

# CONFRONTING ILLICIT TOBACCO TRADE:



## A GLOBAL REVIEW OF COUNTRY EXPERIENCES

AUSTRALIA: ADDRESSING THE ILLICIT FLOW OF  
TOBACCO PRODUCTS IN AUSTRALIA

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TECHNICAL REPORT OF THE WORLD BANK GROUP  
GLOBAL TOBACCO CONTROL PROGRAM.

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**AUSTRALIA**

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## AUSTRALIA:

### Addressing the Illicit Flow of Tobacco Products in Australia

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#### Chapter Summary

##### **Background and Policy Context**

In 2018–19, Australia is taking a number of significant steps to address the illicit trade in tobacco. In the context of ongoing aggressive tobacco tax increases, the new measures now rolling out will strengthen the administration of tobacco imports and create a multi-agency taskforce to increase investigatory and enforcement capability, among other advances.

Australia has earned a reputation for innovation in anti-smoking policy, taking global leadership in areas like plain packaging and the indexation of tobacco excise rates to affordability. Australia has adopted numerous non-fiscal tobacco-control measures, many of which are consistent with the Framework Convention on Tobacco Control (FCTC). These strategies were brought together under the *National Tobacco Strategy 2012–2018*. They have included graphic health warnings, advertising bans, and the prohibition of smoking in public spaces.

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Meanwhile, tobacco taxation policy continues to play an important role in reducing demand for tobacco in Australia. The country has accelerated tobacco excise rates, starting with a 25 percent hike in 2010, followed by 12.5 percent annual increases from 2013 through to 2020. These tax increases are additional to the bi-annual indexation of rates each March and September. The overall effect has been a substantial rise in the tax component of retail cigarette pricing. While this brings Australia closer to the 70 percent tax target suggested by the World Health Organization, it may also heighten incentives for criminals to expand the illicit tobacco market.

Historically, Australia has administered tobacco taxes through a series of licensing and permission-based regimes that seek to facilitate dealings by lower-risk entities and to prevent or tightly control commerce involving higher-risk entities. To manage tobacco tax collections, Australia has a set of regulatory controls administered by its domestic tax agency, the Australian Taxation Office (ATO). These controls recognize that tobacco could, in principle, be either grown and manufactured locally, imported as finished goods, or imported as leaf for final manufacture in Australia. In practice, since 2015, the licit tobacco market in Australia is comprised exclusively of imported finished tobacco products (e.g., cigarettes). All legal domestic tobacco growing and manufacture have ceased. Of note, Australia's tobacco-trade controls do not extend to the use of fiscal markings such as tax stamps, or to the application of track-and-trace technologies to confirm the tax status of tobacco products in the supply chain.

### Enforcement Agencies and Activities

Tobacco tax administration is supported by enforcement and investigative activity, including the high-profile actions of the Australian Border Force (ABF) Tobacco Strike Team, recently credited with Australia's largest-ever seizure of illicit tobacco. Although imports now represent the only legal channel for tobacco trade in Australia, enforcement still involves dual legislative jurisdictions, as illegal domestic cultivation persists. This has led to complexities: for example, the ABF enforces laws relating to imported tobacco products under customs legislation, while the ATO enforces laws relating to local cultivation and manufacture under excise legislation. Further, these dual legislative jurisdictions are often inconsistent in areas such as the level of intent to be proved and the penalties available. Thus, the origin of suspicious tobacco found in the supply chain needs first to be established to ensure successful prosecution.

### Recommendations and Way Forward

A major development in addressing the illicit trade in tobacco was the recent work of the Government's Black Economy Taskforce. The taskforce's 2017 report clearly acknowledged the threats posed by Australia's illicit tobacco market, confirmed the role of organized crime in illicit tobacco, and recognized that existing detection capabilities and applicable penalties must be reinforced. The report presented specific recommendations for strengthening action against illicit tobacco, many of which the Government will implement as of July 1, 2019. However, not all Black Economy Taskforce recommendations on illicit tobacco will

be adopted. Most notably, there will be no introduction of fiscal marking or track-and-trace systems for tobacco products in Australia.

On the positive side, from 2019, the Australian government will tighten its tobacco tax administration by eliminating the status of tax-suspended, or "bonded," tobacco. This will remove an area of significant fraud risk. In addition, an import licensing regime will be introduced, and commercial importation of tobacco will be banned without appropriate licensing. The Government will bolster enforcement capabilities by addressing inconsistencies between import and domestic legislation and will recognize a number of new tobacco-related offenses. Enforcement will be supported by the creation of a multi-agency Illicit Tobacco Taskforce. The new force will build on the existing Tobacco Strike Team by bringing together the legislative powers, intelligence systems capabilities, and resources of several federal law enforcement agencies.

## Part A: What Has Been Done to Address the Illicit Trade in Tobacco, How Was It Done, and What Are the Results?

### 1. Tobacco Control in Australia

Tobacco control began in earnest in Australia in 1992, with the passage of the Tobacco Advertising Prohibition Act, which introduced a range of restrictions on the marketing of tobacco products. Since then, Australia has developed a comprehensive range of measures, both fiscal and regulatory, to address the costs of harm from tobacco consumption. These include high-profile measures that require tobacco products to be sold in plain packaging and that impose graphic health warnings covering most of the surface of cigarette packages. A short summary of key control measures and policy or legislative sources can be found in Table 1.

Tobacco taxation has also become a central component of Australia's tobacco control response. Following an ad hoc 25 percent increase in excise rates in 2010, regular 12.5 percent annual rate increases began in 2013 and will continue through to 2020. In addition to these staged rate increases, there continues to be bi-annual indexation to the base rates. As at 2016, Australia's tobacco excise as a proportion of retail price had reached the range of 52 to 60 percent (DOH 2017; WHO 2017:148). When measured together with the Goods and Services Tax, the total tax as a proportion of cigarette retail price reaches 61 to 69 percent (DOH 2017). Thus, tobacco taxation in Australia is quickly moving the country's tax-to-retail ratio towards the 70 percent target set in the *Guidelines to Implement Article 6.2 of the WHO Framework Convention on Tobacco Control*.

This policy of staged excise tax increases is designed to support the Government's objectives for consumption as outlined in the current *National Tobacco Strategy 2012–2018*

(NTS). These objectives are to reduce adult smoking rates from 19 percent to 10 percent for the general population and to halve smoking rates amongst Aboriginal and Torres Strait Islander peoples. Such excise tax increases, however, can work to stimulate the trade in illicit tobacco products by decreasing the affordability of tax-paid tobacco and increasing profitability for those undertaking illegal activities.

This is recognized by the Government as a risk (Treasury 2016), and funding in recent federal budgets has been directed towards addressing the issue. The tobacco industry has also raised concerns, albeit without providing evidence, that illicit tobacco risks from such tax rate rises will be facilitated by the simultaneous introduction of plain packaging in 2012, which allows illicit traders to more readily conceal their products (BAT 2011; JTI 2011; PMI 2011).

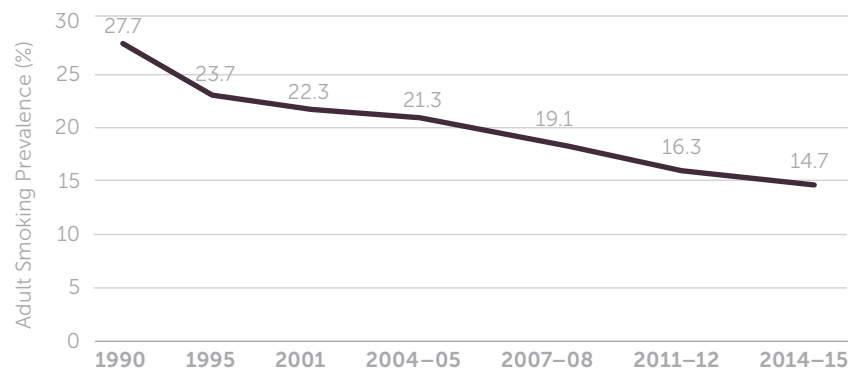
**Table 1. Outline of Australia’s Tobacco Control Framework**

