towards essential government services and critical infrastructure. Instead, it is going into the pockets of criminal syndicates who sell these illegal products.

KPMG found the consumption of illegal tobacco increased by nearly 50 per cent between 2018 and 2019². Based on this massive increase and a smaller decrease in legal sales, KPMG conclude total tobacco consumption in Australia increased overall in 2019. Given that tobacco excise policy is designed to lower smoking rates, it seems it is failing.

This aligns with the Australian Criminal Intelligence Commission's latest National Wastewater report, which showed that nicotine consumption increased between August and December 2019³.

These statistics run contrary to the official government smoking rates, which remain largely stagnant. Official government smoking rates do not accurately capture the consumption of illegal tobacco. Ignoring a fifth of tobacco consumed means Australia does not have a full picture of the impact of existing tobacco control policies.

Illegal tobacco consumption is largely driven by the excise on tobacco in Australia, now some of the highest in the world. High tobacco excise has created an arbitrage opportunity for criminals to undercut Australian businesses and retailers by selling cheap, illegal tobacco products.

Unfortunately, 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.

BATA urges the Australian Government to introduce measures to recoup the billions of dollars in revenue lost to organised criminals to help Australia recover from its first recession in nearly 30 years. The actions that the Australian Government can take fall into two areas:

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

Changes in these areas will better facilitate the Government's objectives of generating tax revenues, tobacco control, and limiting profits from criminal activities.

Recouping even a small portion of the \$3.4 billion lost to organised criminals annually could go towards essential government services and programmes, help improve the Federal Budget's bottom line, or be used to further strengthen our borders.

BATA would appreciate any discussion with the Australian Government on how best to develop these policy reforms and resourcing solutions.

RECOMMENDATIONS

BATA urges the Australian Government to consider the following recommendations to help recover the revenue lost to the illegal tobacco trade:

1. Address the growing issue of illegal tobacco through the mail, either by increasing current authorised personnel, authorising other groups or using technology solutions to remove illegal tobacco from the supply chain;
2. Shut down Australian illegal tobacco online advertisements and websites;
3. The Australian Government should take a nationally collaborative approach to addressing illegal tobacco;
4. Use technology to develop a supply chain oversight model linking tobacco import declarations through the supply chain to reconcile against retail sales data;
5. Formalise agreements between local and international law enforcement agencies on intelligence, detection and prosecution for illegal tobacco; and
6. The Government should not continue to increase tobacco excise at 12.5% + AWOTE after the final legislated increase.

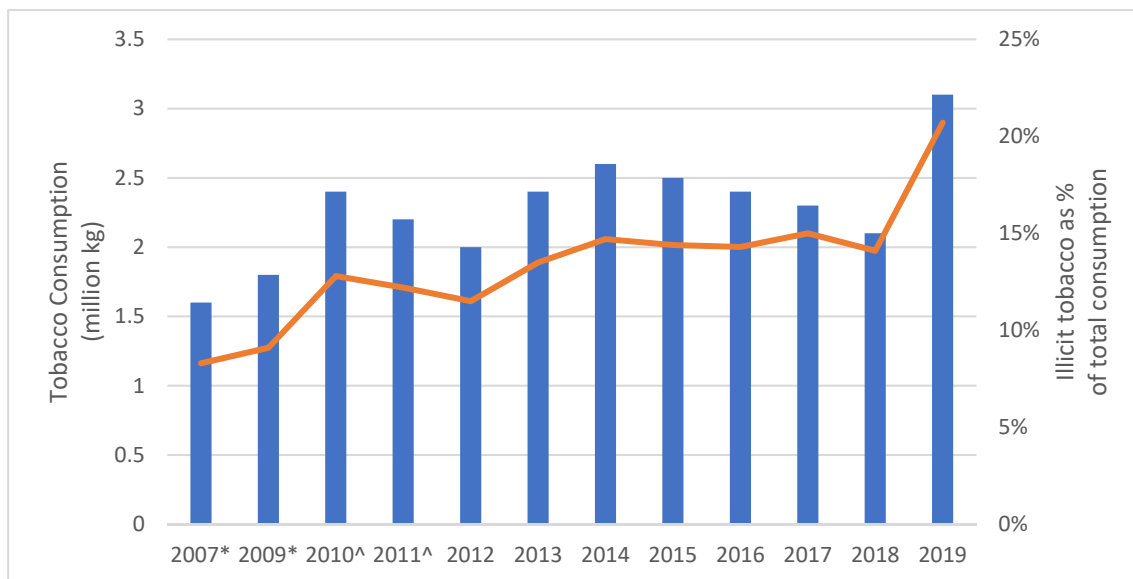
POLICY BACKGROUND

Illegal tobacco consumption in Australia is increasing

Illegal tobacco consumption in Australia is at an all-time 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 20.7 per cent of all tobacco consumed in Australia last year – or over one in five cigarettes – was illegal.⁴ This figure is the highest on record. As a result, in 2019, the Australian Government lost \$3.4 billion in tobacco excise,⁵ denying the Government much needed revenue. KPMG's findings are consistent with the industry view that the illegal market continues to grow strongly, and further reform measures are needed.

