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27 January 2022
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RE: 2022-23 PRE-BUDGET SUBMISSION

INTRODUCTION

Imperial Brands Australasia (Imperial) welcomes the opportunity to participate in the Australian Government's 2022-23 Pre-Budget submission process. Imperial participates in a range of government consultations that are relevant to our business. We do this on the basis that our views will be considered in an objective manner and that the evidence and views we provide will be properly evaluated, with due regard given to relevant legal and legislative requirements and the principles of best practice regulation.

BACKGROUND

Imperial is an Australian-based wholly owned subsidiary of Imperial Brands PLC, an international fast-moving consumer goods company specialising in tobacco and non-tobacco products. Imperial entered the Australian market in September 1999 at the request of the ACCC to ensure that competition was maintained following the global merger between British American Tobacco (BAT) and Rothmans International.

For the 2021/22 year, Imperial delivered approximately \$3.9 billion to the Federal Treasury through excise duties on tobacco products (excluding GST). We employ approximately 225 people in Australia and make further contributions to government through corporate taxation, GST, employment taxes and other revenues of approximately \$530 million annually. In totality, the tobacco industry contributes approximately \$15 billion to the Federal Treasury through excise duty.

THE PRACTICAL OUTCOMES OF TOBACCO TAXATION IN AUSTRALIA

Australia is a high tax environment for tobacco products with prices today among the most, if not the most expensive in the world¹, the cumulative effect of successive annual 12.5% excise increases running from 2013-2020 and initiated by a one off 25% excise increase in 2010. It has historically been proposed that increasing tobacco taxes and cigarette prices is one of the most effective and efficient means of reducing tobacco consumption and raising state revenue. Today, global experience shows raising tobacco excise is looking increasingly ineffectual at achieving either of these objectives.

In December 2021, New Zealand's Associate Minister of Health the Hon Dr Ayesha Verrall commented when speaking on tobacco control; *"We've already seen the full impact of excise tax increases. The Government recognises that going further will not help people quit, it will only further punish smokers who are struggling to kick the habit"*².

There are nearly 3 million adult smokers in Australia, many of whom are from disadvantaged and lower socioeconomic segments of society. The excessive tax levied on tobacco products has created financial hardship and budget pressure on those Australians most in need of relief. The growth in the price of cigarettes has far outpaced the prices of other consumer goods³. The regressive nature of tobacco taxes means lower income smokers face a disproportionately larger burden and are left with less money to spend on general basic needs, or alternatively forced to participate in the illicit market.

The high tobacco tax environment places severe additional financial pressure on low income adult smokers at a time when COVID-19 has already exposed the massive challenges disadvantaged households face. It is an unfortunate actuality that despite the stated public health intentions of tobacco excise, many adult smokers will divert significant portions of their weekly budget away from essential goods such as housing and food and spend more on tobacco consumption. The economic knock-on effect from low income households spending less on essential goods necessitates further consideration of what constitutes a fair and efficient tax structure. Affordability pressures born from years of successive excise increases have also contributed to the

¹ Katherina, Buchholz, Statista August 16 2019; The Price of a Pack of Cigarettes Around the World

² <https://www.beehive.govt.nz/release/historic-step-towards-smokefree-future>

³ Ting I, Tobacco Tax Rise Comes After Cigarette Prices Soar 343% in 20 Years, Sydney Morning Herald 2016

establishment and growth of the illicit tobacco market in Australia. Excise increases are resulting in exorbitantly high prices, ultimately encouraging the movement of consumers out of the legal market and into the illicit market.

THE ILLICIT TRADE OF TOBACCO PRODUCTS

It is necessary to highlight that the illicit tobacco trade is intimately linked to excise. Australia is a high tax environment for tobacco products and this essentially drives both the demand, and supply side of the equation. Excise increases result in higher prices, driving down trading and, ultimately, movement of consumers to the illicit market. These large excise increases also fuel the black market by making it even more lucrative for organised criminals to smuggle illegal tobacco into Australia. For example, a pack of 20 cigarettes is up to 10 times more expensive in Australia than Indonesia⁴. These high profit margins undoubtedly provide an attractive and valuable source of income for organised crime syndicates who are increasingly involved in the illegal trade.

The KPMG Illicit Tobacco in Australia 2020 Full year Report confirms that the black market for illicit tobacco has continued to entrench itself as a significant segment of the tobacco market in Australia. At 16.9% of consumption, the illicit market represents nearly one in every five cigarettes and \$2.9 billion dollars in lost revenue to the Government.