POLICY INSTRUMENT	MEASURES
<i>Tobacco Advertising Prohibition Act 1992</i>	<ul style="list-style-type: none"> <li>› It is an offence for corporations to publish or broadcast a tobacco advertisement (as defined) unless a prescribed exception applies</li> </ul>
<i>Competition &amp; Consumer (Tobacco) Information Standard 2011</i>	<ul style="list-style-type: none"> <li>› Two sets of seven health warnings (rotating over a 12-month period) to cover at least 75 per cent of the front of tobacco packaging, 90 per cent of the back of cigarette packaging, and 75 per cent of the back of most other tobacco product packaging</li> <li>› Warnings in relation to chemical contained in the product</li> <li>› Warnings extended to cigars</li> </ul>
<i>Tobacco Plain Packaging Act 2011 (and Regulations)</i>	<ul style="list-style-type: none"> <li>› Color and finish of primary and secondary packaging (cigarette and other)</li> <li>› Marks which may appear</li> <li>› Use of bar-code, details of manufacturer and brand</li> </ul>
<i>National Tobacco Strategy 2012–2018</i>	<ul style="list-style-type: none"> <li>› Protect public health policies from tobacco industry interference</li> <li>› Eliminate remaining advertising, promotion and sponsorship of tobacco products</li> <li>› Reduce affordability of tobacco products</li> <li>› Increasing smoke free areas in public places</li> <li>› Strengthening mass media and public education campaigns</li> <li>› Improving access to evidence based cessation services</li> <li>› Consider further regulating tobacco product contents</li> <li>› Midpoint review of progress</li> </ul>
<i>Excise taxation (and excise equivalent taxation on like imported tobacco products)</i>	<ul style="list-style-type: none"> <li>› Levied on a “per stick” basis or a “per kilogram” equivalent basis from 2000, where a stick is defined as not being more than 0.8 grams</li> <li>› Indexed bi-annually to average weekly ordinary times earnings</li> <li>› 25% one-off increase in April 2010</li> <li>› 12.5% increases annually 2013–2017</li> <li>› Further 12.5% annual increases 2018–2020</li> <li>› \$7.7m to form ABF Tobacco Strike Team to intercept illicit tobacco</li> </ul>
<i>Pharmaceutical Benefits Scheme</i>	<ul style="list-style-type: none"> <li>› Listing of nicotine replacement therapies (e.g., nicotine patches), bupropion, and varenicline for government subsidies, making smoking cessation more affordable for eligible patients</li> </ul>

## 2. Smoking Prevalence and Trends in Australia

The most recent studies in Australia in relation to smoking prevalence are largely positive, with key indicators showing reduced consumption, deferred uptake, and increased cessation. *The National Health Survey* which since 2001 is conducted every three years (having been conducted every five years prior to 2001), identifies a downward trend, with 14.7 percent of adults smoking daily in 2014-15, compared to 22.3 percent in 2001 and 27.7 percent in 1990, when the series started (ABS 2016). The headline smoking prevalence rates can be seen in Figure 1.

**Figure 1. Australian Adult Smoking Prevalence, 1990-91 to 2014-15**



Source: ABS *National Health Survey: First results 2014-15*

Consistent with the *National Health Survey* are data from the study *Tobacco indicators: measuring midpoint progress reporting under the National Tobacco Strategy 2012-2018*, which analyses specific measures undertaken in the NTS to determine progress against baselines (AIHW 2016). Key results are summarized Table 2.

Table 2 is generally seen as positive. However, in relation to the key or benchmark indicators of prevalence, while the general population is on course for its reduction targets, prevalence rates for the indigenous population remain disappointing. High rates within this group are not falling as quickly as is desired in the NTS.



**Table 2. Summary of Certain Key Results at NTS Midpoint**

INDICATOR	TARGET TO BE REACHED BY...	BASELINE 2012	MIDPOINT 2016	TREND REPORTED
Benchmark:				
› Adult smoking prevalence	Prevalence = 10%	19.1%	14.8%	Reduction (on target)
› Aboriginal & Torres Strait Islander prevalence	Prevalence halved	44.8%	42.1%	Reduction (below target)
Uptake:				
› School children trying	Reduction	23.3%	19.1%	Reduction
› Adults trying	Reduction	62.5%	57.0%	Reduction
› Age of uptake	Older when start	15.4 years	15.9 years	Older when starting
Exposure to smoke:				
› Women smoking while pregnant	Reduction	13.2%	11.7%	Reduction
› Children at home	Reduction	6.1%	3.7%	Reduction
› Adults at home	Reduction	4.0%	2.4%	Reduction
Cessation:				
› Attempting to cease	Increase	44.8%	46.7%	Increase
› Adults actually cease	Increase	47.4%	51.8%	Increase
› Age when ceased	Reduction in age	35.3 years	35.4 years	No change
Continuation of smoking:				
› School children into young adults	Reduction	3.5%	2.7%	Reduction
› Young adults into adults	Reduction	29.4%	23.2%	Reduction

Sources: AIHW (2016)

### 3. Tobacco Taxation

Tobacco and tobacco products are subject to a number of layers of taxation, with the exact nature of taxes dependent upon where the product originates and where final manufacture occurs.

#### 3.1 CUSTOMS IMPORT TARIFFS

Customs import tariffs are levied under the *Customs Tariff Act*. Import tariffs in Australia are generally applied for the purposes of protecting domestic industry, and for tobacco import tariffs are now at zero, as there is essentially no longer an Australian tobacco industry. Freeman (2016) describes the end of tobacco growing in Australia by 2006, when the final contracts between growers and tobacco companies ended and all tobacco growing licenses were cancelled by the ATO. Between 2006 and 2015, the “Australian industry” was a simple value-add process, with cigarettes manufactured under bond, using tobacco leaf imported from Brazil, India, the United States, and Zimbabwe.

2015 saw the closure of the last Australian cigarette production lines. All cigarettes and tobacco products lawfully sold are now imported as finished goods. The import tariff, while set at zero, is actually a composite duty rate and contains what is referred to as an “excise equivalent duty.” This is the current tobacco excise tariff rate that would apply to domestic tobacco products and which is applied to similar imported products. (Excise and excise equivalent duty are discussed in Section 3.3 below as Australia’s primary form of tobacco taxation.)

### **3.2 GOODS AND SERVICES TAX**

The Goods and Services Tax (GST) is a broad based, “value-add” consumption tax and so levied on the sale of most goods and services in Australia. This includes the sale of all cigarettes and tobacco products. The current rate of GST in Australia is 10 percent, irrespective of whether the products are sourced domestically or imported.

### **3.3 EXCISE AND EXCISE EQUIVALENT DUTY**

Excise is the primary tobacco taxation instrument and is applied through the *Excise Tariff Act* for tobacco products manufactured in Australia, including manufacture in Australia from imported tobacco leaf. Excise is also payable on imports of cigarettes and other finished tobacco products via the *Customs Tariff Act* as excise equivalent duty. In this case, the rates of excise and excise equivalent duties are the same for like goods, as required in Article III.2 of the General Agreement on Tariffs and Trade (GATT), with both rates indexed twice a year. Prior to 2014, the indexation was based on Consumer Price Index (CPI).

Australia’s tobacco excise has been applied on a specific rate basis since 2000, levied per stick on cigarettes where a stick contains less than 0.8 grams of tobacco. This move was designed to increase the excise tax and price on each cigarette, which, when taxed on a per kilogram basis, had seen manufacturers reduce the weight of each stick to maintain affordability in pricing.<sup>2</sup>

Tobacco products other than cigarettes in stick form, for example cigars, cigarillos, and roll-your-own tobacco, are still subject to excise taxation on a per kilogram basis, with new legislation now transitioning this per kilogram rate to better align with the per stick rate, so as not to create tax rate differentials between cigarettes and other tobacco products. Over four years beginning in 2017, the per kilogram rate for tobacco products will be adjusted annually so that it equates to a 0.7 gram cigarette stick and not the current 0.8 grams.<sup>3</sup>

### **3.4 TOBACCO EXCISE POLICY REFORMS SINCE 2010**

There have been several significant excise reforms in recent years, beginning on April 29, 2010, with an immediate 25 percent increase in excise tax on all tobacco products. This

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<sup>2</sup> Explanatory Memorandum Excise Tariff Amendment Bill (No 1) 2000.

<sup>3</sup> *The Excise Tariff Amendment (Tobacco Duty Harmonisation) Act 2017* (domestic manufacture) and *Customs Tariff Amendment (Tobacco Duty Harmonisation) Act 2017* (imported finished goods).

followed a recommendation from the National Preventative Health Taskforce (DOH 2018). In 2012, in a move consistent with Article 6.2 of the WHO FCTC, the duty-free allowance for arriving passengers was reduced from 250 cigarettes or 250 grams of tobacco, to 50 cigarettes or 50 grams of tobacco, with excise equivalent duties payable on the entire amount of tobacco, should the passenger exceed this limit (ABF 2012).

In the 2013/14 federal budget, a new approach to indexing tobacco excise rates was announced, in addition to four staged annual tax rate increases. Replacing CPI indexation of rates, tobacco excise was now indexed to Average Weekly Ordinary Times Earnings (AWOTE). This linked the excise rate to income in current prices rather than just to inflation. The budget also set out four annual excise rate increases of 12.5 percent to commence on December 1, 2013 (retrospectively), recurring on September 1 of 2014, 2015, and 2016. The Explanatory Memorandum for the *Excise Tariff Amendment (Tobacco) Bill 2014* and *Customs Tariff Amendment (Tobacco) Bill 2014*, which gave effect to this policy, stated that the measures are designed to make inroads into the affordability of tobacco as a means to address consumption.