Figure 1 shows how illegal tobacco has grown from around 9.1 per cent of consumption in 2009 to 20.7 per cent of total consumption in 2019.

Figure 1 - The market share of illegal tobacco in Australia



KPMG Illicit Tobacco in Australia

Whilst there have been substantial seizures of illegal tobacco recently, availability remains high. Last financial year alone, the Australian Taxation Office (ATO), together with other law enforcement agencies including the Australian Border Force (ABF), took possession of and destroyed 306 tonnes of illegal loose leaf tobacco (some of which was grown in Australia), and 421 million illegal cigarettes, representing an estimated \$779 million in foregone excise.⁶⁷

The continued growth in illegal tobacco is driven by organised criminals rapidly innovating in response to 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 is resource intensive and despite the level of seizures in mail centres in 2019 being in line with 2018, the volume entering Australia is now at an unprecedented level. As recently as 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.⁸

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 46 per cent reduction in international mail item inspections from 2016-17 to 2018-19⁹ and our understanding that only approximately 20 per cent of all parcels are inspected.¹⁰

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

- BATA's marketplace intelligence has identified more than 500 stores across Australia selling illegal tobacco in the past 12 months alone;
- The ABF has recently raided several illegal manufacturers of "chop-chop" tubes of tobacco (ready-made cigarettes, filled with illegal tobacco) and there are estimated to be at least 110 "pop-up" tobacco retailers in Victoria alone who sell nothing but illegal tobacco;
- 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 is funding organised crime

The rise of illegal tobacco also has implications for other illegal activity in Australia. Tobacco is 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.¹¹ 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:

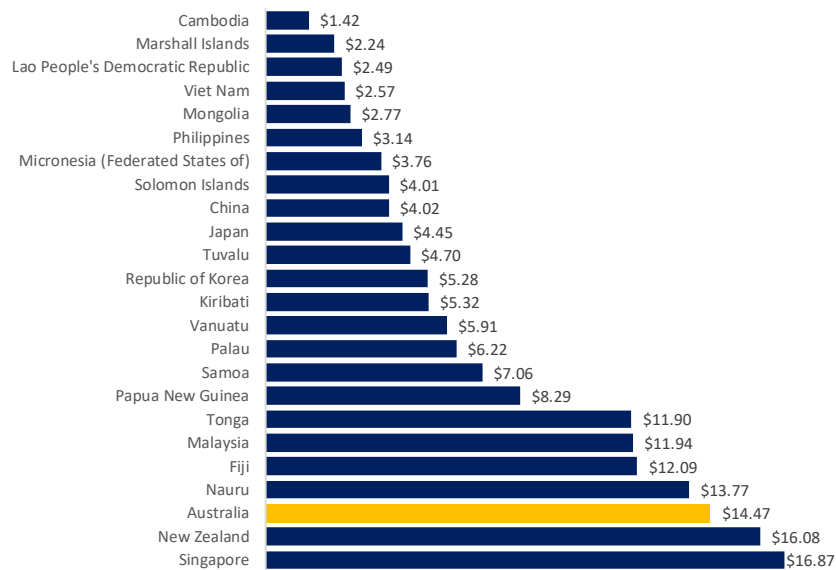
*"What we're seeing is that the organised criminal groups who have sometimes been involved in the trafficking of other illicit commodities, some are now focusing on just tobacco. They are retargeting Australia from a number of other countries in order to get their tobacco through the border."*¹²

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)¹³ shows that cigarette prices in Australia were the fourth highest globally in 2018 (\$USD). The WHO's database also indicates the price of cigarettes is more than 400 per cent higher in Australia than the global average.

