



Australian Government
Australian Taxation Office

Australian Taxation Office Submission

Inquiry into the effect of red tape on tobacco retail

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Executive summary

1. Duties of excise and customs apply to tobacco products delivered into the Australian domestic market for consumption. The ATO is responsible for administering the excise duty system, which applies to specified goods manufactured or produced in Australia. The ATO also administers some aspects of the customs duty system on behalf of the Department of Immigration and Border Protection.
2. The tobacco industry has undergone significant restructuring over the past 15 years. Tobacco is no longer grown in Australia for commercial manufacture and sale, although some growing still occurs for educational or scientific research purposes. Manufacturing of finished tobacco products also no longer occurs in Australia. All tobacco products sold domestically, in legitimate markets, are now imported.
3. This submission focuses predominantly on the administration of the customs systems as currently undertaken by the ATO, to the extent that such administration has the capacity to affect the tobacco supply chain and ultimately retail. As no manufacture of tobacco products for final retail sale is presently undertaken in Australia, this submission has not addressed excise specific administration. Any references to the Department of Immigration and Border Protection include references to the Australian Border Force where appropriate.

Legislative and administrative framework – regulatory touch points

Imported tobacco - excise equivalent goods administration

General

4. *The Customs Tariff Act 1995* (Customs Tariff) imposes duties of customs on imported goods specified in Schedule 3 to the Customs Tariff. Tobacco is a listed product and subject to customs duty. Rates of duty are equivalent to those imposed under the excise legislation to prevent any anomalies occurring between imported and locally produced goods. *The Customs Act 1901* (Customs Act) sets out the administrative framework for, and imposes controls in relation to, the importation and exportation of customable goods, including tobacco.
5. Excise equivalent goods (EEG) are imported goods which, if manufactured or produced in Australia, would be liable for excise duty. As these goods are equivalent to excisable goods and subject to the same rates of duty, they are commonly referred to as EEG.
6. In 2008, the Productivity Commission's *Annual Review of Regulatory Burdens on Business Manufacturing and Distributive Trades*¹ recommended the Government review administrative arrangements for EEG. Prior to this time, imported tobacco was administered wholly by the then Australian Customs and Border Protection Service (now Department of Immigration and Border Protection (DIBP)).
7. In line with that recommendation, the transfer of some functional elements of EEG administration were transferred to the ATO on 1 July 2010. From that date the ATO assumed responsibility for administering EEG warehouses on behalf of DIBP. Specific EEG warehouse functions undertaken by the ATO include, licensing and associated permissions, audits, warehouse checks, issuing demands, remission processing, risk management and monitoring.
8. All functions associated with movement of goods across the customs barrier, customs depots, brokers and cargo terminals reside with DIBP. Also remaining with DIBP is policy responsibility for administration of EEG. It should be further noted that DIBP has not relinquished or been relieved of authority to undertake activities in EEG warehouses directly where it considers those activities to be appropriate and necessary.

¹ <http://www.pc.gov.au/inquiries/completed/regulatory-burdens/manufacturing/report/manufacturing-regulatory-burdens.pdf>.

Duty rates

9. Current duty rates applying to tobacco are:
 - a) \$0.61726 per stick (when delivered in stick form not exceeding 0.8 grams per stick of tobacco content); and
 - b) \$771.60 kilogram (when delivered in any other form)
10. Duty rates for tobacco are subject to indexation biannually in March and September each year. Rates increase based on changes to the Average Weekly Ordinary Time Earnings (AWOTE) over a specified period.² Further to the increase due to changes in AWOTE, in September each year (up to and including 2020) rates are increased by an additional amount of 12.5 per cent.

Licencing controls built into the system

11. Legally imported tobacco must be declared to DIBP. The goods may then be moved to a customs licenced warehouse with permission from DIBP. It's when those goods are moved to the licenced warehouse that ATO responsibility commences.
12. The ATO determines whether or not to grant a warehouse licence. In making that determination a number of matters are considered which in effect are aimed at protection of the revenue. That is, they are targeted toward restricting entities from holding licences where non-compliance with obligations could be an issue. The matters that the ATO may consider are found in the legislation.
13. Obtaining a customs warehouse licence requires the payment of an application fee, which is currently \$3,000³. Upon approval an initial licence fee of \$4,000 (pro rata based on the number of days remaining in the financial year) is payable. Customs warehouse licences must be renewed annually at a cost of \$4,000 each year. The fees are statutorily founded.
14. By storing tobacco at a licenced warehouse, the payment of duty can be deferred until the owner or importer of the goods is ready to deliver the goods into the Australian domestic market, export them, or otherwise acquit the liability via payment or destruction of the goods. Until liability is acquitted the goods remain under the control of DIBP.
15. Goods entered into a licenced warehouse for storage cannot be moved to another licenced site without a permission issued by either the ATO or DIBP.