Following the final scheduled 12.5 percent rate increase, the 2016–17 federal budget extended the policy by applying a further four hikes to take effect on the 1<sup>st</sup> of September of each year from 2017 through 2020. In addition, the duty-free passenger concession for tobacco products was further reduced from 50 cigarettes to an “open pack” of 25 cigarettes (or 25 grams equivalent) of tobacco product. In a review of the 2016–17 federal budget, Thomas (2016) quotes government policy as using the 12.5 percent increases which commenced back in 2013 and that will continue through to 2020 to both “battle smoking-related cancer and return the budget to surplus,” indicating the excise rate increases are based on health and revenue outcomes.

It is also important to note that, in recognition of each of these tobacco excise rate increases, these 2016/17 budget measures were supported with \$7.7 million for enforcement initiatives. Primarily, the money was allocated to expand the ABF Tobacco Strike Team, as budget papers acknowledged that, “Changes to taxation arrangements for tobacco have the potential to increase illicit tobacco activity” (Treasury 2016). This initiative is analyzed further in Section 6 below.

At the time of writing, tobacco excise tax rates are as follows (ATO 2018):

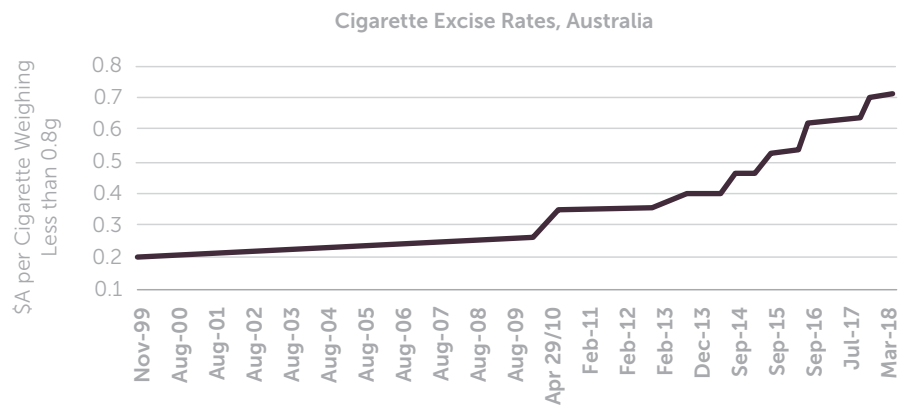
- » In stick form not exceeding in weight 0.8 grams per stick actual tobacco content - \$0.71046 per stick; and
- » Other - \$916.72 per kilogram

These two rates will rise on September 1, 2018, by 12.5 percent plus an indexation against the relevant AWOTE factor. The rate for “other” tobacco will increase further when the per kilogram rate is adjusted for a 0.75 gram stick on the path towards equivalence with a 0.7 gram stick.

Australia's tobacco excise rates since 1999 are graphed in Figure 2 for cigarettes and Figure 3 for other tobacco products. Both figures show a long period of simple CPI-indexed rate increases until the 2010 policy introduced accelerated rate increases, which are scheduled to continue through 2020.

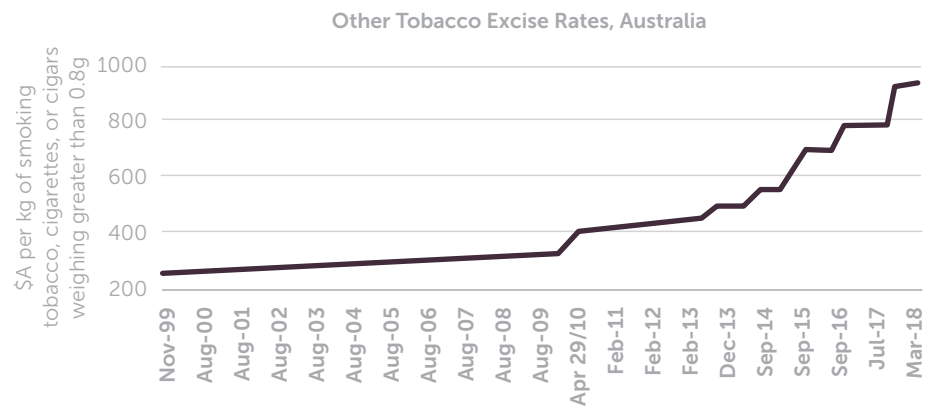
As at 2016, Australia was reported to have the highest price on a 20-stick equivalent pack of cigarettes amongst the OECD countries (OECD 2016) at USD 12.81 per pack, ahead of Norway at USD 12.65 and New Zealand at USD 11.85. As outlined above, with current reforms increasing tobacco excise rates at 12.5 percent per annum, in addition to bi-annual AWOTE indexation, the ratios of excise and total tax to retail price in Australia are expected to increase and start to match those of the country's OECD peers.

**Figure 2. Cigarette Excise Rates in Australia 1999–2018**



Source: Author adapted from ATO tax rate data (2018)

**Figure 3. Other Tobacco (Non-Cigarette) Excise Rates in Australia 1999–2018**



Source: Author adapted from ATO tax rate data (2018)

Figure 3 looks at excise rates for tobacco other than in cigarette form. The numbers again show that, in the 2016 OECD rankings, Australia had the highest excise tax rate (in USD per kilogram equivalent) on non-cigarette tobacco products, at USD 498.66, well ahead of Ireland at USD 323.73 per kilogram and the United Kingdom at USD 284.01 (OECD 2016).

## 4. Framework of Tobacco Taxation Administration

### 4.1 AGENCIES AND LEGISLATION

The nature of tobacco tax administration in Australia is evolving, due to recent government decisions to transfer the management of much of the excise equivalent duty function from ABF to the ATO. Commercial decisions by the tobacco industry to cease local manufacture have also spurred change. This has led to a somewhat complex administrative arrangement, especially for importers, and has in some cases opened up areas of risk for smuggling and revenue leakage. As such, tobacco tax administration will undergo significant reform in 2019 to address these failings. We will analyze the issues in Section 7, below.

In 2006, all tobacco-growing licenses were cancelled by the ATO, as manufacturers sourced cheaper leaf from off-shore suppliers. Manufacturing then ceased in Australia altogether during 2015, with the closure of the last local production operations by Philip Morris International (PMI), then British American Tobacco (BAT) (Scollo and Bayly 2016). Notwithstanding, all legal provisions which control a domestic tobacco industry remain in place, should the sector restart manufacturing.

Legislation supporting the administration and enforcement of tobacco taxation falls under two federal jurisdictions, namely customs law for the importation of tobacco and excise law for domestic manufacture activities. Customs and excise law is then essentially divided into two areas. The first involves the taxing instruments, which include the *Customs Tariff Act* for imports and the *Excise Tariff Act* for all domestic manufacture. Both laws provide for the authority to levy duties and set out the classification of products and relevant duty rates.

The second main legal area is that of the necessary administrative powers for departmental officials to collect duties and enforce compliance. These powers come primarily from the *Customs Act* (and Regulations) for imports of leaf or finished tobacco products, and the *Excise Act* (and Regulations) for the manufacturing and packaging of finished tobacco products, including local manufacture using imported leaf. Given the decline of all forms of domestic production, the application of the *Excise Act* has become increasingly limited in duty collection, but is still very much in use to ensure compliance and in tackling illicit production.

One area of Australian law which differs from other countries is that of the concept of “excise equivalent duty,” which is a customs duty that is levied on imports of goods which if manufactured domestically would be subject to excise. This includes imported cigarettes and other tobacco products. While this concept of applying identical excise duties to like imports is the

same in most countries, what may differ here is the administration of much of these excise equivalent duties over imports by the domestic tax agency, the ATO, and not ABF.

For the importation of excise equivalent goods, including tobacco products, only the initial importation declaration process (either directly into home consumption or into a bonded warehouse), ex-warehouse declaration process for tobacco products leaving a bond, and the actual duty payment, sit with the ABF.<sup>4</sup> The ATO then administers all other functions relating to the importation of tobacco and tobacco products (DOHA 2018) which include:

- » Licensing of the bonded warehouses that will store imported products until delivered to home consumption;
- » Issue of permissions to undertake movement of bonded tobacco products between licensed bonded warehouses, or to a place of export;
- » Issue of permissions to deliver tobacco products into home consumption without first passing an entry, and to report and pay duties on such deliveries weekly;
- » Grant where appropriate remissions of duty for any bonded tobacco damaged or otherwise made worthless; and
- » The conduct of any or all audit and compliance activities at bonded warehouses.

In addition to taxation, prior to delivery into home consumption, importers of tobacco products are also required to ensure compliance with the *Trade Practices (Consumer Product Information Standards) (Tobacco) Regulations 2004*, *Competition and Consumer (Tobacco) Information Standard 2011* and the *Trade Practices (Consumer Product Safety Standard) (Reduced Fire Risk Cigarettes) Regulations 2008*, which support Australia's plain packaging and graphic health warning policies. Compliance with these provisions is self-assessed with non-compliance monitored in the market place. Fines up to \$1.8 million may be applied by the Courts for plain packaging breaches, and up to \$1.1 million for graphic health warning breaches (DOH 2015).