The below graph (Figure 2) shows in 2018, cigarette prices in Australia were among the least affordable in the whole of the Western Pacific region. In purchasing power parity (PPP) terms, the price of cigarettes was over 100 per cent higher than the Western Pacific regional average. Tobacco prices in Australia have continued to increase significantly since 2018 and are likely to have grown 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 International dollars at Purchasing Power Parity)



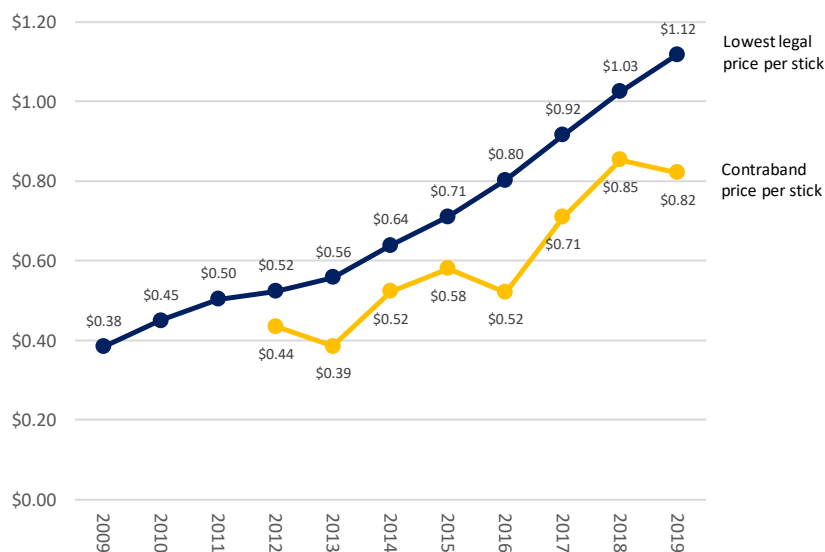
Source – https://www.who.int/tobacco/global_report/Table-9.1-Taxes-and-retail-price-for-a-pack-of-20-cigarette-most-sold-brand.xls?ua=1

Illegal tobacco consumption driven by high tobacco excise

The consumption of 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.

Figure 3 shows the price of illegal tobacco has consistently been cheaper than legal products, incentivising criminals to undercut legitimate retailers and businesses.

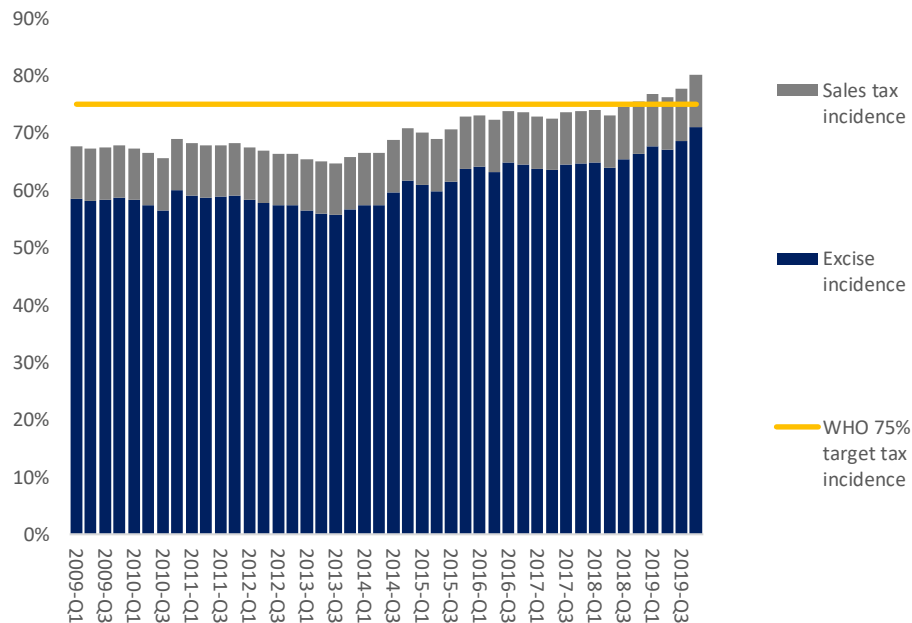
Figure 3 - The price of illegal cigarettes compared to the lowest priced legal, tax-paid, cigarettes



Source – KPMG

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. The tax share of cigarette prices in Australia exceeds the WHO target for more than just most brands sold, it exceeds the WHO target 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 increases in tobacco excise rates will not deliver higher tax revenues

The rapid shift of smokers to illegal tobacco, coupled with the Government revising down forecast tobacco excise receipts each year for the past three years, has led BATA to believe we have reached a “tipping point” whereby continuing to raise tobacco excise by 12.5 per cent + AWOTE per annum will create a decline in overall receipts from tobacco.

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.

DETAILED RECOMMENDATIONS

Recommendation 1

Address the growing issue of illegal tobacco through the mail, either by increasing current authorised personnel, authorising other groups or using technology solutions to remove illegal tobacco from the supply chain.

BATA recommends the Australian Government allocates more resources to law enforcement personnel to prevent illegal tobacco coming into Australia through the mail.