² *Customs Tariff Act 1995* section 19AB.

³ *Customs Act 1901* section 85.

16. Entities may apply for a Periodic Settlement Permission (PSP) in relation to EEG, which authorizes the delivery of EEG into the Australian domestic market over a specified period prior to payment being made to DIBP. The ATO may grant or refuse to grant a PSP.
17. A PSP will usually cover a recurring seven-day reporting period. However, if an entity is eligible for the small business entity concessions, the settlement period may be extended to monthly⁴.
18. Overall the system provides capacity to impose tight controls over the movement and storage of tobacco. These controls are monitored and exercised by the ATO to the extent considered necessary and appropriate for the protection of the revenue.

Quota orders

19. A further tool provided in the legislation is the ability for the ATO to impose quotas on EEG in certain circumstances. In 2011 DIBP authorized the ATO to undertake the imposition of quotas on its behalf.
20. Quotas are a legislative tool used to limit the amount of product that can be delivered into domestic consumption at the prevailing rate of duty prior to a new rate taking effect. They can be imposed in relation to any type of EEG (including tobacco) and on whatever entities the ATO believes may attempt to clear into domestic consumption, volumes of product that are in excess of what might otherwise be the case if a rate increase was not being anticipated.
21. For quotas to be issued, the ATO must declare a period during which those quotas apply. The ATO can impose for any period it considers appropriate, practically ending on the day before the new rate takes effect.
22. A quota itself is based upon a number of factors and attempts to provide sufficient capacity for the entity on which it is imposed to deliver normalised volumes of product. Normalised volumes are those that the ATO determines are appropriate for that entity to maintain normal business activity were it operating in an environment absent of any anticipated rate increases.
23. Where an entity has had quotas imposed on it, the legislation provides a mechanism for that entity to request a variation if it considers the quota is not adequate. There are also appeal mechanisms that can be engaged by the entity if it so chooses.

⁴ *Customs Act 1901* section 69.

24. Importantly, imposition of quotas does not limit the overall volume of product that can be delivered into domestic consumption. If an entity exceeds its quota, it is required to pay an additional amount of duty equivalent to the differential between the old and new rates.
25. Quotas are not restricted to goods being delivered from licenced warehousing facilities. They can also apply to goods being delivered directly into home consumption. This prevents entities obtaining advantage by moving goods directly into consumption from the point of importation rather than moving through warehouse storage facilities.

Remissions

26. A remission is a process that extinguishes the duty liability that was created at the time of importation on goods that have been destroyed before they were delivered into the domestic market for consumption. These differ from refunds which are the repayment of duty that has already been paid. Refunds of duty on imported tobacco are administered solely by DIBP as the goods need to be exported before a refund can be paid.
27. A remission for tobacco product will only be given after an application has been made to the ATO. However, there are some very limited circumstances in which a remission or refund may be made without application.⁵

Effects of administrative powers on tobacco retail

Overview of ATO approach

28. As an overall approach to EEG related licensing and administration, the ATO seeks to minimise costs to industry and interference in the markets. Wherever practically possible, decisions are made on available information so as to not impose unnecessary imposts upon the marketplace.
29. However, it is recognised that tobacco is a high duty value product and readily capable of diversion by entities seeking to operate in the illicit markets. As such, more scrutiny is applied to the tobacco industry than to other industries. The ATO does try to limit compliance checks as much as possible for all industries, however because of the high duty and potential for diversion for tobacco, this does impact on the extent to which the ATO can limit compliance checks compared to the other EEG related products of petroleum and alcohol. The following needs to be read with this in mind.

⁵ Customs Regulation 2015 regulation s 106 - remissions without application may apply where goods have been totally lost, destroyed or cease to exist.

30. The ATO attempts as far as practical to work with industry to resolve matters that may arise from time to time. The vast majority of interaction occurs with the large importers. Typical matters discussed with industry are:
- a) rates changes which will occur
 - b) quota administration if these are to be imposed
 - c) changes to business structures and arrangements
 - d) applications for remission (and destruction of product)
 - e) new products that may be entering the market
 - f) changes in volumes of product being delivered into the market for consumption
 - g) implementation of new measures (such as plain packaging)
 - h) receipt of information from industry about illicit market operations.
31. It should be noted that the ATO approach to EEG (and excise) administration is to engage with industry as far as possible to develop mutually acceptable outcomes. However, the tobacco industry does necessarily have some level of restriction on it. Australia is a signatory to the Framework Convention on Tobacco Control. One of the Articles within that Convention (Article 5.3) restricts interactions relating to policy development and implementation.