## 4.2 ADMINISTRATIVE CONTROLS OVER TOBACCO TAXATION

A central component of the tobacco tax administrative control framework in an increasing number of countries is to introduce "sophisticated markers" on tobacco products. These go beyond simply identifying the tax status of the product, for example tax stamps or ink marks, towards markers that are able to authenticate product and track it through the supply chain (Ross 2015: 45). Australia has never adopted the use of any fiscal markings, nor sophisticated track-and-trace technology, rather it has designed and implemented a set of regulatory controls which are designed to reduce the risk around both those who may deal in tobacco and the types of activities that they undertake. These regulatory controls include:

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<sup>4</sup> See *Taxation Laws Amendment (Excise Arrangements) Bill 2000*.

### *Licensing of those wishing to grow tobacco, manufacture tobacco, or store bonded tobacco*

Licensing is perhaps the central control applied to reduce risk. Under the Excise Act, manufacture of excisable goods can only occur with a license to do so.<sup>5</sup> For tobacco, this extends to the concept of “producing” tobacco material and creates an offense at sub-section 28(1) as follows:

*“A person who does not hold a producer licence must not intentionally produce material that is tobacco seed, tobacco plant or tobacco leaf knowing, or being reckless as to whether, the material is tobacco seed, tobacco plant or tobacco leaf.”*

The maximum penalty for unlawful possession of tobacco seed and tobacco plant is \$105,000<sup>6</sup> or two years imprisonment, while for tobacco leaf it is the greater of \$105,000 and five times the value of the excise duty payable on that leaf, or two years imprisonment. This is now a significant provision of the law, as with the cessation of all legal tobacco growing, it is implied that any Australian tobacco seed, plants, or leaf in the market is illicit.

The license for a bonded warehouse to store imported tobacco will be sought by importers under both the *Customs Act* and into the *Excise Act*. Both have identical requirements to be met in order for the licenses to be issued, and the decision-making process is administered by the ATO. To meet the requirements, the applicant must meet general criteria such as fitness, record keeping, and security as set out in Annex 1. These criteria are designed to ensure that only low-risk entities are able to enter the excise tax system and carry the significant duty liabilities.

The excise licensing regime then aims to keep risk levels low by firstly allowing the placement or restrictions and conditions upon the licensee, provided these restrictions and conditions are necessary to “protect the revenue.”<sup>7</sup> One such restriction may include the ATO requiring the new licensee to deposit a security to cover potential non-compliance. If required, the amount and manner of payment of such a security will be set by the ATO.

Risk levels are also kept at the acceptable level through provisions around the ability to suspend and cancel licenses (although such decisions may be appealed). The suspension or ultimate cancellation of an excise license essentially prevents the business from operating and is seen as a substantial incentive to maintain high levels of compliance. Licenses are valid for a three-year period, after which time they must be renewed, a process which is automatic for licensees with demonstrated compliance.

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<sup>5</sup> See Part III of the Excise Act 1901.

<sup>6</sup> The financial penalty is set out as 500 penalty units, as defined in section 4AA of the Crimes Act, which at the time of writing was \$210.

<sup>7</sup> See *Excise Act 1901* paragraph 39A(2)(l).

### *Permission to move tobacco under bond*

An area of considerable risk is the movement of under-bond or "tax-suspended" tobacco from one location to another, such as from the port of importation to a warehouse, between warehouses, or from a warehouse to a place of export, including specialty premises, such as duty-free shops. Such movements are common, and significant volumes can move in normal distribution arrangements as products are positioned nearer the customer, or sold as exports. However, this sheer volume is inherently difficult to monitor and leakage of tax revenue all too common.

Australia has established a permission system to move bonded tobacco products which attempts to restrict such movements to "lower-risk" entities and relies on post-transaction audit of commercial records. Applications for the bonded movement of tobacco products are made to the ATO under the Customs Act or Excise Act (depending on the origin of the tobacco). The ATO may then approve the types of bonded movements for tobacco, as set out in Annex 2.

Prior to approving an application for a single bonded movement, the ATO will apply certain risk criteria, including the size of the duty liability, the compliance record of both parties and the possibility of diversion into the market (ATO 2015). In cases where a risk is perceived to the revenue, the application could be denied or else the applicant asked to "deposit a financial security" in order to protect that revenue (ATO 2018). Exports of tobacco products will also be subject to an Export Declaration process with ABF, and an approved Export Declaration is required for the products to be able to leave the country.

In reality, most bonded movement permissions are issued on a "continuing" basis and recognize the commercial reality of high numbers of these tobacco movements between bonded premises. These continuing permissions, often issued at a "client level" that allows for an owner to move bonded tobacco between multiple sites (ATO 2015), represent the majority of all bonded tobacco movements. This is managed on a largely self-assessed basis, with the stipulation that the applicant raise certain documentation for each individual movement and make an audit trail available for the ATO. The audit trail is used to confirm dispatch and receipt of the goods and the appropriate transfer of duty liabilities from one entity to the other. Instances of non-compliance or increases in duty liabilities in movements may also result in the ATO's requesting the deposit of a financial security (ATO 2015).

Significant penalties support the under-bond movement system, including for situations in which applicants make unintentional errors in the movement of goods or in accounting for the movement process. The relevant provisions of *Customs Act* Section 35A give the ATO an automatic right to recover any duties from goods that cannot be satisfactorily accounted for before, during, or after a bonded movement, whilst Section 33 applies a penalty for "moving, altering or interfering" with goods under the control of customs. The offense may be one of "non-intent," carrying a maximum penalty of \$12,600, while a conviction for intentionally "moving" or "interfering" carries a maximum penalty of \$105,000. The *Excise Act* penalties



mirror the maximum fines of the *Customs Act*, although one difference is that, under excise law, "intent" must be proved.

*Permission to deliver goods into home consumption without entering them for that purpose*

Bonded tobacco must be kept in a licensed warehouse and must not enter home consumption without fulfilling certain conditions. These may include providing the ABF with an "Ex-warehouse Declaration," with payment of duties for imported goods, or providing the ATO with an "Excise Return" and payment of duties for locally manufactured goods. Those distributing tobacco on which duties have not been paid must predict sales and ensure that sufficient stock is entered for home consumption and duties paid, so that they can supply customers in a timely manner.

In reality, the *Customs Act* and *Excise Act* recognize that this is an inefficient way for business to operate and as such both laws allow for the ATO to issue permissions to deliver without entry, and bring such deliveries to account and pay duties at the end of an accounting period (usually seven days).<sup>8</sup> These permissions are tightly conditioned to protect the revenue and link heavily to the record keeping of the owner and operators of the bonded warehouse from which the tobacco products are delivered. Under these permissions, the raising of a commercial invoice of sale to a customer effectively becomes an authority to remove the tobacco from the bonded warehouse, and the date of actual removal is the date used to calculate the duty payable (ATO 2015). These conditions prevent manipulation of changes (increases) to excise rates, also known as "forestalling," as well as making it difficult for bonded warehouse operators to keep a second set of records, as the legislative process for authorizing deliveries to home consumption and paying duties is intertwined with the business's commercial systems that interact with customers, transport operators, and internal accounting.

Again, penalties are in place to support the operation of the "delivery without entry" arrangement and include a licensee's making intentional or unintentional breaches of conditions in the permission. Perhaps the greatest penalty in this context is the loss of the permission itself, which in effect requires both the lodgment of returns and pre-payment of excise before delivery. *The Customs Act* Section 35A again gives the ATO an automatic right to recover any duties from goods that cannot be satisfactorily accounted for in terms of deliveries that cannot be reconciled, or shortages of stock in the bonded warehouse. In terms of actual fiscal penalties on top of duty recovery, in this case the breach or offence is one of "non-intent." The maximum penalty can be \$21,000, while a conviction for intentional violations carries a maximum penalty of either five times the excise value or \$105,000.

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<sup>8</sup> See Section 69 *Customs Act 1901* and Section 61A *Excise Act 1901*.

## 5. An Overview of Australia's Illicit Tobacco Market

### 5.1 NATURE OF THE ILLICIT TOBACCO MARKET IN AUSTRALIA

In its 2015 report on organized crime in Australia, the Australian Crime Commission (ACC) states that, "Organized crime is now entrenched within the illicit tobacco market" and will continue to be, as long as the practice is considered "highly profitable and low-risk" (ACC 2015:68–69). The same report indicates that criminal activity is centered on the importation of genuine and counterfeit brands on which taxes will not be paid. In 2017, law enforcement officials from a range of agencies provided testimony to the Black Economy Taskforce (Treasury 2017:303) that:

*"...the illicit tobacco market is growing and is largely the domain of organized criminals. This activity is attractive to criminals because it is highly profitable, the risk of detection is low, and penalties are less severe than for dealing in illicit drugs."*

The criminal elements behind the importation of illicit tobacco are seemingly transnational in their organization, and often smuggle both tobacco and narcotics. The significance of the problem was elevated in the words of a senior Federal Police officer, who expressed concern that some proceeds of the illicit tobacco trade may be finding their way back to extremist groups in the Middle East. The officer suggested connections are being made between Middle Eastern crime gangs driving illegal importations and Lebanese charities linked with Hezbollah (McKenzie, 2016). If this is indeed the case, then illicit tobacco may be a national security risk, as well as a tax-revenue and health risk.