The illicit behaviour is being compounded by the entrenchment of 'social norms', or the complicit nature of illicit tobacco, with participants on the demand side of the equation seeing the activity as commonplace and justified based on high pricing of the legal market caused by excessive excise.

Legitimate Australian retailers are anecdotally reporting a growing number of customers seeking out cheaper illicit tobacco products. Businesses choosing to do the right thing have expressed their concern at the loss of regular customers and the corresponding decline in their sales as a result. In order to stay competitive and maintain the profitability of their stores, unfortunately, some retailers within the legal supply chain have felt compelled to participate in the illegal supply of tobacco.

⁴ KPMG Illicit Tobacco in Australia, 2020 Full Year Report, 21 May 2021

In December 2021, a media release from the Assistant Minister for Customs, Community Safety and Multicultural Affairs, the Hon Jason Wood MP underscored the gravitas of the issue⁵;

“Illicit tobacco is an attractive market for organised criminal syndicates due to the lucrative profits that can be made through the evasion of customs duty and associated taxes....The profits made through illicit tobacco are often channelled back into organised crime groups and their activities, rather than funding essential services in the Australian community. Individuals purchasing illicit tobacco are putting money into the pockets of serious and organised criminals and undermining legitimate businesses.”

In the 2020/21 financial year the Australian Border Force made over 214,000 illicit tobacco detections and seizures. These seizures included more than 827 tonnes of loose-leaf tobacco and 598 million cigarette sticks, with a combined excise value of \$1.92 billion.

The growing number of seizures and the considerable amount of excise lost to criminal organisations brings attention to the scope and pervasiveness of the illegal tobacco trade in Australia. Significant efforts have been made to address the problem at the border. We commend the Government on recent steps taken to address this serious issue, although much remains to be done. It is an unfortunate fact that the regularly evolving nature of illicit supply has proven the illicit tobacco trade to be a highly flexible and responsive business phenomenon. The supply of illicit tobacco routinely evolves to take advantage of perceived “loopholes” and in reflexive response to government activity.

The adaptability of criminal organisations involved in the illicit tobacco trade was demonstrated by the changes in illicit market supply following the *Customs Amendment (Smuggled Tobacco) Bill 2012*. The Bill strengthened penalties involved with tobacco smuggling, making the import of illicit tobacco a higher risk venture for criminals. Following the changes, Australia witnessed the establishment, and subsequent growth, of the domestic cultivation and distribution of illegal tobacco. The COVID19 pandemic and resulting reduction in International passengers and overseas freight has served to reinforce the growth trend of domestic cultivation and supply. There are also strong indications of an increase in illicit tobacco coming in through the mail channel.

⁵ <https://minister.homeaffairs.gov.au/jasonwood/Pages/two-tonnes-of-illicit-tobacco-seized-in-four-days.aspx>

In a report prepared for Imperial in November 2020, there was a significant number of standalone e-commerce sites, social media pages and online market place offers for illicit tobacco products;

	Number of potentially interesting results detected
Standalone e-commerce sites and logo sites	1,558
Social media pages	3894
Online marketplace offers	361

The growing number of online illicit tobacco suppliers highlights the rising prominence of the mail channel within the illicit tobacco supply market. As International passenger arrivals and global freight transport declined, illicit tobacco consumers began to seek product online through the mail centres.

Recent ATO seizures of domestic tobacco crop also demonstrate the dynamic nature of illicit tobacco supply. See for example; *\$40 million in illegal tobacco seized from QLD Toowoomba region*⁶ or *\$84.3 million in illegal tobacco seized along the NSW and VIC border in a two-day blitz*⁷.

In a recent joint medial release from the Australian Border Force, The Australian Taxation Office and NSW Police on January 14, 2021, it was stated that “A man has been arrested after 50.3 tonnes of tobacco from an illegal tobacco crop was seized during an operation in NSW by the Illicit Tobacco Taskforce (ITTF)”. The release went on to add; “People who engage in the illicit tobacco trade - whether it is growing, importing, supplying or buying black market tobacco - not only put

⁶ [https://www.ato.gov.au/Media-centre/Media-releases/\\$40-million-in-illegal-tobacco-seized-from-QLD-Toowoomba-region/](https://www.ato.gov.au/Media-centre/Media-releases/$40-million-in-illegal-tobacco-seized-from-QLD-Toowoomba-region/)

⁷ [https://www.ato.gov.au/Media-centre/Media-releases/\\$84-3-million-in-illegal-tobacco-seized-along-the-NSW-and-VIC-border-in-a-two-day-blitz/](https://www.ato.gov.au/Media-centre/Media-releases/$84-3-million-in-illegal-tobacco-seized-along-the-NSW-and-VIC-border-in-a-two-day-blitz/)

money into the hands of organised criminals, but they deprive the community of tax revenue required to fund essential services such as roads, schools and hospitals.”⁸

For the 2020-21 financial year, the ATO ran 9 operations, covering 23 seizures with 109 thousand kilograms and 5 million sticks seized and destroyed representing \$178m in evaded excise duty⁹. Domestic growing operations are increasingly coming under the arm of sophisticated criminal enterprises. For the same financial year, the number of resulting criminal convictions amounted to one.