Licensing

32. The purpose of undertaking specific detailed checks prior to issuing a licence is to minimise the possibility of customs storage licences being issued inappropriately. Matters taken into consideration may include criminal history checks of key persons, compliance history if available and security of premises.
33. As tobacco is a high value product, subject to possible diversion from licensed warehouses, care needs to be taken to minimise as far as reasonably possible, inappropriate activity in the warehouse environment as it can severely damage legitimate operators.
34. In addition to undertaking the specific checks, the ATO works closely with licence holders to assist with risk mitigation and therefore potential further costs of compliance both from their perspective and from the revenues viewpoint. In particular the ATO undertakes the following:
- a) works with licenced entities to set limits on the amount of tobacco that can be stored at sites, potentially reducing insurance premiums
 - b) education on issues that have arisen with respect to insurance policy wording

- c) removing tobacco from storage licences where requested alleviating problems for them in being asked to store
 - d) education for entities new to the licence system to address issues they may have
 - e) consolidation of renewal documentation to reduce costs of administration for those that have multiple licenced sites.
35. The ATO has taken steps to make tobacco related licencing easier, consistent with our focus on reducing compliance costs and placing the client at the centre of everything we do. However, for tobacco we have also needed to balance this against the high risk nature of its storage in bonded locations. These decisions are always carefully made as it is recognised that placing regulatory restrictions on warehouse operations has a cost and may limit the ability for importers to utilise storage facilities affecting cash flows if sufficient warehouse facilities can't be found. These could also potentially have a flow on effect to retail markets although the ATO has not seen evidence that any significant negative effects have been encountered.

Quotas

36. Quotas are generally only issued to the largest entities clearing tobacco into domestic consumption, as they account for approximately 99 per cent of the total annual tobacco duty revenue. There are four of these entities.
37. While quotas may also be imposed on smaller entities if a specific risk to revenue is identified, due to administrative costs (both for duty payers and the ATO) of imposing quotas on these smaller entities, in more recent times no quotas have been imposed. Given the limited amount of revenue paid by these entities this approach has no noticeable effect on the revenue and this also helps keep their compliance costs down.
38. In terms of market position of the four large duty payers and the balance of the industry there is a significant disparity. By not imposing quotas on smaller entities, the potentially distorting effects on entities competing in the same market sector are removed.
39. One outcome of quota imposition that can occur at the retail level is a restriction on supply from entities upon which quotas have been imposed. Where quotas are issued, it is then a matter for individual entities to determine:
- a) whether it will satisfy customer orders where those orders will cause it to exceed its quota; and
 - b) if not, the extent to which it will fill those customer orders.
40. In this regard it is important to note that the imposition of a quota does not limit overall volumes of tobacco that can be delivered into domestic consumption. Rather, quotas do

no more than require entities upon which they have been imposed, to pay additional amounts of duty on the volume of products that have been delivered in excess of the quota order.

41. As stated previously in this submission, the ATO takes into account a number of matters in determining whether, when and what quota amounts it may impose. To this end, as part of our client focus and improved transparency, the ATO in most instances now seeks information from industry and advises them of the likely quota period and likely base period (period used to initially determine quotas being a period during which volumes of product being delivered into consumption are relatively normal).
42. To assist with volumes, the ATO also applies, as a matter of administrative practice, an automatic 5 per cent uplift on volumes ascertained from the base period clearances. From the information provided by industry, the ATO is able to determine any other relevant factors that may need to be taken into account before setting the quota. This reduces significantly the need for variations to be made due to unforeseen circumstances affecting the quotas during the period in which they apply.
43. This approach by the ATO of asking industry for information prior to determining quotas and being open about intentions to impose those quotas, was adopted as a way of reducing significant administrative difficulties for both the ATO and industry with the use of quotas, in relation to knowing what factors need to be considered.
44. Previously, the ATO would not advise if and when quota periods would apply and by implication would not seek input from industry. This led to industry acting in an anticipatory manner (i.e. clearing larger than usual volumes before the ATO acted), consequently requiring the ATO to apply longer than desirable quota periods.
45. Long periods of quotas make the process of estimating accurate quota amounts difficult leading to increased numbers of variation requests and with it increased administration and possible dispute. Reduction in the request for variations has been noticeable since the new approach was adopted. Positive feedback from industry has been received.
46. The process of putting industry on notice of a likely quota imposition does not put revenue at risk, as quota orders can be adjusted down to reverse any advantage gained by industry operators moving early.
47. In effect, in setting and managing quotas, the ATO attempts to allow enough volume to meet normalised demand in the market by estimating normal demand based on known factors and providing uplift for further unforeseen circumstances.
48. Administratively the ATO adopts the view that quotas are not about maximising possible revenue, but preventing actions that may result in large scale loss to the revenue. It is

about striking a balance between the ATO's responsibility to administer the revenue effectively and not imposing unreasonably upon duty payers. Quotas are not currently being imposed for small rate increases such as those that have occurred in March this year.