The ACC (2015:68) has categorized the illicit tobacco market into three product groupings:

- » "Unbranded" loose leaf product which may also be sold in "tubes" and is often referred to as "chop-chop"; this may be illegally grown locally, or illegally imported;
- » "Counterfeit" cigarettes, which involve the copying of a registered trademark brand without the owner's permission; counterfeit products are made available for sale at a much lower price than the brand being copied, generally without payment of duties and taxes;
- » "Contraband" cigarettes, being any cigarettes on which duties and taxes have not been paid. This category includes "illicit white" cigarettes, being manufactured legally in the country of export but not to the legal requirements of the Australian market, in many cases without lawful plain packaging. This is currently a growing trend, with the Manchester brand representing the largest-selling product in this illicit category.

### 5.2 ESTIMATES OF THE SIZE OF THE ILLICIT TOBACCO MARKET IN AUSTRALIA

It is apparent that Australia requires credible research to be undertaken, both to set a baseline tobacco tax gap using appropriately identified measures and then to monitor these indicators annually, perhaps in a manner similar to the tobacco gap analysis which has been

published annually since 2013 by HM Revenue and Customs (HMRC) in the United Kingdom. The methodology applied by HMRC is a “top-down” approach. It begins with deriving total consumption from the Office of National Statistics’ commissioned Opinion and Lifestyle Survey, corrected for under-reporting using a measure from the Health Survey for England (HMRC 2018). From total consumption, lawful consumption is then subtracted, with lawful consumption comprising official HMRC tax-paid clearances and declared duty-free sales. This leaves an estimated remainder which is believed to be “non-tax paid” tobacco. Non-tax paid tobacco is then split between cigarettes and hand-rolled, and both measures are expressed in bands, with upper and lower ranges accounting for smokers who consume both types, as well as a central range which represents the longer-term trend.

In terms of an actual attempt at quantifying the Australian illicit tobacco market, government estimates have provided estimates of 3.4 percent for the year 2013 (DOH 2016), and more recently 5.6 percent for the fiscal years 2015–16 (ATO 2018). The 3.4 percent figure from the DOH is included in its most recent report to the WHO on FCTC implementation, citing the 2013 National Drug Strategy Household Survey, which saw 0.8 percent of respondents indicating that they consume illicit products half or more of the time.<sup>9</sup> The ATO in its estimates was concerned that there may have been under-reporting of illicit consumption in this survey, as respondents may have hidden their use of an illegal product or indeed may not be aware the product was non-tax paid (ATO 2018).

The ATO instead attempted an estimate by studying the various channels in which tobacco enters the market, in what may be termed a “supply-side, bottom-up” approach. This approach analyzed seizures in the import and domestic cultivation channels, as well as non-reconciliation of stock in bonded warehouses to come up with an estimate of total illicit activity, to which total formal clearances were added, so that the illicit quantities could be expressed as a percentage of total consumption, which for 2015/16 was 5.6 percent (ATO 2018). There is, however, very little detail provided by the ATO on how seizures, intelligence, and other data were extrapolated into a total illicit quantity in each channel.

Industry-based estimates of Australia’s illicit tobacco trade are much higher, with the most recent estimate for 2017 suggesting that the illicit tobacco market represents 13.9 percent of total tobacco consumption in Australia (KPMG 2018:6). The KPMG studies which have been conducted annually since 2012, using an empty-pack survey as part of their methodology. However, the sampling technique, which showed bias towards collecting “foreign-looking packaging” in areas more likely frequented by foreign students and tourists, has now been largely discredited (Cancer Council of Victoria 2014:7; DIBP 2016:3).

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<sup>9</sup> See National Drug Strategy Household Survey 2013 <https://www.aihw.gov.au/reports/illlicit-use-of-drugs/2013-ndshs-detailed/data>

### 5.3 RECENT ILLICIT TOBACCO SEIZURE ACTIVITY

Seizures are publicly reported by both the ABF and ATO, and media releases on significant seizures are often made to highlight the problems associated with illicit tobacco. Table 3 is a summary of seizures by both agencies going back to 2007-08, the ABF making interceptions as illicit tobacco crosses the border, while the ATO pursued illegal local-based cultivation and distribution.

**Table 3. Australian Illicit Tobacco Seizures, in Tonnes, 2007/8 to 2016/17**

YEAR	ATO (TONNES)	DIBP/ ABF* (TONNES)	TOTAL (TONNES)
2007/8	9.9	287	296.9
2008/9	0	180	180
2009/10	5.7	311	316.7
2010/11	31.1	258	289.1
2011/12	26	177	203
2012/13	0	183	183
2013/14	35	183	218
2014/15	16**	182.3	198.3
2015/16	58.2**	146.8	205
2016/17	30.1**	381.5	419.6
2017/18 (YTD)	32.5**	N/A	N/A
Notes:			
*ABF formed 1/1/2015			
**Calculated from ATO's new reporting format of revenue loss			

Source: DBIP Annual Reports (2015/16; 2016/17); ATO Submission to Parliamentary Inquiry into Illicit Tobacco (2016); ATO (2018; 2018b)

As would be expected, the largest volumes of illicit tobacco are intercepted in sea cargo consignments that have been mis-declared to lower the risk profile and the likelihood of inspection. Consignments may claim to contain items such as "paper cups," "table tops," or "toilet seat covers and trash cans" (ABF 2016; ABF 2018). These tobacco products appear to originate most frequently from China, Korea, and the United Arab Emirates, with involvement of nationals of these countries. The ABF points to the involvement of crime syndicates with links to other forms of serious crime, particularly narcotics. This connection was confirmed again as recently as May 2018, with the detection of 1.6 tonnes of illicit tobacco declared as

dates, leading to the seizure of mature cannabis plants and hydroponic equipment at the premises identified in import documents (ABF 2018c).

The most significant of these sea cargo seizures was 71 tonnes spread over three shipping containers, with two intercepted in Sydney and a third stopped en route in Indonesia under a joint operation<sup>10</sup> between the ABF and Indonesian Customs (DIBP 2016:5; ABF 2018). Based on such precedents, the ABF has approached regional agencies to conduct workshops on addressing and disrupting illicit tobacco supply chains region-wide (DIBP 2017).

Smaller but more frequent seizures are made through international mail centers. For example, in 2016–17, some 128 seizures were made from sea cargo consignments, with yields totaling 264 tonnes, while from international mail there were almost 60,000 seizures yielding a total of approximately 54 tonnes (ABF 2018).

Seizures are also being made from arriving air passengers and imported air cargo consignments, although as yet ABF are not recording these seizures for publication. In some cases, these operations have yielded notable results (DIBP 2016:5–6), including:

- » July 2015, 1.92 million cigarettes from an airfreight container unpacked in a bonded warehouse;
- » August 2015, 5.9 million cigarettes in an air freight consignment; and
- » October 2015, 46,000 cigarettes in the baggage of an arriving passenger, reflecting an emerging threat of “fly in fly out” cigarette smugglers.

The ATO, with its focus on domestically based illicit tobacco, reports conducting 26 raids under warrant since July 1, 2016, destroying crops and seizing tobacco with a potential tax revenue loss of \$179 million (Kenny 2018). To give a perspective on the ATO’s enforcement activity, in 2018, the following illicit tobacco seizures were made (ATO 2018a; ATO 2018b):

- » 53 acres, 28 tonnes and 45,000 seedlings in Bundaberg, Queensland (\$30 million);
- » 20 acres of crop under cultivation in Telopea Downs, Victoria (\$9 million);
- » 16 acres of crop under cultivation in Mooroopna, Victoria (\$7 million);
- » 12 acres of crop under cultivation in Dunnstown, Victoria (\$6 million);
- » 1.3 tonnes of dried leaf (and re-plantings) in Oaklands Junction, Victoria (\$1.3 million)

### 5.4 ENFORCEMENT FRAMEWORK

The “dual” character of the administration of tobacco taxation is also reflected in enforcement and investigation, which similarly depends upon the origin of the tobacco and whether it is imported or grown locally. Imported tobacco falls under the *Customs Act* and the jurisdiction of the ABF, although once the product is transferred to a bonded warehouse, responsibility for ensuring compliance shifts to the ATO. In addition, the ATO has

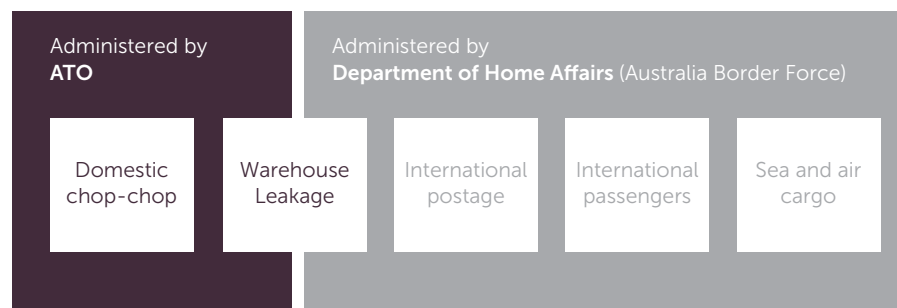
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<sup>10</sup> Known as Operation Wardite, this collaboration prevented the loss of \$27 million in duties.

responsibility for enforcing the *Excise Act* in relation to the cultivation and/or manufacture of tobacco domestically. The framework as summarized on the ATO's website is reproduced in Figure 4.