In November 2020, the Parliamentary Joint Committee on Law Enforcement (PJCLE) tabled its final report on its inquiry into illicit tobacco. The Committee made a number of recommendations to Government to further enhance the steps being taken to tackle the illicit tobacco market.¹⁰ Imperial Brands has been calling for increased enforcement capabilities at both a federal and state level to address this considerable issue and appeared before the Joint Committee to present industry intelligence which suggested criminal gangs are gaining in sophistication in order to evade authorities.

In November 2021, the Government responded to the PJCLE Inquiry into Illicit Tobacco. While the Government recognised the importance of combatting the illicit tobacco trade, they unfortunately fell short of making any commitment to impact real change. Imperial continues to call for an increase in law enforcement at the retail level and suggests the Government address inadequacies in state and territory legislation and enforcement especially where it concerns retailers and an increase in other resources to law enforcement, such as scanning equipment and sniffer dogs. A more coordinated approach from state and federal government and a national illicit tobacco strategy would help to address ongoing areas of concern.

The only accepted recommendation, from the eight made by the Committee, was that; *the ATO continue with its tax gap project on a permanent basis*. The Government commented on how the information was used to assist in understanding the scale of the illicit tobacco market in Australia¹¹.

⁸ Illegal Tobacco Crop Seized and Destroyed, January 14, 2021

⁹ <https://www.ato.gov.au/general/the-fight-against-tax-crime/our-focus/illicit-tobacco/>

¹⁰ https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Law_Enforcement/IllicitTobacco46th

¹¹ Senate, Wednesday 24 November 2021, Intelligence and Security Joint Committee Law Enforcement

We believe an accurate assessment of the illegal market is critical for sound policy development, but unfortunately do not see the tax gap project as providing the timely and accurate information required. The currently available ATO tax gap figure is for the 2019-20 financial year and is reported as approximately \$909 million in lost excise revenue. In addition to being outdated, there is a lack of transparency with the process and some questions around the methodology considering the figure sitting well below recently published ABF seizure figures.

NEXT GENERATION PRODUCTS

Harm reduction is a well-established concept in public health that is simple and compelling: to provide a range of policies, regulations and actions directly designed to reduce health risks by encouraging less risky behaviours. Face masks during the current COVID-19 pandemic, sun cream and seat belts are all everyday examples of harm reduction. While they do not eliminate risk completely, they do reduce it, improving outcomes for both individual and broader public health.

Tobacco harm reduction works in the same way: its aim is to provide adult smokers, who would otherwise continue to smoke, the option to transition to less harmful products that still deliver nicotine – but with fewer and substantially lower levels of toxicants than those associated with burning tobacco. These nicotine products, which either do not contain tobacco leaf or do not combust tobacco, are termed Next Generation Products (NGPs). NGPs include e-cigarettes (also known as ‘vapour products’), heated tobacco and oral nicotine pouches. A growing number of public health bodies, regulators and governments fully endorse and advocate tobacco harm reduction to reduce smoking-related risks. For example, the UK, New Zealand, and Canada actively endorse and encourage adult smokers who are uninterested or unwilling to quit smoking, to transition to e-cigarettes.

Australia is one of only 2 OECD nations, the other being Turkey, which has impeded adult smokers from accessing less harmful NGP. Imperial was discouraged with recent TGA scheduling changes which further restrict access to liquid nicotine for adult smokers. Electronic Vapour Products represent a huge public health opportunity. There is a growing international consensus that e-

cigarettes are significantly less harmful than conventional cigarettes¹² and lead to an accelerated decline in both youth and adult smoking rates in markets where sold¹³.

There is a growing consensus that nicotine e-cigarette use among adult smokers is increasing despite the regulatory measures designed to inhibit their use. There is evidence of a domestic nicotine black market emerging. For example, ABC News has previously reported that NSW health inspectors visited 227 retailers selling e-liquids from November 2015 to April 2018 and found that over 40 per cent of these retailers were selling products that contained nicotine¹⁴.