49. It is the ATO view that the simplified approach adopted in more recent years is as minimalist as possible to still achieve the intended outcome of the quota process, being appropriate protection of the revenue.

Remissions

50. Remission applications for tobacco are often granted with an associated supervision. That is, the ATO undertake a check of the goods being subject to destruction, that volumes match the application and supervise the destruction of the goods at commercial waste facilities.
51. Once a remission is granted, the goods no longer need to be accounted for. It is for this reason that the supervision occurs. It provides a level of assurance that the goods do not subsequently find their way into domestic consumption without payment of duty, thereby potentially causing loss to the revenue and competitive anomalies for industry.
52. This requirement for ATO approval before destroying goods is an additional but important step in the process of destruction. The ATO is aware that some importers of tobacco may also be retailers, and as such any delays in being able to destroy unwanted goods may cause some inconvenience and be seen as a regulatory burden. As with many regulatory requirements, the balance between not imposing unreasonably on industry and enforcing the law needs to be struck. The ATO believes, relevant to the tobacco industry and given the duty value of the goods, that it has the appropriate balance.

Summary of Administration Effect

53. Overall the regulatory system works well and is considered to be effective in controlling the legitimate movement and storage of goods. It works to restrict entities that may pose a risk to the revenue if they were otherwise uncontrolled. This is important for revenue administration purposes and to protect legitimate industry operators within the supply chain.
54. The ATO is aware that regulatory requirements can be seen as a burden on industry. As such, with our strong client focus, the ATO has worked hard with industry to implement new approaches that endeavour to minimise compliance and administrative costs while still achieving the desired regulatory and legislative outcomes.

Illicit tobacco

55. The ATO is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products. As commercial production in Australia of tobacco has ceased and no associated production licences now exist, all detections of tobacco growing in the field relate to illegal crops.
56. DIBP is responsible for preventing tobacco from being illicitly imported into Australia.
57. The ATO identifies illicit crops by using formal networks, community 'tip-off' information and intelligence from partner law enforcement agencies.
58. With respect to the illicit manufacture of excisable goods and other tobacco related offences against the legislation, the ATO liaises with the Commonwealth Department of Public Prosecutions, the Australian Federal Police, and State and Territory police as, and when, required. The ATO will also share information with other State and Territory licensing authorities when necessary.
59. In addition, the ATO is a member of the Interdepartmental Committee (IDC) on Tobacco Control. The IDC is part of a whole-of-Government approach to the development and implementation of tobacco control policies. The terms of reference for the committee task is to:
 - a) Ensure that the interests of various member departments/agencies are balanced in discussing and making recommendations on Australia's overall tobacco control policy including:
 - i. measures relating to the reduction of demand for tobacco (such as price and tax measures, tobacco product content disclosure and regulation, packaging and labelling regulation, and regulation of tobacco advertising and promotion);
 - ii. measures relating to the reduction of the supply of tobacco including tackling illicit trade in tobacco products;
 - iii. measures relating to the protection of public health policies from commercial and other vested interests of the tobacco industry;
 - iv. measures relating to emerging tobacco products and other products that may resemble tobacco products, including but not limited to personal vaporisers (such as e-cigarettes); and
 - v. any other relevant issues that may arise from time to time.
60. Illicit tobacco is a cause for concern for legitimate retail outlets. Illicit tobacco product is sold below prices at which legitimate operators can sell similar goods. The ATO takes strong actions to detect, destroy and disrupt illicit growing activities.

Cross agency and other relationships

61. In administering tobacco the ATO works with other agencies and industry to deliver outcomes as efficiently and effectively as possible within resource and legislative constraints. Other regulatory bodies bear responsibility for community health and safety issues and industry protection considerations. For example measures relating to health policy, tobacco control, consumer protection and retail licensing are not the responsibility of the ATO. The ATO focus is on revenue collection and protection.
62. To assist administration the ATO chairs the Tobacco Stakeholder Group, which is a consultative forum for representatives of the tobacco industry, ATO, and DIBP to discuss issues of mutual interest in relation to the tobacco industry. The stakeholder group is committed to improving both the administration and operation of the excise and customs tobacco duty systems.
63. Representatives from other Australian Government agencies including the Australian Competition and Consumer Commission and the Department of Health have attended meetings. The group meets bi-annually. Minutes of meetings are published on the ATO website.