There is a level of coordination between the ABF and the ATO, which also involves interaction with other government policy bodies and law enforcement agencies, as well as with the tobacco industry, both distributors and retailers.

**Figure 4. Tobacco Enforcement Jurisdiction**



Source: ATO website, accessed 23 May 2018.

The ATO chairs what is known as the Tobacco Stakeholder Group (ATO 2018c), which meets bi-annually. From the government side, this body includes the Department of Home Affairs (DOHA, which includes the ABF), DOH, Treasury, and the Australian Competition and Consumer Commission. From the tobacco industry side, importation and distribution are represented by PMI Limited, BAT Australia, Imperial Tobacco Australia, and Richland Express. The Alliance of Australian Retailers and Australian Retailers Association represent the interests of those involved in the retail sale of tobacco products. The stakeholder group has a wide Terms of Reference that includes "adding value" to the administration of tobacco taxation. The issue of tackling illicit tobacco has been on the agenda of the group's most recent meetings and has been raised regularly by industry since at least 2015 (ATO 2018c).

Similarly, the DOHA chairs the Illicit Tobacco Industry Advisory Group, which has an identical membership of government and industry representation. The last documented meeting, in November 2017, was jointly chaired by the ATO and DOHA and appears to have been a joint meeting of both stakeholder forums. Previous to this, the Illicit Tobacco Industry Advisory Group had met bi-annually, with a very specific focus on "continuing to prevent, deter, and disrupt the illicit trade in tobacco" (DOHA 2018). While the DOHA affirms that this group is part of a "commitment to work with industry," the agency states that interactions will be guided by the obligations of Article 5.3 of the FCTC.

### 5.5 THE ABF TOBACCO STRIKE TEAM (TST)

The establishment of the TST from October 1, 2015, was an indication of the priority that the DOHA placed upon the interception of illicit tobacco being smuggled into Australia. Early successes, including Australia's largest illicit tobacco seizure of 71 tonnes, saw the Government announce a \$7.7 million "boost" to the TST as part of the 2016–17 federal budget (Dutton 2016). The Minister's announcement shed some light regarding next steps for the TST, stating that the additional funds were to be used to:

*"establish two new specialist investigation teams comprising 14 personnel. It will also allow the ABF to build stronger ties with key international law enforcement partners involved in combating tobacco smuggling at various points along the supply chain."*

Thus the TST was moving beyond a simple interception role at the border and taking on an investigatory role to identify the criminal elements behind the importation of illicit tobacco. Further, the team was to look beyond the border and work with countries that are part of the illicit tobacco supply chain. The TST applies what it refers to as an "intelligence-led model" (DIBP, 2016:5), suggesting that it identifies risk through various sources, which for the most part would appear to involve building partnerships with domestic and international law enforcement agencies and other stakeholders. From the information obtained, the TST develops appropriate "responses" and "opportunities" for the detection of illicit tobacco and the undertaking of enforcement activities related to the identified risks and risk responses.

The ABF recently summarized the TST's results to Parliament. The Commissioner of the ABF stated that, since its creation in October 2015, the TST had:

- » Seized over 100 tonnes of tobacco leaf;
- » Seized over 247 million cigarettes;
- » Prevented tobacco duty evasion of over \$300 million;
- » Charged 115 people with offenses under the *Customs Act*; and
- » Seen 69 of those people found guilty of the charges.

Further, thanks to the TST, in conjunction with the Criminal Assets Confiscation Taskforce, some \$6 million has been forfeited as "proceeds of crime," and another \$3 million is subject to a forfeiture process (ABF 2018b).

Meanwhile, however, senior ABF staff expressed the view that the TST did not have sufficient powers to be fully effective under current legislation. TST officers were, for example, unable to "use tracking devices, conduct certain types of raids, or make certain arrests" (Mckenzie, 2016). This analysis was supported by the Black Economy Taskforce, which suggested the formation of a multi-agency taskforce so that a full set of legislative powers could be marshaled to maximize law enforcement responses (Treasury 2017:309).

Perceived legislative constraints on agencies' current capacity to investigate illicit tobacco offenses suggest an agenda for improving Australia's approach to the illicit tobacco trade. These issues are at the center of the next part of this case study.

## Part B: What Can and Will Be Done in the Future to Better Address the Illicit Trade in Tobacco?

### **6. A New Enforcement and Regulatory Framework**

This question of "What can be done in the future?" with regard to illicit tobacco is currently being addressed in Australia, with significant measures being introduced to strengthen both enforcement capabilities and tobacco tax administration. Following the work of the Black Economy Taskforce, the Government has responded by announcing a range of new measures which include:

- » An upgrade of the TST to a multi-agency Illicit Tobacco Taskforce;
- » Heavier penalties for illicit tobacco offenses;
- » Eliminating the requirement to prove the origin of illicit tobacco for prosecution;
- » Creating additional new illicit tobacco offenses;
- » Banning tobacco imports that fail to comply with a new licensing regime; and
- » Moving the taxing point for imported tobacco (i.e., all legal tobacco products in the market) from ex-bond to point of importation (Treasury 2018:18).

The anticipated revenue return from these measures is \$3.6 billion over the four-year "forward estimates" of the federal budget to fiscal year 2021/22. However, it should be emphasized that approximately \$3.2 billion will be a one-off receipt, obtained as bonded warehouses holding tobacco products under bond are required to pay their excise duties on that bonded stock (Budget 2018:12).

The Black Economy Taskforce offered a number of recommendations that have either been "noted" or explicitly "disagreed with" by the Government, the most salient being the use of track-and-trace technology (Treasury 2017: 310–311). Regarding track-and-trace, the Government has opted for a wait-and-see approach, preferring to review at a later date the success or otherwise of the other control measures just described (Treasury 2018: 35).

#### **6.1 THE ILLICIT TOBACCO TASKFORCE**

In May 2018, the Treasurer and Minister for Home Affairs jointly announced the establishment of the Illicit Tobacco Taskforce (ITT), a new multi-agency force to be headed by the ABF. The Ministers described this move as reflecting the "marked success of the ABF's Tobacco Strike Team." The new force seeks to build upon and enhance the effectiveness



of this proven dedicated-team approach. In this case, the enhancement of capabilities will come through the streamlining of offenses to enable simpler prosecution; the definition of certain new offenses; and, importantly, the ability to access the greater investigative powers of the non-ABF agencies joining the ITT.

In relation to the streamlining of offenses, one critical area identified by the Black Economy Taskforce was that of technical risks to prosecution due to the need to positively identify the source of intercepted illicit tobacco (Treasury 2017: 307). This reflects an underlying jurisdictional issue, in that the ABF must limit its role to imports of illicit tobacco and the ATO to domestically grown illicit tobacco. A seizure of tobacco in the illicit supply chain does not necessarily reveal that tobacco's origins, and today the absence of this information can delay or derail prosecution. This difficulty will now be overcome by a new *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018*, under which prosecutors will no longer be required to prove the origin of illicit tobacco. The Bill also aligns penalties between the *Customs Act* and *Excise Act*. Discordance between these laws has meant that two offenders arrested with the same quantities of illicit goods in the same circumstances have faced different penalties following successful prosecution.<sup>11</sup>

On the issue of penalties, the Bill will now set "penalties at a level to deter illegal activity." Tobacco smuggling and tax evasion had been seen as a "soft crime," with the Black Economy Taskforce concerned about the relationship between risk and return for illicit tobacco, as compared to narcotic drugs (Treasury 2017:306). The Taskforce wrote:

*"...We have been informed that cocaine with a street value of \$2.3 million here will have a cost of about \$150,000, with heroin being similarly priced. The penalty for smuggling both is imprisonment. Whereas smuggling tobacco costing \$150,000, with a street value of \$10 million here, would, under current sentencing practices, generally result in a modest fine..."*

In this regard, the Bill will increase maximum penalties and will include a number of possible custodial sentences of up to 10 years imprisonment, in addition to maximum fines over \$200,000.

There will now also be a new concept of "reasonable suspicion that excise duty was not paid," rather than the need to establish criminal intent, as well as a new offense of being in possession of equipment used to manufacture illicit tobacco. This follows a recommendation by the Black Economy Taskforce to ban the importation of equipment such as cigarette tube filling machines that are used to convert domestic "chop-chop" tobacco into stick form (Treasury 2017:307–308).