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

Shut down Australian illegal tobacco online advertisements and websites.

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

Websites selling illegal tobacco like ozziesmoke.com.au, bargainbongsonline.com.au, 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.

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.

Closing these websites is an opportunity for the government to collect higher tax receipts from legal tobacco use.

Recommendation 3

The Australian Government should take 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 2020-21 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.

BATA submits that the Australian Government should consider the harmonisation of state and territory legislative provisions to address illegal tobacco. A review of state and territory provisions could 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.¹⁴ Allocating more resources will in turn yield higher revenues for the Government.

A further opportunity also exists for the Australian Government, through the ITTF to provide education and resources, where appropriate, to manage illegal tobacco. Given the financial losses the Government sustains as a result of illegal tobacco, the Australian Government could also consider an incentive scheme to encourage state and territory governments to address illegal tobacco at a retail level.

Recommendation 4

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

BATA recommends utilising technology to reconcile retail sales data against tobacco import declarations to better track legal tobacco sales and the origin of imported tobacco products.

Such a system would use blockchain technology (or similar) to link existing 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. This would demonstrate where gaps are being filled by illegal tobacco and, if used as an enforcement tool, allows for exclusion of those known to be dealing in illegal tobacco from the entire supply chain

Recommendation 5

Formalise agreements between local and international law enforcement agencies on intelligence, detection and prosecution for illegal tobacco.

As a part of the national approach, there should be an agreed approach to managing illegal tobacco across all jurisdictions. This would address the significant gaps in enforcement at the state and territory level and give clarity on who is responsible. It would also provide retailers, manufacturers and the Australian public with a single law enforcement point of contact on illegal tobacco.

There is also an opportunity for Australian Government officials to work co-operatively with regional counterparts from known illegal tobacco source markets. This regional cooperation allows the sharing of intelligence to intercept and seize illegal tobacco at the Australian border.

BATA considers the ITTF to be an effective means of addressing illegal tobacco at Australia's border and should play a key role in this, including being given additional and ongoing funding to help recoup the estimated \$3.4 billion in lost in excise revenue each year.

Recommendation 6

The Government should not continue to increase tobacco excise at 12.5% + AWOTE after the final legislated increase.

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.

Conclusion

BATA appreciates the opportunity to make a pre-budget submission to the 2020-21 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.

Unless there is a consistent, national approach, and a reduction in the rate at which tobacco excise is increased each year, the Australian Government will continue to be deprived of essential revenue and organised criminal syndicates will continue to profit.

Reforming the current tobacco excise model and focusing on law enforcement resourcing, not just at a Federal level, but across states and territories, is needed to ensure revenue is effectively recouped and illegal emerging markets for tobacco are shut down.

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

References

¹ KPMG, Illicit Tobacco in Australia. 2019 Full Year Report

² ibid

³ Australian Criminal Intelligence Commission, National Wastewater Drug Monitoring Program – Tenth Report, June 2020.

⁴ KPMG, Illicit Tobacco in Australia. 2019 Full Year Report

⁵ ibid

⁶ Australian Taxation Office, ATO destroys \$171 million of illicit tobacco. [https://www.ato.gov.au/Media-centre/Media-releases/ATO-destroys-\\$171-million-of-illicit-tobacco/](https://www.ato.gov.au/Media-centre/Media-releases/ATO-destroys-$171-million-of-illicit-tobacco/)

⁷ Australian Border Force, ABF Cracks quartz cigarette smuggling concealment.

<https://newsroom.abf.gov.au/releases/ae327c59-95fe-4592-9865-43d9fbccae9d>

⁸ Australian National Audit Office, Performance Audit Report: Case Management by the Office of the Commonwealth Director of Public Prosecutions, March 2020 <https://www.anao.gov.au/work/performance-audit/case-management-the-office-the-commonwealth-director-public-prosecutions>

⁹ Department of Home Affairs Annual Report 2018-19, Appendix A, Table 20, page 209

<https://www.homeaffairs.gov.au/reports-and-pubs/Annualreports/home-affairs-annual-report-2018-19.pdf>

¹⁰ Australian National Audit Office, Screening of International Mail, published 18 June 2014

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¹¹ ABC 7.30 Program. Interview with AFP Assistant Commissioner, Wayne Buckhorn. 2016

¹² Senate Legal and Constitutional Affairs Legislation Committee, Monday 21 October 2019.

¹³ World Health Organization, WHO report on the global tobacco epidemic 2019,

https://www.who.int/tobacco/global_report/en/

¹⁴ Australian Government, 2018-19 Budget, Budget Paper 2.