Another ABC News article quoted one tobacco control expert as saying ‘it was an “open secret” that you could buy e-liquid containing nicotine’ and that he had been told ‘there’s a fair amount of amateur, backyard lab production of e-juices which are being sold’¹⁵. The Daily Telegraph has also previously reported that liquid nicotine products ‘remain widespread in Victoria due to under-the-counter sales and products purchased over the internet’¹⁶.

The nicotine black market wholly disregards fundamental safety matters surrounding the use of nicotine including its toxicity, potential for abuse, appropriate and lawful dosage, formulation, labelling, packaging and presentation. Indeed, it may be anticipated that the nicotine black market would operate much like the illicit tobacco black market in that it may be more easily accessible for underage users, bypass health information on packaging, and present nicotine products with vastly more dangerous health risks than those manufactured by reputable regulated industries¹⁷.

NSW Health reported seizing 50,000 illegal nicotine e-cigarettes in the first six months of 2021. Recent seizures, including one in October 2021 in Griffith NSW, where more than 1230 nicotine

¹² See for example; <https://www.gov.uk/government/news/phe-publishes-independent-expert-e-cigarettes-evidence-review>, or; <https://www.rcplondon.ac.uk/projects/outputs/nicotine-without-smoke-tobacco-harm-reduction>

¹³ Australian Tobacco Harm Reduction Association

¹⁴ Flint Duxfield, ‘NSW Health Department finds not all e-juices are as nicotine free as they claim’, ABC News (online, 12 June 2018)

¹⁵ Olivia Willis, ‘Nicotine found in ‘nicotine-free’ e-cigarette liquids sold in Australia, study finds, ABC News (online, 14 January 2019) < <https://www.abc.net.au/news/health/2019-01-14/nicotine-found-in-nicotine-free-e-cigarette-liquids/10709786>>.

¹⁶ Grant McArthur, ‘Retailers still pushing banned liquid nicotine products’, The Daily Telegraph (online, 10 March 2020).

¹⁷ Black Economy Taskforce (Final Report, October 2017) 305.

containing e-cigarettes with an estimated street value of \$55,000¹⁸ add further support to the anecdotal evidence of a significant and growing illicit electronic vapour product segment.

Reducing the health impacts of tobacco requires that governments, regulators and public health bodies play a positive role, which includes implementing a legislative framework that allows the NGP category – specifically e-cigarettes - to develop and give adult smokers the confidence to try, and ultimately transition, to these less harmful products.

CONCLUSION

Excessive tobacco excise increases have had a number of negative economic and socio-economic consequences. The high tax environment has exasperated affordability pressures and places a huge financial burden on some of the most disadvantaged segments of society. The regressive nature of tobacco taxes means that lower income adult smokers shoulder a disproportionately larger burden and are often forced to forego basic goods to maintain consumption patterns. These affordability pressures exemplify how tobacco excise strengthens the demand for illicit products while simultaneously creating the incentive for criminal supply.

The illicit tobacco trade is a serious, and complex, problem. The World Health Organisation recognises that “From many angles, the illicit trade of tobacco products is a major global concern, including health, legal and economic, governance and corruption.”

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

The legislative framework, and the enforcement of such, are equally important foundations for effectively, efficiently, and appropriately dealing with the illicit tobacco trade. There currently exists

¹⁸ <https://www.miragenews.com/police-charge-man-over-supply-of-illegal-e-681401/>

opportunities to close “loopholes” and/or to make more effective the various pieces of legislation which deal with illicit tobacco, specifically State and Territory legislative frameworks.

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

According to the National Drug Strategy Household Survey 2019 (Tobacco section)¹⁹, Australia now has more than 520,000 e-cigarette users, with the main reasons for use being harm reduction (i.e. to reduce and replace combustible cigarette smoking). This demonstrates that, notwithstanding the current regulations for e-cigarettes in Australia, adult smokers are seeking out e-cigarettes and vaporisers as an alternative to combustible cigarettes. The growing weight of independent scientific evidence strongly points in favour of providing Australian adult smokers with the choice to legally access, purchase and use less harmful tobacco-free e-cigarettes and vapouriser products.

Effective regulation should support vaping products being made more attractive to adults to support them to transition to less harmful products. Practically, that requires:

- providing attractive alternatives to consumers;
- enabling consumers to access those alternatives; and
- providing consumers with advice and education around the use of alternatives.

Imperial Brands Australasia recognises the important role we have to play in reducing the harm caused by cigarettes and as such, we would welcome the opportunity to discuss any elements of this submission in further detail and clarify any questions that you might have.

¹⁹ <https://www.aihw.gov.au/getmedia/7ebfd47a-9063-4ae0-b22f-1aef56a30dc/aihw-phe-270-Chapter2-Tobacco.pdf.aspx>