In addition to new criminal offenses, there is also a civil offense consisting of the possession of two kilograms of tobacco without documentary evidence of how that tobacco came

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<sup>11</sup> See the Explanatory Memorandum to the Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018.

into the person's possession. This civil offense can be dealt with by infringement notice or summarily. New and revised offenses and their new penalties for illicit tobacco crimes are listed in Annex 2.

Parallel to the introduction of the *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018* will be the *Customs Amendment (Illicit Tobacco Offences) Bill 2018*. This Bill on its passage will confirm that the changes made to the domestic excise and taxation laws in terms of offenses and penalties will apply equally to imports of illicit tobacco in customs law. Of note however, are amendments unique to the *Customs Act*. For example, authorities can invoke the concept of "recklessly" importing tobacco without payment of duties, removing the need for "intent" to be proved, and the new legislation gives ABF officers the power to arrest without warrant, where there are reasonable grounds to impute a reckless attempt to import tobacco without payment of duties.

Previously, the ABF could only arrest suspects when, in addition to grounds to impute criminal intent, officers had plausible reasons to believe suspects might subsequently fail to appear in court, or that they might interfere with evidence and witnesses. New provisions will loosen these constraints and assist the ABF in future investigations.

However, the main benefit arising from the creation of an inter-agency ITT is that each agency brings unique sets of investigatory powers. Under the leadership of the ABF, other key partner agencies will include the ATO, Australian Federal Police (AFP), Australian Criminal Intelligence Commission (ACIC), Austrac, and Commonwealth Department of Public Prosecutions (CDPP), as well as other operational areas of MOHA as required (ABF 2018).

Previously, key investigatory tools such as access to surveillance devices were denied to the ABF, whose officers either were required to seek external assistance from the AFP or undertake inefficient and resource-intensive physical surveillance (Maher 2017; Treasury 2017). Under the new partnership, improved surveillance technologies will soon be available to the ITT. The ACIC, with its immediate access to all law-enforcement databases and power to coerce evidence, as well as Austrac, with its capacity to monitor movements of cash, will significantly boost the team's intelligence and evidence-collecting capabilities (ACIC 2018).

## **6.2 AMENDMENTS TO TOBACCO TAXATION ADMINISTRATION**

In addition to the enforcement initiatives through the new Illicit Tobacco Taskforce there will be a number of significant changes to the arrangements for the administration of tobacco taxes.

### *Moving the taxing point from delivery ex-bond to importation*

As detailed above, the current taxing point for tobacco is where it is delivered into home consumption, either from the place of importation or from a bonded warehouse. Given the extent of excise duties, the taxing point was invariably a delivery from a bonded warehouse located closest to the customer, to allow for these duties to be deferred as long as possible. Deliveries from a bonded warehouse are made under the "periodic settlement permissions,"

also described above, meaning that duties are subsequently reported and paid on the Monday following the actual delivery of the tobacco products from bond.

This opportunity to bond tobacco into a warehouse will cease from July 1, 2019, date after which importers will be required to identify their duty liabilities at time of import and bring that to account immediately (Budget 2018:12). There will be no credit terms available to importers, and full payment of duties and taxes to the ABF will be made prior to a release of any tobacco products into the country. This approach was justified on the basis that it will “reduce the potential for leakage from bonded warehouses in the black market.”<sup>12</sup>

Despite the cessation of all domestic manufacture, the *Excise Act* will have a similar amendment to that applied to imports, and excise will be payable upon manufacture at the licensed manufacturing site. This will prevent any change to distribution arrangements by importers, such as manufacturing cigarettes with imported leaf to overcome the loss of duty deferral capacity at the border.

One issue to manage will be that of cigarettes and tobacco products already in bond on July 1, 2019. Measures will include a transition arrangement for such goods that will run for 12 months. It is assumed importers will be required to settle the duties on all bonded stocks on hand before June 30, 2020.

As of June 30, 2020, there shall be no cigarettes or other tobacco products in the domestic supply chain that are bonded, and thus opportunities to divert bonded product from these warehouses without duty payments will disappear. This measure directly targets imports, and there will be additional resources committed to the illegal local growing and manufacture of tobacco. For this, the ATO will receive additional resources of \$4 million in 2020–21, rising to \$7 million in 2021–22 (Budget 2018:12). This commitment is expected to yield an additional \$12 million and \$17 million, respectively, in excise duties that would not otherwise have been paid for the illicit cultivation during these years.

### *New import license*

In addition to moving the taxing point, there will also be a new requirement for those wishing to import tobacco to first obtain the proper license. This will be achieved by making tobacco a “prohibited import,” as of July 1, 2019. There will, however, be an exemption from the prohibition for travelers who have cigarettes and tobacco products within the prescribed duty-free allowance limit, which at present is set at 25 grams of tobacco product or cigarette-stick equivalent (MOHA 2017).

Australia’s *Customs (Prohibited Import) Regulations* are the expected mechanism, as these instruments set out Schedules of differing prohibitions and restrictions, with tobacco likely to be prescribed within Schedule 2. Schedule 2 of the regulations is a listing of goods for which import is banned unless written permission (i.e., a permit or license) has been granted.

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<sup>12</sup> See Joint Press Release Treasurer and Minister for Home Affairs 6 May 2018.

This is proposed to make it easier for the ABF to take enforcement action and seize tobacco on which the proper duties and taxes have not been paid (Budget 2018:13). The effect of this provision is that any quantities of tobacco intercepted in the supply chain by the ABF or ITT will need to be accompanied by a license, and where such a license cannot be produced by the entity in possession of the tobacco, this establishes a “reasonable suspicion” that duties were not paid.

## 7. What Else Could Be Considered

There can be no doubt that Australia has affirmed its intent to address illicit tobacco. However, a number of notable anti-tobacco measures have not yet been adopted, and other key strategies have not even been openly discussed as potential options. Several of these measures are contained in the WHO FCTC Protocol to Eliminate the Illicit Trade in Tobacco Products. The Protocol has not yet come into force, and at the time of writing, a further four parties must still ratify the Protocol and deposit their ratifying instruments with the Depository, in order for the instrument to become law.<sup>13</sup> Australia’s last stated position on the Protocol indicated that the country is unable to accede until certain domestic legislative and regulatory changes are made, but that a process was underway to “inform the decision as to whether to accede” (DOH 2016:4).

The main area to consider is that of track-and-trace mechanisms for tobacco products. These are discussed in Article 8 of the Protocol. While considered and recommended by the Black Economy Taskforce, track-and-trace was “put on hold” by the Government, while awaiting the impact of other measures, which some believe might make a track-and-trace system superfluous. There are, however, multiple potential benefits in introducing a track-and-trace system. For example, such a system can support the investigative component of illicit tobacco seizures, given that data held in the track-and-trace tag can be used to confirm characteristics such as the authenticity of the product, product description, manufacturer, first customer, and intended market of consumption.<sup>14</sup>

Notwithstanding, Australia is also part of regional and global tobacco supply chains, albeit largely at the consumer end. Given the aspirations of Article 8 to build regional and global tracking and tracing, the lack of a national track-and-trace system in Australia also creates a gap in the control of global tobacco supply chains.

Another area of interest to the author is that of the concept of “due diligence,” considered in Article 7 of the Protocol. In the context of Article 7, due diligence imposes greater responsibility on the tobacco industry itself and makes it more accountable in respect of commercial decisions by importers and distributors. It is reasonable to expect that importers

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<sup>13</sup> The Depository for lodging instruments is the UN. See Article 46 of the Protocol.

<sup>14</sup> See paragraph 4.1 of Article 8 of the Protocol

and distributors could readily identify unusual or suspect business transactions or purchase requests, and elect not to proceed with those operations. This can extend to regular commercial relationships in which unusual supply requests are made.

The Government could establish guidelines or regulations which may assist by specifying the nature of transactions to be avoided. These rules might initially be based on the guidance of the Protocol. They might, for example, include requiring importers or distributors to confirm:

- » Customers hold the appropriate licensing to acquire tobacco products;
- » Bona-fides for first time customers, including whether customers have been black-listed by authorities;
- » Payments in cash or kind are not permitted;
- » Market of intended sale;
- » Quantities are not irregular or unusual volumes; and
- » Market where product sold is usual market.

The same regulations can also require importers and distributors to report to the appropriate authority (e.g., ABF or ATO) any business dealings in which problematic points have arisen.

Finally, certain aspects of licensing could be introduced to fully implement Article 6. The manufacture of tobacco products is subject to a licensing regime, as are tobacco imports, as of July 1, 2019. However, other aspects of the supply chain are not subject to licensing: in particular the import and possession of manufacturing equipment, as well as wholesale and retail sales.

“Possession of equipment being used in the manufacture of illicit tobacco” is now defined as a specific offense, but this is not tied to a licensing arrangement. The new offense should facilitate tackling illicit domestic production of cigarettes and “chop-chop.” This is important, given the unclear fate of cigarette-making equipment following the closure of local PMI and BAT manufacturing plants. BAT’s 2016 Annual Report discussed the sale of land and buildings after these closures, but not the actual cigarette manufacturing equipment (BAT 2016:101).

Australia also lacks nationally consistent licensing of wholesale and retail sales businesses. A DOH-sponsored study in 2002 found that, among Australian states, only South Australia, Tasmania, and the Australian Capital Territory had wholesale and retail licensing regimes at that time. Other states simply regulated the activities of such operators.<sup>15</sup> Since 2002, Western Australia has also introduced licensing.<sup>16</sup> However, to date, no nationally coordinated wholesale and retail licensing approach is in place to ensure that a standard “fit and proper” test is applied to entities and persons selling tobacco products at the end of the supply chain.

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<sup>15</sup> The DOH contracted the Allen Consulting Group to study the ‘Licensing of tobacco retailers and wholesalers’ in 2002. See [http://health.gov.au/internet/main/publishing.nsf/Content/51D4A401FD339C40CA257BF000212035/\\$File/license.pdf](http://health.gov.au/internet/main/publishing.nsf/Content/51D4A401FD339C40CA257BF000212035/$File/license.pdf) (Retrieved 21 June 2018).

<sup>16</sup> See the *Tobacco Products Control Act 2006*.

Notwithstanding such gaps, many of Australia's current and proposed responses to the illicit trade in tobacco are positive. Yet the country still experiences revenue leakage, as a certain percentage of tobacco consumed locally has clearly by-passed domestic and import based controls and found its way into the market without duties and taxes being paid. The next point to watch in the Australian environment will be the July 2019 tobacco taxation reforms. At that time, the new Illicit Tobacco Taskforce will have been in operation for 12 months, with its enhanced investigatory capabilities to prosecute a new range of offenses with greater penalties.

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# Annexes

## Annex 1

### Licensing Requirements: Manufacture of Tobacco Products

#### 1. EXCISE ACT CRITERIA TO OBTAIN A LICENSE TO STORE BONDED TOBACCO PRODUCTS UNTIL 1 JULY 2019

CRITERIA	REQUIREMENT
Fit and proper (person or corporation)	<ul style="list-style-type: none"><li>› In the past 12 months has not been charged with an offence under the <i>Excise Act</i> or any Commonwealth, State or Territory Acts that carries a penalty in excess of \$105,000</li><li>› In the past 10 years has not been convicted of an offence under the <i>Excise Act</i> or any Commonwealth, State or Territory Acts that carries a penalty in excess of \$105,000</li><li>› History of compliance under any tax law in past four years</li><li>› No previous cancellation of a licence</li><li>› Sufficient financial resources, and</li><li>› Not in receivership</li></ul>
Skills and experience of key staff	<ul style="list-style-type: none"><li>› Sufficient to run the bonded operations</li></ul>
Physical security of premises	<ul style="list-style-type: none"><li>› Appropriate for the nature of the goods</li><li>› Appropriate for the type of premises</li><li>› Procedures in place to secure premises</li></ul>
Plant and equipment	<ul style="list-style-type: none"><li>› Appropriate to support the operations of the business</li></ul>
Market	<ul style="list-style-type: none"><li>› A viable market for the products exists</li></ul>
Accounts	<ul style="list-style-type: none"><li>› Sufficient for an audit to be conducted which can confirm the duty liabilities have been properly acquitted</li></ul>
Duty payment timing	<ul style="list-style-type: none"><li>› Not solely to store goods so as to defer duty</li></ul>

Source: Author adapted from ATO Industry Guide-lines (2018) for licensing under the *Customs Act and Excise Act*.

2. TYPES OF UNDER-BOND MOVEMENT AVAILABLE FOR TOBACCO UNTIL 1 JULY 2019

TYPE OF MOVEMENT	PURPOSE	CONDITIONS
Single movement	Ad hoc or one-off need	May require security
Continuing	Contractual commercial relationship between parties dispatching and receiving Intra-company movement	Evidence of relationship Cannot change ownership in transit Record keeping
Export (single)	Ad hoc or one-off sale to overseas customer	May require security Export Declaration with ABF
Export (continuing)	Contractual commercial relationship with export customer	Evidence of relationship Record keeping Export Declaration with ABF
Tobacco seed and plants (single)	Ad hoc or one-off need	May require security
Tobacco seed and plants (continuing)	Contractual commercial relationship between grower and manufacturer	Evidence of relationship Cannot change ownership in transit Record keeping
Export of tobacco seed and plants (single)	Ad hoc or one-off sale to overseas customer	May require security Export Declaration with ABF
Export of tobacco seed and plants (continuing)	Contractual commercial relationship with export customer	Evidence of relationship Cannot change ownership in transit Record keeping Export Declaration with ABF

Source: Author based on data/information from ATO website (2018) on movement permissions

## Annex 2

### New Offenses and Penalties for Illicit Tobacco Crimes

#### PROPOSED OFFENSES AND PENALTIES FOR ILLICIT TOBACCO

OFFENCE	PENALTY
1. The possession, buying or selling by a person in Australia (excluding the external territories) of tobacco, in the quantities set out, for which there is a reasonable suspicion that excise or excise -equivalent customs duty has not been paid.	<ul style="list-style-type: none"> <li>› 500 kg or more – five year’s imprisonment, or the higher of 1,000 penalty units or five times the amount of duty on that tobacco, or both;</li> <li>› 100 kg or more – two year’s imprisonment, or the higher of 500 penalty units or five times the amount of duty on that tobacco, or both; or</li> <li>› 5 kg or more – the higher of 200 penalty units or five times the amount of duty on that tobacco.</li> </ul> <p>NB: penalty unit currently set at \$210 per unit.</p>
2. The possession, manufacture or production by a person in Australia (excluding the external territories) of a thing that is tobacco, for which the full amount of excise duty has not been paid.	<ul style="list-style-type: none"> <li>› 500 kg or more – ten year’s imprisonment, or the higher of 1,500 penalty units or five times the amount of duty on that tobacco, or both;</li> <li>› 100 kg or more – five year’s imprisonment, or the higher of 500 penalty units or five times the amount of duty on that tobacco, or both; or</li> <li>› 5 kg or more – the higher of 500 penalty units or five times the amount of duty on that tobacco.</li> </ul> <p>NB: penalty unit currently set at \$210 per unit.</p>
3. The possession by a person in Australia (excluding the external territories) of tobacco that equals or exceeds 2kg without documentation indicating how the person obtained the tobacco.	<ul style="list-style-type: none"> <li>› Civil penalty of 100 penalty unit.</li> </ul> <p>NB: penalty unit currently set at \$210 per unit.</p>
4. Possessing equipment used or for use in producing or manufacturing illicit tobacco.	<ul style="list-style-type: none"> <li>› One year’s imprisonment or 120 penalty units.</li> </ul> <p>NB: penalty unit currently set at \$210 per unit.</p>

Source: Explanatory Memorandum *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018*

## COVER QUOTE SOURCES

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<sup>i</sup> WHO Framework Convention on Tobacco Control Press Release, June 28, 2018.  
<https://www.who.int/fctc/mediacentre/press-release/protocol-entering-into-force/en/>

<sup>ii</sup> World Health Organization Press Release, July 19, 2017.  
<https://www.who.int/en/news-room/detail/19-07-2017-who-report-finds-dramatic-increase-in-life-saving-tobacco-control-policies-in-last-decade>

<sup>iii</sup> Combatting illicit trade in tobacco products: Commissioner Andriukaitis' Statement on the EU's adoption of an EU-wide track and trace system. European Commission Press Release, December 15, 2017.  
[http://europa.eu/rapid/press-release\\_STATEMENT-17-5269\\_en.htm](http://europa.eu/rapid/press-release_STATEMENT-17-5269_en.htm)

<sup>iv</sup> How to design and enforce tobacco excises? International Monetary Fund, October 2016  
<https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2016/12/31/How-to-Design-and-Enforce-Tobacco-Excises-44352>

<sup>v</sup> World Bank Group: "Global Tobacco Control: A Development Priority for the World Bank Group", Preface of WHO Global Tobacco Report 2015.  
[http://www.who.int/tobacco/global\\_report/2015/timevansandworldbankforeword.pdf?ua=1](http://www.who.int/tobacco/global_report/2015/timevansandworldbankforeword.pdf?ua=1)

“To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation.”<sup>i</sup>

– **Dr. Vera Luiza da Costa e Silva**  
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

“Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences.”<sup>ii</sup>

– **Dr. Tedros Adhanom Ghebreyesus, Director-General**  
World Health Organization

“Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade.”<sup>iii</sup>

– **Commissioner Vytenis Andriukaitis**  
Health and Food Safety / European Commission

“Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions.”<sup>vi</sup>

– **Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)**  
Fiscal Affairs Department / International Monetary Fund

“Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year.”<sup>v</sup>

–**Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)**  
Health, Nutrition and Population Global Practice / World Bank Group

